Multinational corporations in the neo-liberal regime

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Introduction

The left's concern with globalization is, of course, nothing new. Marx wondered whether the process of globalization would crush incipient revolution in his "small comer of the planet." And today, we ponder whether the recent acceleration of globalization will crush all national prospects for egalitarian and sustainable development. Yet, despite a good deal of hand wringing, discussion, and research, we are still quite far from understanding the implications of this much-discussed phenomenon for the lives of people, communities, and nations around the globe.

Here we look at one aspect of globalization: the role of multinational corporations (MNCs) and foreign direct investment (FDI). What has been the effect of MNCs and FDI on wage stagnation, inequality, and unemployment? More generally, what do future trends hold for the long-run impact of MNCs on our standard of living? We identify five views of the likely effect of MNCs on the trajectory of the world economy.

1. "Foreign direct investment" refers to an equity investment outside of the parent corporation's home country. It implies some control over economic activity, usually a greater than 10 percent stake. The term "multinational corporations" generally refers to companies that have significant economic operations in more than one country (Caves 1996). We do not use foreign direct investment and multinational corporations interchangeably because as we briefly discuss below, multinational corporations undertake significant economic activities outside their home countries independently of foreign direct investment, including licensing and outsourcing activities.

The authors would like to thank James Burke and Esra Erdem for excellent research assistance and the Economic Policy Institute for financial help. Thanks to the participants at the previous EN conferences, and especially to Ilene Grabel, Keith Griffin, Tim Koechlin, Bob Pollin, and Jim Stanford for extremely helpful comments. We also thank participants at seminars given at the University of Denver and University of Massachusetts, and especially Sam Bowles, George DeMartino, Ilene Grabel, Tracy Mott, and Christian Weller. In addition, we received very useful comments from students who participated in Crotty and Epstein's graduate seminar on "Globalization and Inequality" at the University of Massachusetts in spring 1996: Elissa Braunstein, Rob Bums, Stephanie Eckman, Esra Erdem, James Heintz, Mark Howard, Gene Reilley, and Eric Verhoogen. Perhaps our greatest debt is to David Gordon, who, by gently badgering us at the first conference, forced us to rethink many issues and, as a result, greatly helped us to clarify our ideas.


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The first is "the race to the bottom" (Bluestone and Harrison 1982; Barnet and Cavanagh 199-1: Greider 1997). According to this view, capital will increasingly be able to play workers, communities, and nations off against one another as they demand tax, regulation, and wage concessions while threatening to move. According to this view, increased mobility of MNCs benefit capital while workers and communities lose. A modified version is that the winners in the race to the bottom will include highly educated (or skilled) workers, or workers in particular MNC rent-appropriating professions (e.g., lawyers and investment bankers), along with the capitalists: the losers will be unskilled workers and the unemployed.

The second view, "the climb to the top," is the opposite of the first. It suggests that multinational corporations are attracted less by low wages and taxes than by highly educated workers, good infrastructure, high levels of demand, and agglomeration effects arising from the existence of other companies that have already located in a particular place. According to this view, competition among states for FDI will lead countries in both the North and the South to try to provide well educated labor and high-quality infrastructure in order to retain and attract foreign investment (Reich 1992). Thus, footloose capital and competition, far from creating a race to the bottom, will induce a climb to the top around the world.

This climb to the top could lead to the outcome represented by the third view: "neo-liberal convergence." This is the widely held mainstream claim that free mobility of multinational corporations, in the context of deregulation and free trade, will produce increased living standards in all countries. This process will, moreover, transfer capital and technology abroad, thereby raising the standards of living of those in the poorer countries at a faster rate than those in the wealthier ones, eventually generating a worldwide convergence in living standards (Sachs and Warner 1995). This may result from the process of competition for capital described above, or simply from the market processes of dissemination of capital and technology throughout the globe.

These same processes could, however, lead to the outcome envisaged in the fourth view, "uneven development." This view has a long and, now, ironic history: it holds that one region of the world will grow at the expense of another region. Of course, for decades, the dominant version of this view was the theory of imperialism: if the South integrated itself with the North, the North would grow at the expense of the South. Now, the fear seems to be the opposite: by having to compete with cheap Southern labor, an integrated world economy will help the South grow, but this time at the expense of the North (Blecker 1997b; Krugman and Venables 1995; Wood 1994, 1995).

The previous four views, though they differ greatly, have at least one thing in common: they hold that FDI and MNCs have a big impact. By contrast, many analysts, both mainstream and heterodox, subscribe to the fifth and final view: "much ado about nothing" (Krugman and Lawrence 1994; Gordon 1988a). As the name implies, according to this view, FDI and MNCs play a rather modest role in generating negative outcomes, such US increases in inequality, unemployment, and wage stagnation. Adherents argue that FDI is still a relatively small percentage of nations’ gross domestic products; that most of it is between the rich countries and therefore there is neither convergence nor a race to the bottom; that of the FDI that does go the developing countries, most of it goes to a handful of nations, with 80% of developing country FDI going to fewer than 10
countries; and that, while in some countries, like the U.S., there are large FDI outflows, there are also large FDI inflows, so net FDI is not very large (UNCTAD 1997).

Which of these views is correct? Of course, we cannot provide a complete answer, nor, we suggest, could anyone else, given the current state of knowledge. In this chapter we develop a framework for thinking about this question and develop a set of hypotheses that only future research can fully evaluate. Our framework does suggest that the race to the bottom outcome 1, likely in the current context dominated by neo-liberal policies of deregulation and market dominance on a global scale.

More generally, we argue that foreign direct investment is neither inherently good nor bad. Which of the fire views best approximates reality will strongly lie on the overall national and international context within which capital mobility occurs. In particular, we focus on three aspects of the overall context that we think are especially important in determining the impact on the effects of FDI and MNCs: aggregate demand (AD), the nature of the domestic and international rules of the game and institutions governing investment, and the nature of domestic and international competition. We argue that these three factors have a significant impact on the effects of FDI and MNCs on the economy, and in particular on their effects on wages, inequality, and the level of unemployment.

More concretely, when FDI occurs in a context of high level, of aggregate demand and effective rules of the game which in turn limit the destructive the destructive aspects of competition, then FDI may indeed have a positive impact on nations and communities. On the other hand, when FDI occurs in a context of low levels of aggregate demand and destructive economic and political competition in the absence of effective rules of the game, then FDI can have a significantly negative on workers in both home and host countries.

While the mechanisms through which these three factors condition the impacts of FDI and multinational corporations are myriad, we focus on two: the effect of these three factors on the bargaining power of firms relative to workers, nations, and communities; and their contribution to coordination problems that hinder the ability governments at all levels to make policies that can capture the benefits from FDI. The increased relative bargaining power of capital means that firms’ threats to leave can lead to reductions in wages, worsening of working conditions, and lower tax rates and revenues for governments. As for coordination problems, this weakened bargaining position and these weakened rules of the game make it more difficult for communities and nations to avoid "prisoner's dilemma" solutions in which countries' wages, tax rates, expenditure choices, and regulatory structures are severely distorted from the point of view of the community as a whole as they try to compete for capital. Indeed, they may become so distorted that they are suboptimal from point of view of the corporations themselves. As a result, in this context FDI can contribute in a significant way to the problems of unemployment, wage stagnation and inequality.

This framework leads to the key observation that the same level of FDI can have very different effects in different contexts. For example, consider the contrast between the effects on workers and communities of outward flows of FDI from the United States in the 1960s with the probable effects today. During the 1960s, outward FDI was of

2. In fact, there is an enormous amount of recent research on these issues, much more than we can review here. See, for example, the excellent essay by Kozul-Wright (1995) and the excellent book by Greider (1997). Also see the Journal of Economic Perspectives, summer 1995, and Federal Reserve Bank of New York Economic Policy Review, January 1995, Vol.1, No.1 for recent surveys of this rapidly growing literature.
roughly the same order of magnitude relative to the size of the economy as in the 1990s. In the high-employment, high-growth era of the 1960s, FDI was more likely to increase exports from domestic companies rather than substitute for them (Epstein 1993). But even when FDI led to domestic plant shutdowns, replacement jobs were much easier to find for workers and communities. As a result, companies had much less bargaining power over workers and communities through threats of shutdown. Companies were therefore much less able to bargain down wages and tax rates. By contrast, in the 1990s, with a shortage of high-paying jobs and critical budget problems, workers and governments are much more subject to the bargaining power of companies as they threaten to move abroad or even from state to state.

