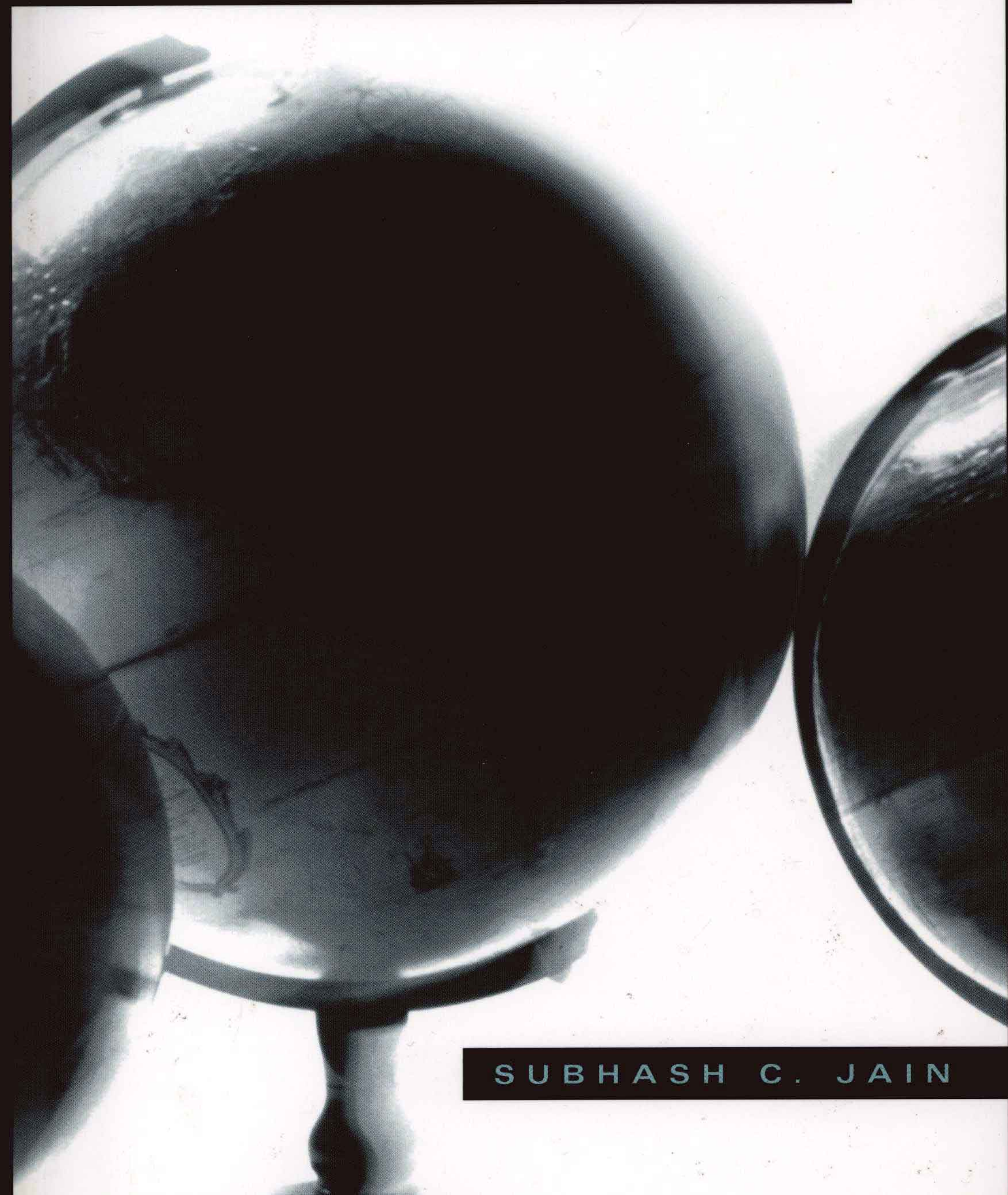
Toward a Global Business Confederation

A Blueprint for Globalization



SUBHASH C. JAIN

TOWARD A GLOBAL BUSINESS CONFEDERATION

A Blueprint for Globalization

Subhash C. Jain

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Toward a Global Business Confederation

Praise for *Toward a Global Business Confederation*

"A contemporary 'classic' book on international business has finally arrived. *Toward a Global Business Confederation* vividly demonstrates the economic, geopolitical, and social implications of today's multinational companies and their conflicts and cooperation with the nation-states for welfare generation on a global basis. This is a must reading for international business scholars and policymakers."

