Foreign Firms: Powerful or Persecuted?

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The Debate

"The ultimate subject and sovereign ruler of the world is the transnational corporation, operating by collective prescription and enforcement through the World Trade Organization in concert with its prototype the NAFTA, its European collaborator, the EU, and such derivative regional instruments as the APEC, the MAI, the FTAA, and so on.

Together these constitute the hierarchical formation of the planet's new rule by extra-parliamentary and transnational fiat."

John McMurtry, "Why the Protestors are Against Corporate Globalization", *JBE*, 2002, p.202

The Big Picture

The past 30 years have seen an almost monotonic shift across every country in the world toward great rights and protections for foreign investors.

- Are governments seeking to redress real historical prejudice against foreign investors?
- Or does - as the quote above would suggest - this trend confirm and further cement the power of multinational firms?

Why do we Care if Foreign Firms are Powerful or Persecuted?

Understanding the relative power of foreign firms is important for determining whether:

- Commitment to policies which give foreign investors extra rights and protections (e.g. International Investment Protection and Promotion Agreements) is justified, or rather
- Entry of more foreign firms unfairly disadvantages domestic firms and jepordizes public policy process, and
- We should support calls for international investment law to be strengthened to protect the rights of host governments.

Foreign Firms versus Multi-national Corporations

- Foreign direct investment (FDI) is generally spoken of as a positive thing.
- Multinational corporations are often referred to negatively.....
- but aren't they the same thing?

- Foreign direct investment (FDI) occurs when a firm in one country buys a share of a firm in another country.
- A multinational firm is defined as a firm with operations or holdings in more than one country.
- That is, when a firm engages in FDI, it becomes a mutli-national.

More on this later....

Research Questions

1. Do ‘foreign firms’ have more influence over Government than domestic firms?
2. Do ‘foreign firms’ enjoy less regulatory constraint that domestic firms?
3. Is greater influence associated with less regulatory constraint?
   3.1 If not, why not? Government intervention?

Data Source

- The World Bank's World Business Environment Survey.
- Responses from over 10,000 firms in 80 countries.
- Wide range of questions about firm-government government relationship.
- Note: self reporting.
  - Firms say how influential they perceive themselves to be etc.

The Influence Question

Firms were asked with regard to each of the:

- Executive,
- Legislature,
- Ministry, and
- Regulatory Agency

"When a new law, rule, regulation, or decree is being discussed that could have a substantial impact on your business, how much influence does your firm typically have at the national level of government on the content of that law, rule, regulation or decree? (Very influential - Frequently influential - Influential - Seldom influential - Never influential)"

The Regulatory Constraint Question

"Please judge on a four point scale how problematic are these different regulatory areas for the operation and growth of your business.".

The regulatory areas were:

- Environmental Regulations,
- Business Licensing,
- Customs/Foreign Trade Regulations in your country,
- Labour Regulations,
- Foreign Currency/Exchange Regulations,
- Fire & safety Regulations,
- Tax Regulations/Administration,
- High Taxes

The Intervention Question

"How often does the government intervene in the following types of decisions by your firm? (Always - Usually - Frequently - Sometimes - Seldom - Never)".

Firms were asked to give separate responses for decisions relating to:

- Investment,
- Employment,
- Sales,
- Pricing,
- Merger/Acquisitions,
- Dividends, and
- Wages.

The Question of Foreignness

Typically in the economics literature:

- Foreign owned firms, FDI and multinationals are often referred to as the same concept.
- FDI or foreign-owned firms $=$ firms with 10% or greater foriegn ownership.
- Firms with $1-10\%$ foreign ownership $=$ portfolio investment.

In the current paper:

- Foreign firms $=$ firm answers "Yes" to having some foreign ownership.
- Multinational firms $=$ firm answers "Yes" to company having operations or holdings in other countries.
- Identify four mutually exclusive types of firm:
  - Purely domestic firms, Multi-nationals in their home country (Parents), Multinationals in a foreign country (Subsidiaries), and Non-multinational foreign firms.

Other Firm Characteristics

The data allows us to control for a range of other firm characteristics including:

- Export status,
- Government ownership,
- Size,
- Age,
- Sector (Manufacturing, Services, Agriculture, Construction, Other),
- Value of sales to fixed assets, and
- Country of operation.

Empirical Approach

- Regressions for the correlates of Influence, Intervention and Regulatory Constraint considered separately.
- Linear regression and ordered logit (results qualitatively the same).
- All the variables in previous slide used as controls.