Similarly, in Singapore and Malaysia, many have benefited from FDI. This has been due to these countries' strong institutional structures and rules of the game vis-à-vis foreign direct investment and the economy more generally. (See Chang in this volume.) Now that these structures are being dismantled, it seems unlikely that they will continue to benefit to the same degree.

We can now state the central claim of this paper. We believe that in the current "neo-liberal" regime, FDI and MNCs make a race to the bottom much more likely than many mainstream economists believe. Our view stems from the claim that within the neo-liberal regime, there are strong secular forces that lead to insufficient levels of aggregate demand and therefore chronic unemployment, coercive competition, and destructive domestic and international rules of the game - that is, precisely those factors that undermine the potentially positive effects of FDI. These key components of the neo-liberal regime are well known. (See Pieper and Taylor in this volume.) Some of the most important components include budgetary austerity, financial liberalization, privatization, increased labor market "flexibility," and trade and investment liberalization.

Looking at MNCs and FDI this way helps to resolve several conundrums. First, it helps to explain how the impact of FDI can be much larger than its sheer size would suggest. Threat and spillover effects of FDI create a "magnification effect" beyond what simple quantities of flows or stocks would imply. Second, this framework helps to explain why these problems are created even if FDI flows are primarily between the Northern countries rather than between the North and the South, for it is the mobility and the threat of mobility per se that generates many of the problems, even if that mobility is between similar nations or even between similar states or provinces. For the same reason, workers and communities may be harmed even if a country, for example the U.S., has both large inward as well as large outward flows of FDI, for it is not only net mobility of capital but also the problems associated with the possible destructive impact of gross mobility of capital in a particular setting. Third this way of looking at FDI suggests that there may be negative impacts even if countries or locales do not (or indeed especially is they do not) receive any FDI, for at the behest of promoters of neo-liberal ideology and policy, countries and locales may engage in destructive bidding and structural changes to attract FDI, yet not receive much.

This latter point helps to resolve a puzzle that has bothered us for a while: progressives often criticize FDI as a destructive force while at the same time decrying the fact that many poor countries can't seem to attract any. It may be that the only thing worse than engaging in this bidding war and getting FDI is engaging in it and not getting any.

This shift in bargaining power and the destructive competition among nations and locales for capital suggests an important paradox. Studies overwhelmingly indicate that foreign direct investment is attracted by high levels of demand, high quality infrastructure, and high levels of skills and human capital (Caves 1996). Yet the process of foreign direct investment and capital mobility within the neo-liberal structure undermine those very factors that attract and sustain MNCs. In one neo-liberal regime, countries find it increasingly difficult to offer companies what they need. In the long run, companies may find it increasingly difficult to get the demand, infrastructure, and skills that they want.

More specifically, this analysis has implications for the currently common view, even among critics of massive flows of short-term capital that have wreaked so much havoc on the Mexican and Asian economies, that FDI is a more stable and beneficial type of financial flow and should be encouraged. While there may well be important benefits to be gained from FDI under the right circumstances, the neo-liberal structures that are being implemented and, in some cases, imposed on governments in many parts of the globe (most recently Korea and other parts of Asia) make it much more difficult for workers and communities to reap those benefits. Hence, FDI in that context is unlikely to be a panacea.

We will develop this argument in the rest of the chapter. We do not pretend that in this chapter we have established its truth. Much more theoretical and empirical work remains to be done. We do hope to convince the reader that this way of looking at FDI has the potential to help us understand both the real constraints policy makers face from increased flows of FDI and activities of MNCs, as well as the real options we face for policy reform.

**Trends in foreign direct investment**

It is difficult to measure worldwide trends in the activities of multinational corporations because the most widely available data, the standard measures of foreign direct investment, have serious problems. Perhaps the most important problem from the perspective of this chapter is that MNCs increasingly engage in international activities in ways that do not involve foreign direct investment. These include licensing, joint ventures, and outsourcing (UNCTAD 1995, 1997; Feenstra and Hanson 1996a, 1996b). We do not yet know how to incorporate these activities into a single measure of the overall activities of MNCs, but there are good reasons to believe that, because of them, standard measures of FDI underestimate the activities of MNCs.

Still, looking only at standard measures, one can see that FDI flows are growing rapidly. Table 1 shows the increase of FDI relative to other measures of international interactions. Clearly, FDI has been growing much more rapidly than trade and other measures of economic activity.

As we argued above, to understand the effects of FDI, it is important to look at both net and gross flows of FDI - inflows plus outflows. As we explain below, under current conditions, gross flows, with their effects on job churning and threats, can have significant impact on wages, income distribution, and the incidence of unemployment. Tables 2 and 3 show how gross FDI flows and stocks relative to the flows of domestic investment and

GDP have evolved in recent years in different regions of the world: these tables demonstrate that gross capital mobility has increased dramatically. To be sure, FDI is spread quite unevenly around the globe, with the bulk of it going to the most developed economies. Nonetheless, as these data show, the amount going to the developing world is also growing rapidly (see also Chang in this volume).

**Capital mobility, transactions costs, and enforcement**

The standard explanation for this explosive growth, favored by mainstream and heterodox economists alike, is that dramatic reductions in transactions and communications costs spurred by the revolution in computer technology have greatly reduced the costs of multinational production. While technological change is undoubtedly important, this explanation fails to come to grips with the fact that, already at the turn of the 20th century, technology was advanced enough to deliver a highly integrated international capital market (Zevin 1992). So the dramatic increase in capital mobility since the 1960s is unlikely to be explained by improvements in technology alone.

What has also changed enormously in the last several decades is the "enforcement structure," the set of domestic and international institutions and rules that secure the property rights and enhance the prerogatives of multinational corporations. These have undergone a revolution in the last 20 years at least as dramatic as

Table 1: Indicators of growth of international economic activity, 1964-94 (average annual percentage change)

<table>
<thead>
<tr>
<th>Period</th>
<th>World export volume</th>
<th>World FDI flows</th>
<th>International bank loans</th>
<th>World real GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1964-73</td>
<td>9.2</td>
<td>--</td>
<td>34.0</td>
<td>4.6</td>
</tr>
<tr>
<td>1973-80</td>
<td>4.6</td>
<td>14.8</td>
<td>26.7</td>
<td>3.6</td>
</tr>
<tr>
<td>1980-85</td>
<td>2.4</td>
<td>4.9</td>
<td>12.0</td>
<td>2.6</td>
</tr>
<tr>
<td>1985-94</td>
<td>6.7</td>
<td>14.3</td>
<td>12.0</td>
<td>3.2</td>
</tr>
</tbody>
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Table 2: *Ratio of foreign direct investment inflows and outflows to gross fixed capital formation*

<table>
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<tr>
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<tbody>
<tr>
<td>All economies</td>
<td>4.4</td>
<td>8.8</td>
<td>8.7</td>
<td>10.8</td>
</tr>
<tr>
<td>Developed economies</td>
<td>4.9</td>
<td>11.3</td>
<td>9.0</td>
<td>10.7</td>
</tr>
<tr>
<td>Western Europe</td>
<td>6.9</td>
<td>14.6</td>
<td>13.6</td>
<td>16.2</td>
</tr>
<tr>
<td>Developing economies</td>
<td>4.7</td>
<td>4.4</td>
<td>9.2</td>
<td>12.2</td>
</tr>
<tr>
<td>Latin America</td>
<td>4.3</td>
<td>5.1</td>
<td>10.0</td>
<td>16.2</td>
</tr>
<tr>
<td>Asia</td>
<td>3.4</td>
<td>4.1</td>
<td>9.2</td>
<td>12.7</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td>2.2</td>
<td>5.0</td>
<td>10.7</td>
<td>14.7</td>
</tr>
<tr>
<td>minus China</td>
<td>5.2</td>
<td>4.8</td>
<td>9.2</td>
<td>10.3</td>
</tr>
</tbody>
</table>