—Masaaki Kotabe, The Washburn Chair Professor of International Business and Marketing, Temple University

"A strong, well-presented grasp and analysis of the reality of the power of multinational corporations in our globalized world. A clear and focused argument for the opportunity and need to harvest that power to bring about a mutually beneficial global economic prosperity."

—Robert D. Werner, former Chairman, Timex Watches Ltd.

"Eye opening and intriguing, *Toward a Global Business Confederation* is a wonderful book for all current and future international business people. It lucidly lays out the basics of globalization and proffers a Global Business Confederation as a link between today's multinational corporations and nation states and a bridge to a more equitable and peaceful world of the future. While one may or may not agree with this solution, one will definitely look at the path of globalization in a different and much more informed way."

—Gregory A. Boyko, Member of the Board of Advisors, University of Connecticut School of Business

"Subhash Jain has exposed many of the challenges facing business and nations in the coming decade, in both the developed and developing economies. With the increasing power of the multinational corporations and innovative technology, new approaches will be needed to handle the enormous growth of international markets. The author provides provocative ideas as to how these issues could be addressed. This book must be required reading for all who expect to survive and flourish in the globalized world."

—Marjorie D. Anderson, Executive Director, World Affairs Council, Hartford, Connecticut

"Jain's effort to define and promote a worldwide confederation of governments, companies, and interest groups that would set rules on multinational company activities is an admirable step toward development of needed global institutions. His analysis points out the many benefits produced by these companies, and the need to harness their positive contributions while responding to their activities that diverge from broad public interest. Jain has raised an excellent concept (of the Global Business Confederation), and one that should be explored in careful detail in today's globalized world."

—Robert Grosse, Professor of Economics, Thunderbird, The American Graduate School of International Management

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PREFACE

Enough evidence is available to support the fact that globalization leads to worldwide economic prosperity. It is the most powerful force for good the world has seen. The foundation of globalization is worldwide capitalism. Thanks to capitalism, life expectancy is up, infant mortality is down, education is richer, horizons are broader, environmental awareness is greater, and global cooperation is possible. Above all, capitalism is the reason we can provide reliable social welfare on a mass scale. The activities of capitalists generate the money to pay for education, medical research, and social welfare and help provide the incentives for people to invent things to make our lives better.

Measured either in terms of trade or direct investment, globalization has been highly uneven. A few developing countries have managed to increase their trade a lot. They are the same countries that have attracted the lion's share of foreign direct investment. And they have also seen the benefits of openness. According to the World Bank, 24 countries—home to 3 billion people and including China, India, Brazil, Argentina, and the Philippines—have substantially increased their ratios of trade to gross domestic product (GDP) in the past 20 years. These countries are the low-income globalizers. On average, their growth rates have improved as well. The GDP per head in these economies grew by an average of 5 percent a year during the 1990s, and their poverty rates declined. Rich countries in the same time period grew by 2 percent.

However, another 2 billion people live in countries that have become less, rather than more, globalized. In these countries, including Pakistan and much

of Africa, trade has diminished in relation to national income, economic growth has been stagnant, and poverty has risen. Apparently, globalization has not been global. Much of the world, home to one-third of its people and including large tracts of Africa and many Muslim countries, has simply failed to participate. Thus, the process of globalization has not finished. Nonglobalizing developing countries must become a part of the process.

Over the next 20 years, the rich world's population will fall slightly, while the developing world will acquire 2 billion additional people, many of them in countries that are currently political and economic failures. Unless, with help from the rich countries and from one another, they can find ways to integrate into the global economy, much of the potential gains of globalization will continue to be limited to the rich and a few developing countries. Such a failure is good for neither rich nor developing countries. After the September 11, 2001, attacks on New York City and Washington, D.C., no country—least of all the United States—can believe it is immune from the effects of poverty and political collapse halfway around the world. Thus, the goal must be to spread the benefits of globalization more widely.

This book supports economic globalization because it leads to worldwide prosperity. Multinational corporations (MNCs) play a key role in making globalization feasible. Unfortunately, the movement toward globalization is too slow. To a large extent, this slowness can be attributed to the barriers that nation-states create in furthering globalization. To enhance the pace of globalization, it is essential that nation-states not force their national rules and regulations on multinationals. Rather, global rules and regulations must be enacted to allow MNCs to perpetuate globalization at full speed.