Results Preview

- The distinction between foreign-ownership and multinational status matters.
    - The two variables have very different patterns of relationship with Government.
- More influential firms *do not* on average experience less regulatory constraint.
- More influential firms *do* tend to experience more Government intervention.
- Government intervention is more robustly correlated with regulatory constraint than influence is.

Average Influence

Controlling for other firm characteristics, the 4 types of firms from most to least influential are:

- Multinationals in their home country,
- Multinationals in foreign country,
- Non-multinational foreign firms, and Domestic firms (no statistically significant difference between these two groups).

Thus:

- **Multinationals are influential just as globalization's critics would argue**, but
- foreign multinationals are less influential than their domestic multinational competitors, hence
- **MNC Executives might be excused for their view that there is a bias against foreign firms?**

Influence by Branch of Government

Considering separately reported influence over the Executive, Legislature, Ministry and Regulator:

- The results are qualitatively the same as for the average case, except
- Foreign multinationals and non-multinationals have relatively less influence over Executive and Legislature.

$\Rightarrow$ **Elected arms of government appear less foreign-friendly.**

Influence by Sector

Considering separately reported influence by Firms in the Manufacturing and Services Sectors:

- The larger influence for domestic multinationals is confined to the services sector,
  - In the manufacturing sector foreign multinationals are marginally the most influential group.
- The relative lack of influence of non-multinational foreign firms is concentrated in the manufacturing sector,
  - In the manufacturing sector the disadvantage of foreign non-multinationals is statistically significant for the first time at the 10% level.

Regulatory Constraint

- Concerns about Government anti-foreign bias leading to ‘regulatory takings’ are not substantiated.
  - Neither foreign multinationals nor non-multinationals experience higher levels of regulatory constraint (c.f. domestic multinationals), indeed
  - Foreign multinationals experience significantly less constraint in w.r.t. taxes and environmental regulations,
  - Foreign non-multinationals experience significantly less constraint w.r.t. labour regulations.
- The regulatory advantage of foreign firms does not appear to be related to their influence.
  - The regulatory advantage for non-multinational foreigners is most pronounced in the manufacturing sector,
  - The regulatory advantage for multinational foreigners is most pronounced in the services sector,

Influence and Regulatory Constraint

- Concern about firm influence on government stems from a belief that it will allow the firm to obtain unfair or socially inefficient advantages - e.g. a more favorable regulatory environment.
- However the pattern of influence and constraint suggests influence is not correlated with regulatory freedom.
- Include influence in a regression on perceived regulatory constraint,
- **Find greater influence is significantly correlated with more regulatory constraint**
    - across all regulatory categories (e.g. environment, labor, customs),
    - except those related to taxes (both level and administrative burden).

Influence, Intervention, and Regulatory Constraint

- A separate set of regressions revealed that the same types of firms which perceive themselves as influential also report the most frequent intervention by government in their affairs.
    - Exception: foreign multinationals who experience equal or significantly less (w.r.t. wages) intervention than comparable firms.
- Could correlation between intervention and influence cause the counter-intuitive relationship between influence and regulatory constraint?
- Controlling for both influence and intervention in regressions on the regulatory constraint variables, we find:
    - Intervention is highly significantly correlated with increased constraint.
    - Influence has no explanatory power for non-tax related regulatory areas,
    - Influence significantly correlated with decreased constraint from taxes and related administration.

Results Recap

Influence, Intervention and Regulatory Conditions:

- Influential firms report higher regulatory constraint,
- Influential firms tend to suffer more frequent intervention from government,
- Even when controlling for intervention, influence is only associated with lower regulatory constraint with regard to taxation.

Foreignness and Influence:

- Multinationals are more influential than other firms,
- Other things equal foreign firms are slightly less influential than similar domestic firms,
- The pattern of influence varies by sector:
    - Manufacturing sector - foreign multinationals more influential and non-multinationals less influential.
- Foreign multinationals are special in that they enjoy high influence and low intervention.

Conclusion

Policy Conclusions

- I find no support for the argument that anti-foreign bias leads to justifies the need for stronger legal protections for foreign investors.
- Neither do my results validate concerns that powerful multinationals are able to use their influence to obtain socially inefficient regulatory conditions - except potentially in regard to taxation.
- Foreign firms do experience less constraint from labour and environmental regulations, but this seems more likely to be driven by their operating advantages (technology etc.) than by undue influence on regulators.

Economic Conclusions & Future Directions

- The correlation of influence and intervention suggests that being important is a double-edged sword.
- The foreign multinationals' unusual combination of high influence and low intervention is consistent with theoretical