Table 3: *Inward and outward FDI stock as a percentage of GDP*

<table>
<thead>
<tr>
<th></th>
<th>1930</th>
<th>1985</th>
<th>1990</th>
<th>1995</th>
</tr>
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<tbody>
<tr>
<td>All economies</td>
<td>10.5</td>
<td>12.3</td>
<td>16.4</td>
<td>20.0</td>
</tr>
<tr>
<td>Developed</td>
<td>11.3</td>
<td>13.5</td>
<td>18.1</td>
<td>20.6</td>
</tr>
<tr>
<td>Western Europe</td>
<td>12.4</td>
<td>20.1</td>
<td>23.2</td>
<td>29.1</td>
</tr>
<tr>
<td>Developing economies</td>
<td>4.8</td>
<td>9.1</td>
<td>10.5</td>
<td>19.9</td>
</tr>
<tr>
<td>Latin America</td>
<td>6.8</td>
<td>11.8</td>
<td>12.8</td>
<td>20.1</td>
</tr>
<tr>
<td>Asia</td>
<td>4.1</td>
<td>8.1</td>
<td>9.2</td>
<td>20.2</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td>4.4</td>
<td>7.6</td>
<td>11.4</td>
<td>22.1</td>
</tr>
<tr>
<td>minus China</td>
<td>5.3</td>
<td>10.1</td>
<td>11.2</td>
<td>19.9</td>
</tr>
</tbody>
</table>


changes in technology and transaction costs (Epstein and Gintis 1992). The North American Free Trade Agreement (NAFTA), while one of the most significant multilateral treaties offering investment protections, is by no means the only such recent agreement.

3 Epstein and Gintis (1992) propose the idea of an "international credit regime." Such a regime consists of both an "enforcement structure" and a "repayment structure" (see also the excellent book by Lipson (1986) and the study of enforcement in the age of Pox Britannica by Kelly (1998). The "enforcement structure" is the set of institutions and practices, which creditors create internationally and in their home countries, to try to enforce their credit relations. The "repayment structure" is the set of institutions and practices that debtor countries try to establish to attract credit. To simplify the terminology in this chapter we will refer to the whole international credit regime as the "enforcement structure."
Over the period 1991-96, 95 percent of the 599 changes in countries' regulatory FDI regimes were in the direction of liberalization. "They mostly involved the opening of industries previously closed to FDI, the streamlining or abolition of approval procedures and the provision of incentives;" according to the U.N. Conference on Trade and Development (UNCTAD 1997. xviii). The enforcement structure has also been enhanced by bilateral investment treaties (BITs) signed for the protection and promotion of investment. As of January 1, 1997, there were 1,330 such treaties involving 162 countries, a threefold increase in five years. Approximately 180 such treaties were concluded in 1996 alone (UNCTAD 1997). Moreover, the OECD continues efforts to formulate a broader investment agreement, the Multilateral Agreement on Investment (MAI).

This dramatic improvement in the enforcement structure has greatly enhanced firms' exit options. And the promotion by international agencies and others of the idea that FDI is crucial for successful development has contributed to an increase in the desire by countries around the globe to attract and retain FDI. The disintegration of the Soviet Union and the evident discrediting of its economic model, along with decades of attempted sabotage by the U.S. and international organizations of alternative development models, has dramatically enhanced the "TINA" view prevalent among today's governments: There Is No Alternative to integration into the world economy. Hence, there has been a large increase in both developed and developing countries' openness to multinational corporations and increased willingness on the part of developed and developing countries to enter into treaties to protect foreign investment.

It is important to note that the enforcement structure is a political choice. Unlike declines in transactions costs, particular enforcement structures can be more or less efficient. Equally important, the choice of enforcement structure is reversible. Hence, the notion that one cannot reverse the recent trend of increased capital mobility, often stated as one cannot put the "genie back in the bottle" is almost surely incorrect.

How will this new context affect the impact of MNCs and FDI? We will argue that this new enforcement structure, in the context of the other factors we discuss, will not only lead to greater quantities of FDI, but will also likely reduce the quality of FDI from the view point of workers and communities.

Theories of the effects of FDI and MNCs

Mainstream models
While most mainstream theorists subscribe to the neo-liberal convergence (Sachs and Warner 1995) or "much ado about nothing" schools of thought (Krugman and Lawrence 1994; Slaughter 1995), there are a number of interesting mainstream models that predict uneven development rather than convergence from the joint impact of capital mobility and technological change (Krugman and Venables 1995; Markusen and Venables 1996; Johnson and Stafford 1993; see Stanford in this volume for a review).

A recent influential monograph by Dam Rodrik (1996) is an important addition to the literature, an addition that complements the analysis developed here. Rodrik argues that gross capital mobility and trade, even between countries with similar levels of income, increase the elasticity of demand for labor and thereby can negatively affect the distribution of income. Rodrik's model differs from ours in that it assumes full
employment. But his model will have some impacts on labor that are similar to the ones we describe.

In short, there are numerous mainstream models of MNCs, trade, and technological change that allow for the possibility of either uneven development or a race to the bottom. Neo-liberal convergence is only one of a number of possible outcomes and therefore has no theoretical priority even within the mainstream.

**Heterodox models**

It is important to note that, as in Rodrik's analysis, virtually all the mainstream models assume full employment. In contrast, one advantage of heterodox models is that they do not make the (unrealistic) assumption of full employment. Moreover, they place center stage the distribution of income between capital and labor rather than focus exclusively on the distribution of income between skilled and unskilled labor.

Blecker (1997b) develops a series of heterodox models to investigate the effects of trade and capital mobility on income distribution and growth in the North and South. The distinctive feature of one of Blecker's models is that workers' wages can be affected by the threat of moving by MNCs, since the threat can lower the bargaining power and wage share of Northern workers. As we suggest below the effects of such threats may be the key to understanding why an evidently small share of outward FDI may have a relatively large impact on wages.

**An alternative framework**

Our alternative framework starts with the point emphasized by Blecker on the importance of bargaining power and threat effects on macroeconomic outcomes. Here, we emphasize three actors that have a strong impact on bargaining power: (1) the level of aggregate demand, (2) the nature of competition, and (3) domestic and international rules of the game. The nature of these three factors in the current neo-liberal regime, we argue, has a directly negative impact on inequality, unemployment, and wage stagnation. But, more relevant to the argument in this chapter, they make it more likely that FDI and MNCs will have a negative impact on these three phenomena.

**Our model**

Imagine there are two countries and that in each country there are two "communities," at least one of which has an excess supply of labor (i.e., unemployment, measured or disguised). Now assume there are two multinational corporations, one located in each country, so that in each country there is one community without an MNC. Also, to attack the argument against us, assume that there is a substantial fixed cost of moving from one locale to another, but that if the MNC pays that fixed cost, it can close down its operation in one place and move to the other. Similarly, assume that wages and all other costs, including taxes, and productivity levels are initially the same in all four communities. Assume that neither the MNCs nor the communities can collude, that the companies want to maximize expected profits, and that, initially, the communities want to maximize the sum of total wages accruing to them. For simplicity, the workers (working and unemployed) are represented by unions.
Now, let's say that, due to a change in norms or other aspects of the external environment, the two MNCs decide to open their location decisions for bidding and tell all four communities that they are willing to move to the location of the highest bidder. First, assume that the only issue on the table is wages. The communities without MNCs located in them will put in a bid low enough to attract the MNCs, that is, low enough to pay for the fixed costs involved in moving, as long as the lower wages are above the opportunity costs of the unemployed workers of taking the jobs (or their fallback positions). Whether it is above the fallback position will depend on a host of factors, most notably the level of the fixed cost facing the MNC, the unemployment benefits, and the family structure prevalent in the community (for example, whether unemployed workers are expected to perform child care within the family are compensated for doing so. etc). The lower the fixed cost, the worse the social safety net, and the lower the opportunity cost within the family of outside employment, the more likely a bid will be put in that is low enough to induce MNC movement.

Given that bid, the workers in the communities where the MNCs are currently located will have to decide whether to lose their jobs or take a pay cut to reduce the differential between their pay and that of the other communities to a level that is less than the fixed cost. If the opportunity costs of employment are the same in all communities, then they will reduce their wage offers to close the gap to a level below the fixed costs. Note that their wages will not be driven all the way down to the offers of the worker in the other communities - they will be driven down to match the other offers only if there are no fixed costs of moving. In either case, the MNCs will not move. There will be no FDI. But *there will be a decline in wages induced by the threat of moving: this is an example of what we have called the "magnification effect."*

In the foregoing analysis, substitute the word "taxes" for "wages" and there will be a decline in tax rates resulting from the threat of moving, despite the fact that there will be no movement of capital whatsoever.

Note that the existence of the other communities not only causes a shift down in the demand curve (actually, the bargained wage curve) for labor. It also increases the elasticity of the curve, making it more difficult to raise wages or taxes (see Rodrik 1996).

Now assume that there is an allotment of new investment that each MNC wants to make and that the cost of the new investment is independent of the locale in which it is placed. Each MNC will initiate a bidding war and, if the four communities are identical the bidding war will drive down the wages to the opportunity costs of employment in these communities (though one must take into account that some of the communities already have MNCs and therefore their opportunity cost might be different). Assume that the new allotment of investment flows randomly, since the MNCs are indifferent to where it goes and therefore it makes no difference to the outcome whether it goes to one country (net FDI), goes to both counties (no net FDI but gross FDI ), or stays in the home country (neither net nor gross FDI). So, in this case there can be declines in wages (or tax rates) even if there is no net investment but there is gross investment. If there are agglomeration effects so that it is more profitable to make the new investment where the old one has already existed, then the wages (or taxes) in the communities where the investment is currently located will not be bid down to the same level as in
the other countries, but they will be bid down nonetheless, unless the agglomeration
effects are quite large.

Of course, the situation becomes worse for the workers in these two countries if now
a third country opens itself up to investment with all the same characteristics as the first
two but with lower opportunity costs of employment. Then the FDI will flow away from
the first two countries to the newly opened country, say China. But one needn't have
this third country to get the changes in wages and taxes pointed to above. Note that if
there are risks associated with FDI, and these risks increase with the amount of
investment in one locale, then even if the third country does open up, not all investment
will go there, even absent transaction costs.

Finally, look at the countries that have bid for the FDI but have not received any,
because, for example, their productivity levels are too low. They have reduced their tax
rates and wage rates. If this, in turn, lowers tax and wage rates already prevailing in
these countries, then the existence of this bidding process has altered the distribution of
income and reduced the level of public services that the community can afford. In short,
bidding can have negative effects even if no investment comes.

Assumptions necessary to drive the results
To deliver these results, first there must be insufficient aggregate demand to provide
full employment. Second, there must be a set of practices of multinational corporations
that leads them to alter the way that they have done business in the past and put up their
location decisions for bidding, while at the same time being willing to lay off workers,
close down plants, and move elsewhere to increase profits. Third, there must be an
absence of must be an absence of domestic or international rules of the game that would pre-
vent communities and workers front driving down their own wages and tax rates.

It is these three factors, inadequate aggregate demand, coercive competition, and weak
domestic and international rules of the game, that, among others, characterize the neo-liberal
regime and lead, we argue, to these negative impacts.

Justifying the basic assumptions: aggregate demand, coercive competition, and rules of
the game in the neo-liberal regime
In this section, we will try to justify the claim that the neo-liberal regime has the three key
destructive characteristics isolated in the previous section. A basic argument is that the forces
operating to raise AD in the new regime are structurally weak, while pressures on firms to
lower costs through downsizing or "labor shedding," speedup, and wage cutting are structurally
strong The heightened competition characteristic of the neo-liberal regime in the face of
sluggish product market growth is, we argue, likely to generate slow trend growth in the
demand for labor. Normal patterns of labor supply growth, therefore, should generate a
persistent problem of excess labor supply, resulting in continued high trend levels of
unemployment (which will appear in the form of "disguised" unemployment in countries-both
Northern and Southern-without an adequate social wage). Secularly high unemployment, along
with continued deterioration of the institutions that have sustained workers' economic and
political power, should continue to generate slow or stagnant wage growth and rising wage
inequality. Within this context, increased mobility of FDI and MNCs will be more likely to
have a negative impact on workers and communities than under the old "Golden Age" regime
because MNCs will be able to bargain down benefits to workers and communities. Moreover,
global labor supply patterns are unlikely to be "normal": a number of countries previously insulated to a substantial degree from the global capitalist marketplace are in a slow, uneven, and incomplete process of integrating themselves within it. Russia, India, China, and Eastern Europe (the "RICE" countries) are most important. Many of these countries have substantial quantities of skilled and educated workers who are low priced by standards of the Organization for Economic Cooperation and Development (OECD) countries. Under the assumption that increased global openness and technical progress make it ever more feasible to locate production, distribution, research and development, and even coordination functions of MNC business in diverse geographical locations, these skilled workers, along with the skilled workers being educated and trained in the East Asian newly industrializing economies (NIEs), will provide lower-cost alternatives for MNCs to many of the higher wage skilled Northern workers whose jobs and wages were not significantly affected by globalization in the 1980s.

**Coercive competition**

In our "bargaining" or "conflict" view, the constitution of the bargaining agents, their choices of bargaining strategies, and resultant outcomes are profoundly affected by: (1) the character of interfirm relations or the "competitive regime" (which affects, among other things, the level of economic rents available to be split between the bargainers); (2) the institutional environment within which bargaining takes place; and (3) macroeconomic conditions.

Here we focus on the competitive regime. The idea of the competitive regime and its effect on economic performance is discussed in Crotty (1993). In the "corespective" competitive regime of the Golden Age in the North, cooperating oligopolistic firms in key Northern industries took advantage of fast market growth and limits on both domestic and international competition to generate substantial, dependable profits and rents. Firms could accumulate capital without excessive concern that national AD would fail to grow, that imports would steal their customers, that financiers would take huge chunks of future profits, or that their new capital would be made prematurely obsolete by the outbreak of fierce cost-cutting battles over market share. High rates of investment and productivity growth followed. Strong unions, government support for the maintenance of a fair share for labor, distributive accords or understandings between capital and labor, and sustained full employment produced a division of substantial oligopoly rents that was satisfactory to the bargainers. The strong real wage growth thus generated in turn helped sustain the rate of growth of AD.

This regime broke down in the 1970s and early 1980s, partly from internal contradictions, but partly under the pressure of the increasingly open national borders associated with the globalization process. It was eventually replaced by a new regime of "anarchic" or "coercive" competition (Crotty 1993). With AD now consistently inadequate to generate rapidly growing markets or full capacity utilization and with barriers to international competition breaking down everywhere, firms entered a more Hobbesian world. In the core industries of the North, firms were forced to reconsider every traditional aspect of the structures and strategies they used in the preceding co-respective regime - geographical location, pricing, financing, product mix, choice of technology, labor relations, and even the organization of the enterprise itself.

Corporate response to these altered circumstances differed substantially across the OECD, though as time goes on the general direction of strategic changes is becoming ever more convergent. In the U.S. -the model toward which many countries aspire to converge - the two most important aspects of corporate America's new competitive strategy in the late 1970s and early 1980s were the choice of conflictual rather than cooperative relations with labor (the disavowal of the traditional accords) and a rejection of support for an effective social
"contract:" one that assured both full employment and the maintenance of an adequate social wage. The corporate attack on labor was multidimensional. It included, among other thing, war on unions, political support for stripping workers of their legal rights, the widespread use of replacement workers during strikes for the first time in the post-World War II era, outsourcing, and FDI.

It is crucial to analyze the effects of technical change on Northern labor markets in light of this competitive regime shift and the subsequent move to antiworker corporate strategies. Under severe competitive pressure, companies took advantage of union weakness, a more business-oriented government judicial and regulatory framework, and advances in information processing and computerized machine control to invest in technologies that helped them implement these new strategies. Where neo-classical economists posit exogenous technical change that just happens to be skill biased, we see instead an endogenous process in which corporations under intense competitive pressures chose to develop or adopt technologies that helped them reduce labor costs through downsizing, speedup, and wage cuts. Technical change in the 1980s probably was on balance skill biased, though no more so than in previous decades (Mishel and Bernstein 1991). But its distinctive characteristic was that it was labor saving or labor shedding, and labor disempowering as well.

While we have emphasized the U.S. experience here, there is evidence that as the neo-liberal regime spreads, this process of coercive competition will spread as well. Below we discuss the impact of the recent Asian financial crisis in the South. Here we note that the regime is spreading in the North. For example, in a recent survey of research on comparative industrial relations by Locke, Kochan, and Piore, the authors note that: "In almost every country covered in the study, various government regulations and norms governing recruitment, dismissal/redundancy, lay-offs and the allocation of labor have been relaxed or modified so as to give individual employers greater discretion" (p. 145): "[e]verywhere unions are in decline and management is resurgent" (p. 147): and "in all countries, there was a resurgence in inequalities in income or in employment opportunities" (pp. 151-2). Nonetheless, the authors also stress that workers continue to fare best in those countries with a traditional government commitment to intervention in labor markets and significant union involvement in industry or national bargaining.

Together these processes have two effects relevant for our argument: first, this coercive competition helps to explain why MNCs would alter their strategies toward communities and labor and begin a coercive process of leveling-down bidding as described in the model above. Second, they help explain why inadequate aggregate demand is likely to be an important feature of the neo-liberal regime, a second necessary component of our model. We explain this latter point more fully now.

**Global aggregate demand growth**

Next we turn to a defense of the assumption that global growth in aggregate demand is likely to be sluggish in the new regime. Quite obviously, AD growth has in fact been relatively slow in the quarter century since the end of the Golden Age. In Europe, for example, real GDP growth since 1973 has been only about half as fast as it had been in the preceding two decades (Glyn 1995b, 43), so that, even with relatively slow measured productivity growth, unemployment rose to double-digit levels. Is growth likely to pick up substantially in the coming years? Consider the components of aggregate demand.
Take consumption spending first. Given our argument about pressures for labor-saving organizational and technical change in the North unless AD growth picks up substantially, high unemployment and stagnant wages will continue to constrain the growth of consumption spending. Investment spending in the North has also grown at a modest pace in the past 20 years, and outside the computer- and software related industries there may be no forces that will sustain an increase. It is an open question as to how powerful an impetus might emanate from the computer industry itself. As we argued above, this is precisely the industry that facilitates labor shedding and therefore reduces aggregate demand. Assessing the net outcome of these two forces - the labor shedding on the one hand and the spur to new investment on the other - requires further research: but optimists who hail the computer industry as an obvious source of increased labor demand ought to be more cautious in their prognostications. Next we turn to export growth. Export growth has been rapid in the last decade or so, but it seems unlikely it can be sustained in light of the Asian financial problems that, we argue below, are directly related to the neo-liberal model.

As we have seen, consumption, investment, and export demand are all problematic in the neo-liberal regime. To make matters worse, to counter an AD shortfall, they would have to be positive enough to outweigh the enormous deflationary forces emanating from national and international macroeconomic policy that are likely to prevail in the future. First, central banks around the world have adopted the neo-liberal credo that pursuit of low inflation is their primary, perhaps sole, responsibility. Second, the enormous buildup of government debt in the hands of both domestic and foreign rentiers over the past two decades has given them enormous power to punish both fiscal and monetary authorities who adopt expansionary policies that are perceived to be against rentier interests. (See Felix in this volume and the discussion of Asia below.) Since an ever-increasing percent of government debt is in the hands of nonnationals, and since foreign debt holders are quicker to sell it at the onset of inflation, this particular impediment to expansionary policy is likely to strengthen in the future as national financial markets become ever more powerful and globally integrated. Third, both internal and external pressure has mounted in virtually every country to put a stop to the ongoing rise in government deficits and debt-to-GDP ratios brought on by the slow growth and rising unemployment of the past two decades. Fourth, in the absence of internationally coordinated macro policy, it is harder for governments to try to grow at a pace substantially faster than their neighbors and competitors.

In short, inadequate aggregate demand is likely to prevail in the neo-liberal future.

International rules of the game: enforcement and tax competition

In addition to the neo-liberal forces described above that contribute to secular unemployment and coercive competition, changes in the rules and practices governing international enforcement have a significant impact on the relative bargaining power between multinational corporations on the one hand and nations and communities on the other. They also create difficult coordination problems for countries wanting to tax and regulate MNCs for the community's benefit. In this regard, in the period up until the late 1970s many countries, both in the North and the South, imposed numerous conditions and controls on entry and operations of MNCs (Fatouros 1996, 47). As the data on the increase in bilateral and multilateral investment treaties discussed above show, this is now changing.

Bilateral and international investment agreements, by restricting what governments can do, take a number of policies off the bargaining table and out of the realm of possibility. For example, to the extent that they make performance requirements such as domestic


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content rules illegal, these agreements reduce the scope for industrial policy. While governments that negotiate such treaties may have no interest in pursuing industrial policy, the treaties, by design, tie the hands of future governments as well.

In sum, these three aspects of the neo-liberal regime, coercive competition, insufficient aggregate demand, and absence of domestic and international rules of the game that would allow countries to control MNCs and avoid bidding wars, are precisely those conditions that our model suggests are likely to contribute to a negative impact of FDI and MNCs on workers' and communities' standards of living.

Evidence on the effects of FDI and NINC s on wages and taxes in the neo-liberal regime

The hypotheses discussed before suggest an entire empirical research program based on the idea that, where the neo-liberal regime is most widespread, one ought to observe a number of negative impacts from FDI and MNCs. For example, threat effects ought to reduce wages and the quality of working conditions; the capital share of income ought to be increasing and, except for those groups of employees who have direct access to MNC rents (lawyers, investment bankers, and the like), the wage share ought to be declining; and there should be an increase in unemployment (real or disguised) associated with an increase in net outflows of FDI and MNCs. In terms of taxation and host bidding, one would expect a decline in taxation of MNCs and an increase of subsidies available to them, as well as a decline in government restrictions facing them, whether or not MNCs actually end up investing in a particular locale. Countries are unlikely to be able to capture many of the benefits from MNC technology transfer unless they have a strong regulatory structure.

There is a great deal of crude evidence consistent with these implications. But a careful consideration of these testable implications requires substantial future research. The only direct study of threat effects that we are aware of is that of Bronfenbrenner (1996), who reported on a U.S. survey covering 1993 through 1995. It showed that 50 percent of all firms and 65 percent of manufacturing firms that were targets of union organizing campaigns threatened to close down and move if their workers unionized. Though only 12 percent of those firms that ended up unionized subsequently shut down, workers found the threats credible - where threats were made, unions lost a larger percent of elections.

Most of the empirical work directly linking MNCs and FDI to wages has been concerned with their effects on inequality among workers rather than their impacts on labor relative to capital. Still, even in this literature one can get some inkling of the effects on labor versus capital. The most interesting work in this area is that by Feenstra and Hanson, who study the joint impact of "outsourcing" and technological change. They note that outsourcing, defined as importing of intermediate inputs, has increased substantially within the U.S. manufacturing sector, at an annual rate of 4.6 percent between 1979 and 1990. At the same time, while the production wage share declined substantially during the 1979-90 period (at an annual rate of -1.4 percent), and the nonproduction wage share has only slightly increased, the capital share increased by an average rate of 1 percent a year over the period (Feenstra and Hanson 1997, Table 2). The
authors argue that these changes are the result of an imprecisely measured combination of outsourcing and technological change.

There have been a great many studies to determine the employment and wage effects of FDI (see Caves 1996 for a recent survey). For example, Blomstrom, Fors, and Lipsey (1997) find that in the year they studied, 1989, increased sales by U.S. multinational foreign affiliates abroad reduced employment in the U.S. parent multinational, with the impact for employment in MNC investment in less-developed countries being much stronger than for MNC activities in the North. James Burke finds that increased investment abroad by U.S. multinational corporations tends to reduce multinational investment at home for highly indebted U.S. multinationals (Burke 1997).

A number of recent studies have investigated the effects of capital mobility on tax competition and corporate tax rates. For the United States, for example, there has been a dramatic decline in the corporate tax burden in recent years, from an average of 64 percent in the 1970s to 42 percent in the 1990-96 period (Poterba 1997, Table 2). Without further study it is, of course, impossible to tell how much of this may be due to capital mobility, though Tanzi (1995) suggests that capital mobility is an important culprit. Not only might competitive bidding reduce tax rates, but multinational corporate production gives enormous opportunities to reduce tax burdens through such mechanisms as income shifting and transfer pricing (Hines 1996; Grubert and Slemrod 1991; Tanzi 1995).

The "war between the states," as the competition among U.S. states for investment and jobs has come to be called, may well be a microcosm of what could be emerging in the global arena as the neo-liberal regime strengthens. Subsidies and tax breaks to attract investment cost local governments tens of billions of dollars in lost tax revenue; yet as the willingness to offer such concessions becomes universal, they have less and less effect on plant location decisions. The Federal Reserve Bank of Minneapolis has called for a federal law prohibiting state and local tax incentives for particular companies in an attempt to reduce this destructive war (see Federal Reserve Bank of Minneapolis 1991; Holmes 1995).

This competition is spreading more widely to the South as well. In addition to removing barriers to inward capital flows, governments attempt to entice FDI with a variety of investment incentives. However, the empirical literature suggests that investment incentives have not been effective in attracting direct investment flows. Instead, this literature has identified market size as the dominant influence on direct investment inflows (UNCTC 1991, 1992a, 1993). Despite and perhaps due to their pervasiveness, tax holidays do not seem to lure direct investment. Moreover, even if flows arrive they may not benefit the domestic economy, especially if, because of liberalization agreements themselves that lock governments' hands, they cannot regulate the MNCs in the community's interest (UNCTAD 1992a, 1992b, 1994a). One of the ways in which MNCs could improve growth prospects in the South is by transferring technology and training that would spill over into productivity increases in the domestic economy (UNCTAD 1994a). However, a review of the empirical literature suggests that the spillover effects on wages in developing nations have been low to nonexistent. For example, Chittrakar and Weiss's (1995) analysis of the effects of foreign investment in Nepal indicated that foreign investment had only a small impact on labor income. In addition, Aitken, Harrison, and Lipsey (1995) concluded that foreign direct investment in Mexico and Venezuela had no spillover effect on wages in the domestic sector of those economies.
Although compared to other low- and middle-income nations the East Asian countries demonstrate income equality. Wood (1994) suggests that in recent years their performances on this index have been somewhat mixed. He links these fluctuations to outsourcing to lower-wage countries and slowing of educational expansion. The former is particularly troubling, since it suggests a pernicious leveling down cycle that now pits middle-income countries against low-income countries as well as high-income countries against low- and middle-income countries.

**Domestic structures matter and the spread of neo-liberalism in the South: the Asian financial crisis**

All nations, North and South, have had to confront economic pressures emanating from the emerging neo-liberal global regime, but there are enormous differences across countries in the institutions, structures, and social and political priorities that intermediate between firms, workers, and governments on the one hand and MNCs, international rentiers, and international organizations on the other. Since a key point of our analysis is that the context strongly affects the impacts that MNCs have, it should come as no surprise that we believe that these structures have made a significant difference in the way national economies have experienced global economic forces and responded to them. Countries that have been able to insulate themselves from and manage global forces have performed the best. Here the East Asian miracle economies are the most important examples in the South, while Sweden is an example from the North. But now, both models are being undermined by domestic and external forces of neo-liberalism. Their stories suggest how the spread of neo-liberal structures will intensify and broaden the negative practices and institutions we have focused on here.

In this section we briefly discuss the rise and fall of the Asian model from this perspective. In the next section, we study Sweden.

**The Asian financial crisis and the rise and fall of the Asian model**

Most of the developmental success stories of past decades were in Asia, especially East Asia. Indeed, the outstanding economic performance of Japan, Korea, Taiwan, China, and others over recent decades has led to widespread recognition of an East Asian "economic miracle" and admiration of what came to be known as the "East Asian model" of economic development (see Amsden 1989; Nemhhard 1996). Of course, recognition of the outstanding economic performance of these countries does not imply support for all aspects of their political economy or, in particular, their lack of democracy. Nevertheless, there is no denying that, in countries such as Japan and Korea, enormous economic progress has been made in recent decades, and prosperity has been widely shared.

Though the East Asian model is profoundly anti-neo-liberal, these nations have integrated themselves to varying degrees in international markets (though some, such as Korea and Japan, purposely minimized the role played by foreign MNCs and inward FDI). But they did so, at least until recently, more or less on their own terms and in pursuit of their own economic interests. Though these countries differ in many important ways, development has been guided in every case by some form of state-led industrial policy, utilizing credit allocation, regulated and differential interest rates, government-controlled central banks, regulation of labor markets, high state spending on education and infrastructure managed trade, and controls over the movement of money capital and inward and outward FDI.
All of the East Asian models have evolved and adapted over time: no specific national political-economic structure or concrete model of state-led development policy can remain effective across decades of growth and change. For a variety of reasons, in the late 1980s and 1990s it became necessary to make significant changes in both state and private sector practices in all of the Asian countries. Over this period, debates arose in every country over how the structures of the "model" should be adapted. Most of the proposals for change involved some degree of deregulation (see Crotty, Epstein, and Kelly 1998).

Of course, the composition and perceived interests of various class strata evolved over time as well. Powerful domestic financial and industrial enterprises and wealthy and politically influential families, having enriched themselves in the process of economic development through state-led industrial policy, came to believe that substantial deregulation, especially of domestic and international financial markets, rather than a revision of reform of state-controls, was in their individual economic interest. The changes they pushed did not constitute a coherent or viable stable model, nor a full neo-liberal package. Indeed, they maintained allegiance to those dimensions of state regulation that continued to suit their interests.

Thus, the issue was not whether change was needed - everyone agreed it was - but what form change should take. However, this internal demand for financial deregulation was strongly reinforced by the forces of global neo-liberalism, which increased in power throughout the 1980s and 1990s. The U.S. and other large Northern countries, important transnational industrial firms and banks, and the international financial institutions (IFIs) came together to pressure Asian nations in the direction of full-blown neo-liberalism.

This brings us to the core of our argument: external neo-liberal forces profoundly influenced, and in some cases may even have determined, the outcomes of these national debates by substantially altering the perceived costs and benefits attached to the various possible new development strategies and structures available. In so doing, they empowered certain domestic class strata and severely weakened others. These forces deflected structural change away from evolution of the East Asian model and toward the neo-liberal path of deregulation, liberalization, and privatization.

The combined influence of this coalition of domestic elites and global forces turned out to be determinate in the period from 1980 through mid-1997. At different times and to different degrees in different countries, governments that had formally regulated domestic financial markets, set interest rates, and carefully monitored the allocation of credit began to cede these functions to the private sector. In like manner, governments that had imposed controls on the movement of money capital across their borders began to loosen them.

The relatively low interest rates in Japan and the U.S. in the early 1990s were an instigating factor in the crisis that followed: investors looking for higher returns now found the Asian markets open and willing. The result was that conditions were constructed that could lead to super-heated Keynes-Minsky speculative boom and bust cycles - super-heated because, if and when the inflow of foreign "hot" money became substantial, it would accelerate speculative fever. And, in the absence of capital controls, the bust phase of the cycle was likely to be exacerbated by a run on the currency by foreign and domestic investors. This is precisely what happened.

In short, ill-conceived deregulation movements and global capital market events turned a number of Asian countries from economic miracles to economic disasters in what seemed to be a matter of weeks. Neo-liberal economists, who had been denying for years that the success of

the East Asian miracles had been created by state-led industrial policy, who insisted that it was generated by free markets, now claimed that the crisis was caused by the same powerful but inefficient state industrial policies whose existence they had denied until the crisis broke.

**The IMF-U.S. ‘rescue’**

The International Monetary Fund (IMF) - U.S. "rescue" packages for East Asia were thinly disguised attempts to impose neo-liberal structures on Asian economies and to open them for Western business interests. The rescue package for Korea, for example, was the type likely to create precisely those neo-liberal conditions that we have argued here are so destructive to the effective regulation of globalization in general and FDI in particular: they imposed austerity and the reduction of the state's ability to regulate and control investment and capital mobility.

Take austerity first. Though austerity is standard IMF medicine, in Korea it was applied to a country that did not have the standard symptoms; unlike recipients of IMF aid in Latin America, Korea had low inflation and its budget was in surplus. The IMF insisted on cutbacks in government spending, an increase in (regressive) taxes, and a substantial rise in interest rates, which were already high in real terms.

But the U.S.-IMF program demanded far more than austerity; it sought the complete transformation of the Korean "model" and the opening of all Korea's markets to unrestricted access by foreign MNCs, banks, and financial investors. The IMF demanded that the government end its control over central bank policy and give up its influence over the allocation of credit by the private sector - credit allocation would henceforth be regulated solely by considerations of private profit. These steps would destroy the government's remaining ability to direct credit and provide preferential interest rates to targeted firms and industries, a cornerstone of the East Asian model. And experience suggests that independent central banks tend to follow policies designed to minimize inflation at the cost of growth and employment.

The program called for the elimination of managed trade: tariffs and export subsidies were to be drastically reduced or eliminated. Legal impediments to the foreign takeover of Korean firms and banks were to be eliminated by early 1995. Even the prohibition against hostile foreign takeovers was to be ended. This represented such a great victory for Northern multinational banks and nonfinancial corporations (which have been trying for decades to more deeply penetrate Korean markets) and such a potential blow to Korean firms that they could be expected to try to find ways to subvert its intent. Foreign ownership of Korean commercial banks would be especially devastating in a system where large industrial firms have high debt/equity ratios even in normal times, and bank-firm relations are at the core of Korea's success story.

The last IMF dictate we consider is the demand that the government remove all remaining restrictions on cross-border financial flows. Under this regulation, foreigners are able to invest in the Korean financial markets on the same terms as citizens, and all restrictions on foreign investment by Korean nationals are removed. Again, the complete elimination of capital controls over even the shortest-term speculative loans and investments appeared to many observers to be a disastrous policy.

The question arises as to why the Korean government accepted such draconian measures. The answer, in part, is that the major Korean corporations, the chaebol, believed that they could use the IMF against the labor unions and the government to win major labor concessions and to eliminate burdensome regulations, including constraints on their ability to borrow abroad. This is an illustration of the key point made earlier: the creation of neo-liberal...
structures in non-neo-liberal countries is facilitated by the new incentives facing domestic corporations resulting from the emerging neo-liberal international economy.

In sum, the IMF medicine is precisely the type to contribute to the creation of the three negative factors we have emphasized in this chapter: insufficient aggregate demand, coercive competition, and weakened domestic rules of the game.

**FDI in the neo-liberal regime: the case of Sweden**

We have argued that, while FDI did not have a significant negative effect on working people in the North in the full employment Golden Age regime, it can pose a serious threat to jobs and wages within the structures of the neo-liberal regime. To see how FDI and neo-liberal structures can interact with one another to create an economic and political crisis for workers, consider the case of Sweden, one of the outstanding Northern success stories of the post-World War II era.

MNCs have always been very important in the Swedish economy: they accounted for 69 percent of manufacturing employment in 1970. Yet in the Golden Age FDI was probably helpful to Swedish workers and the Swedish economy. Outward FDI was modest, on average less than 1 percent of GDP per year through the 1970s. Given Sweden's record of sustained full employment, FDI was not a threat to domestic jobs, and, under a centralized bargaining structure that had the allegiance of corporate leaders, FDI did not restrain wages or disrupt the ongoing decline in inequality. To the extent that outward FDI helped facilitate and maintain a high level of Swedish exports (through the maintenance of effective marketing and distribution networks), it helped Swedish firms take advantage of technical change, gain economies of scale, and achieve higher productivity growth rates than would have been possible if production were primarily for the small domestic market. At worst, FDI did not prevent the Swedish economy from posting an outstanding postwar economic performance. Its impressive combination of sustained low unemployment and an egalitarian income distribution was maintained through most of the 1980s.

However, by the early to mid-1980s global instability, world recession, and a falling domestic profit rate began to exacerbate emerging strains in the Swedish corporatist economic system. While unemployment remained extremely low, inflation picked up, creating problems in the crucial export sector. By the mid-1980s Swedish MNCs had become openly antagonistic to the set of traditional relations and mutual obligations connecting business, labor, and the state that had come to be known as the "Swedish model." Lindbeck points to the onset of an "ideological offensive" by capital in the early 1980s designed to replace traditional arrangements with a "more free market oriented position" (1997, 1277). Employers first pulled back from the centralized bargaining system: Sweden's "long-standing solidaristic wage policies followed throughout most of the 1970s gave way somewhat as business pushed hard to decentralize bargaining structures and to lower labor costs" (Locke, Kochan. and Piore 1995, 151). They also pressured the state to deregulate the economy.

The threat of capital flight (moving operations overseas) and capital strike (refusing to invest at home) are two key structural sources of power business can use to pressure labor and the state to bend to its will. The ability of Sweden's MNCs to flee the domestic economy through outward FDI and to substitute foreign for domestic investment gave them leverage over labor (through the threat to jobs and wages) and the government (by

making its traditional economic objectives impossible to attain). This leverage was magnified by technical change, which made FDI easier, and by the evolution of the new global regime, which created external pressures to liberalize. Outward FDI was both a major contributor to the deterioration of Sweden's economic performance in the 1980s and, especially, the 1990s, as well as a powerful weapon used by capital to force its neo-liberal political and economic policies on the rest of society.

Sweden's MNCs virtually fled the country in the second half of the 1980s. This created enormous pressure on both labor and the state to accept the MNCs economic and political agenda. Between 1981 and 1992 outward FDI averaged an astounding 13.1 percent of domestic investment, while inward FDI was just 3.2 percent (Glyn 1995b: 44). But the "flow of outward FDI during the 1986-1990 period was almost five times higher than in the 1981-1985 period," so that the "Swedish share of the MNCs production had fallen to below 40 per cent by 1990," down from 61 percent just four years earlier and from 72 percent in 1978 (Blomstrom and Kokko 1994: 5, 34). Outward FDI grew from 1 percent of GDP in the early 1980s to 2 percent by 1985, then skyrocketed to an unprecedented 6 percent (or 28 percent of all investment) by 1989. MNCs were using the high profits of the mid- to late 1980s to finance outward FDI rather than domestic investment.

The problem was not just that this flight of capital cost jobs, income, and exports. Having renounced their commitment to the domestic economy and to the institutions of the Swedish "model," Sweden's MNCs were hollowing out domestic manufacturing, exporting primarily the high value-added, high-skilled parts of the production process to their foreign affiliates while leaving lower-skilled raw material processing and intermediate goods production for their home operations. Blomstrom and Kokko argue that this FDI outflow harmed the economy in numerous ways: the big MNCs now employ a lower share of high-skilled workers than does the rest of Swedish industry; the fruits of Swedish R&D appear in their high-tech foreign operations rather than at home; and there have been serious negative spillover effects on domestic suppliers and subcontractors. Moreover, for the low-tech products left at home, "there is already fierce price competition in global markets" rather than the oligopolistic rents of high-tech markets, so that "continued competitiveness in these industries requires cost reductions and perhaps also falling wages" (Blomstrom and Kokko 1994: 23-4).

Capital flight made it difficult for the state to continue to play its traditional role. Under business pressure, the government began to dismantle important components of its regulatory apparatus. The domestic financial system was deregulated in 1985, forcing domestic interest rate upward toward global levels. Credit rationing had traditionally been one of the state's most important tools of countercyclical macro policy. Thus, the deregulation of domestic financial markets drastically reduced the ability of the state to avoid speculative booms and maintain full employment. Capital controls were weakened, then, in 1989, virtually eliminated. The dismantling of capital flows in turn induced a huge inflow of short-term foreign funds. This helped facilitate a subsequent explosion of credit-financed speculation, creating a cyclical upturn but overleveraged household and business sectors as well. When this speculative boom eventually went bust, the financial fragility it left behind constrained consumption and investment spending. In the absence of capital controls, funds quickly left the country, putting downward pressure on the


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krona. The government resisted this pressure through the maintenance of high interest rates right through the recession.

The MNC-led business sector was now in a position to launch an all-out assault on the remaining elements of the traditional structure. Shorn of many of the tools traditionally available for use in resisting recession, and pressured by its MNCs not to do so, the Swedish government turned its back on its half-century commitment to full employment and embraced overly restrictive monetary and fiscal policy (in part to try to converge to EC inflation rates as a prelude to hoped-for membership). The early 1990s saw the deepest recession since the 1930s. Real GDP fell by 5 percent between 1990 and 1993. and unemployment rose to unprecedented heights - from 1.5 percent in 1990 to 9.5 percent in 1994. Yet the government maintained high interest rates and restrictive fiscal policy throughout.

There is no doubt that the Swedish model was destroyed by internal contradictions as well as external pressures: rising capital mobility was hardly the only threat to its reproduction. But it seems reasonable to conclude that the ability to "flee" the country gave Swedish MNCs enormous leverage in their successful campaign to change the structures of domestic industrial relations and the role of the state in the economy. The unprecedented flight of real capital in the 1980s, while to some degree a response to the economic strains that had developed in the late 1970s and early 1980s, clearly helped create the economic crisis that severely damaged the Swedish "model" in the 1990s and gave capital the power to shape the reconstruction of Swedish political economy. Sweden's recent history shows that, within the neo-liberal regime, the greater the importance of MNCs in the economy and the weaker the state's control over cross-border capital flows, the greater the economic and political damage that MNCs can cause through outward FDI.

A framework for policy

We have argued that FDI and MNCs are likely to have a negative impact in terms of wage inequality, wage stagnation, and unemployment where the bargaining power of corporations is significantly increased relative to workers, communities, and nations due to three aspects of the neo-liberal regime: (1) insufficient levels of aggregate demand; (2) institutions and rules of the game that facilitate capital mobility and encourage national and subnational competition for capital; and (3) the promotion of coercive rather than co-operative competition among firms.

What, if anything, can be done to reverse the negative impact that FDI and MNCs will increasingly have as the neo-liberal regime spreads? Are there policies that can restore the relative bargaining power of workers, communities, and nations and can close off the road to the bottom, while reducing international coordination problems to make the climb to the top more likely?

Here we can only propose a framework for thinking about policy in the area of MNCs and FDI, a framework that evolves from the analysis of the problem that we have presented here. Within this framework we give examples that focus on policies and institutions that can address the three central problems we have identified. A distinction must be made among levels of policy implementation as well as between the actors involved. In the first place, we can distinguish among local, national, regional, and international levels of policy implementation. In the second, we can distinguish between state-led policies and worker- or citizen-led actions.
In making the latter distinction, we recognize that a central problem in trying to devise policies to alter the bargaining power between the government and capital is that, in many instances, capital is the government. An essential difficulty in devising and implementing any of these policies is the relative lack of power that citizens have in determining government policy.

**Insufficient aggregate demand**

If our analysis is correct, restoring high levels of aggregate demand and the tight labor markets that follow in their wake would greatly reduce the negative impacts of FDI. Expansionary policies and institutions could be established at the international, regional, or national levels. In this era of large speculative short-term capital flows, policies to reregulate such flows at any or all of these levels will be necessary (see Felix, Schaberg, and Pollin in this volume: Crotty and Epstein 1996).

But even if a national or global Keynesian expansionary policy were initiated, it would have to be supplemented by supply side policies and new capital-labor accords and social contracts to be sustainable (see Glyn and Pollin in this volume). Moreover, with the extremely high levels of surplus labor in the developing world, expansionary Keynesian policy and short-term capital controls would not equalize labor costs around the world, and therefore would not completely eliminate the downward pressures on wages, taxes, and working conditions emanating from global competition.

**Institutions, roles of the game, and norms**

**State-led changes**

A second implication of our analysis is that improvements in the norms and rules governing international investment to reduce incentives for a "race to the bottom" is essential if FDI is not to have such negative impacts. There are a number of actions that states and citizens could take to improve domestic and international rules governing FDI.

First, there should be a moratorium on all international agreements promoted by international organizations or Northern countries to liberalize the last governing controls over FDI, including those taken by the OECD, the World Trade Organization (WTO), and NAFTA (and its proposed extensions). This moratorium should remain in place until an effective set of international rules governing FDI is put into place. An example of such a rule would be an international agreement forbidding unproductive tax competition: this rule could be implemented and enforced by an international organization such as the WTO. Some international organizations are investigating voluntary agreements along these lines (UNCTAD 1995). Such agreements ought to be implemented as well at regional and national levels (Federal Reserve Bank of Minneapolis 1994).

Second, international organizations such as the World Bank and the IMF should stop pressuring developing and transitional countries to open their economies to foreign direct investment as a condition for receiving credit, as they are doing in the case of South Korea. This simply contributes to the wasteful competition we have described.

**Citizen-led changes**

*International labor standards and corporate codes of conduct.* More controversial are policies to implement international labor standards. While some standards such as those forbidding slave labor receive widespread support, others, such as enforcing wage and working

conditions internationally through the use of social tariffs, are much more controversial (see Michie and Smith 1995; on social tariffs, see Cullenberg and DeMartino 1995). Advocates of such standards argue that they will reduce countries' destructive international bidding over wages and working conditions. Critics argue that standards unfairly penalize the poorest workers of the world to line the pockets of the wealthiest. According to these critics, labor standards are a form of imperialism.

One solution to this controversy is to create a framework within which workers and their representatives from both rich and poor countries can get together and decide what types of standards they want, if any. Currently, most of the debate is waged by economists and policy makers, and few direct representatives of those most affected by the policies in North and South are represented. Efforts in this direction are already ongoing (see, for example, Cavanagh et al. 1996). These groups are also discussing standards for multinational corporate codes of conduct. Initiatives aimed at labeling products to indicate how labor and environmentally friendly their production processes are is another example of "citizen-led international coordination" that ought to be extended.

Reining in coercive competition. The most important national policies for reducing coercive competition would be to reinforce laws and support institutions that make it more difficult for corporations to place excessive burdens of restructuring on workers and communities. We need policies to strengthen unions and rebalance bargaining power, rebuild the social wage or social safety net, and introduce worker and community influence in corporate governance. For example, in the U.S., passing living-wage legislation that would place a higher floor under wages would be an excellent beginning (see Pollin and Luce 1998).

Capital controls. As mentioned above, given the speculative nature of capital markets, some controls on short-term capital flows will also be necessary. Regulatory changes, Tobin taxes, and keeping open the option for stronger controls are also likely to be helpful (see Felix and Schaberg in this volume; Tobin 1978; Crotty and Epstein 1996; Grabel 1996).

Other measures. If all these measures were taken, additional measures to rein in coercive competition may not be required. However, in the event that they are, policies that limit the rate of increase of imports over a medium-term period may be needed to slow down the pace of structural change and allow companies and communities to adjust. Similarly, controls on the movement of FDI across borders may be needed. Note, however, that changing the overall context within which trade and FDI occur are very likely to go a long way toward solving the problems associated with them, thus reducing the likelihood that direct controls would be required.

Conclusion

We end with the central questions posed for our consideration by this volume: "globalization and progressive economic policy: what are the real constraints and options?" We suggest that increased capital mobility within the neo-liberal regimes is imposing increasingly severe constraints on workers, communities, and states. However, we do not agree with the extreme versions of neo-classical economics or the "globalization thesis" that see these constraints as an inevitable outcome of technological change or as an irreversible juggernaut. On the contrary, our main point is that the effect of FDI depends crucially on the domestic and international context within which it occurs. Different domestic and international structures produce very different outcomes.
Thus, progressive policy options are available. Policies to expand aggregate demand, reduce
the destructive effects of competition, and create a more worker- and community-friendly set
of domestic and international institutions are being studied and debated in all corners of the
globe and are feasible. Thus, pessimism is not the order of the day. Still, we cannot make
progress unless we confront and overcome the increasingly powerful constraints imposed by
the forces of the neo-liberal regime.