The book proposes the establishment of a global business confederation (GBC) to regulate and encourage MNCs to bring about global economic prosperity in a manner responsive to cultural, social, and human issues. This proposal amounts to a new type of capitalism, which may be called *globally shared capitalism*. Under such an arrangement, MNCs, following global rules and regulations established by the GBC, would seek global economic and business integration. The role of MNCs would expand while the roles of nation-states would decline. MNCs would work in full concert with other special interest groups such as labor, environmentalist, human rights, and other groups.

The GBC would be a unique, treaty-based, institutional framework that would define and encourage activities of MNCs around the globe in the greater interest of worldwide economic and social prosperity. The world-

wide treaties (e.g., on labor practices) agreed to by nation-states, MNCs, and special interest groups would create communities of shared sovereignty in matters that would enhance the effectiveness of MNCs in generating global well-being while being responsive to social needs. The GBC would operate on the principle of subsidiarity. That is, it would be granted jurisdiction over those policies that could not be handled effectively at the level of the nation-state.

In the wake of the 9/11 terrorist attack, we are confronted with the question of whether the threat of today will destroy the promise of yesterday. In the 1990s, the impulse toward global economic integration survived financial crises and a rising tide of protest. The terrorists have multiplied the force of the challenges. That integration should be sustained is beyond serious question. Closing borders can only exacerbate instability, resentment, and poverty. It is in the long-run interests of the rich countries of the North to offer the rest of the world the opportunities afforded by economic integration, just as it is in the interests of the poorer countries of the South to exploit these opportunities. The challenge is doing so in today's more perilous times.

It is encouraging that globalization has proved resilient to shocks. Despite the financial crises in the developing world, no country has chosen to turn its back on the world economy. Although there is debate on how globalization should proceed, few question its desirability. Even the global economic slowdown has failed to generate wholesale resort to protectionism or beggar-thy-neighbor polices.

The terrorist attacks have added a new range of anxieties. The state is now called on to serve its primary function of protecting the citizenry. Suspicion has replaced international friendship. Movements of people, goods, information, and money are monitored even more closely. Business must bear the extra costs of security.

Yet it would be wrong to exaggerate these threats. The striking feature of the response to terrorism has been the width of the coalition formed to combat it. Nobody wants to live in the same world as private armies capable of such atrocities. In the Islamic world, too, the way of Osama bin Laden is increasingly viewed as a dead end. Such a coalition is also well suited to strengthening the underpinnings of the integrated global economy. Indeed, it has already helped launch the trade talks in Doha, Qatar. This cooperation is heartening. It also reflects a proper appreciation of the national interest. Even the United States, the world's strongest power, cannot secure a prosperous world economy on its own. Yet it is on such widespread prosperity that its own prosperity in large part depends.

The challenge is to deepen global economic integration without impairing security. The requirements for both are essentially the same: the right blend of leadership and cooperation. Times of danger are, as the Truman administration showed after World War II, times of opportunity. The world's leaders have recognized the dangers. They must also seize the opportunities.

This book proposes a blueprint for increasing the speed of globalization through the establishment of a GBC. This text will develop a framework of global rules and regulations for MNCs to successfully operate globally and bring about economic prosperity to the human race.

I am grateful to a number of individuals who stimulated my interest in this subject. The book is partly dedicated to all my students at the University of Connecticut who have been concerned about the future of this world. It reflects their genuine concern about billions of people in developing countries who live in poverty and squalor. The book also has been stimulated by the growing interest in the academic literature and among policy makers with regard to the role of MNCs in global economic integration—a subject that has until recently escaped the mainstream of international business studies. I had very useful and thought-provoking discussions about the linkage of MNCs, nation-states, the environment, and labor with Thomas G. Gutteridge, Wes Cann, Richard Vengroff, Elizabeth Hansen, Elizabeth Mahan, Susan Sbiggle, Jack Veiga, Chandra Roychoudhri, and Boris Bravo-Ureta at the University of Connecticut and with Claude Cellich, International University in Geneva, and Sushil Vachani, Boston University. I am indebted to them for the insights they shared on the subject. I am thankful to Kelly Dunn, associate director, Center for International Business Education and Research (CIBER), for administrative help in completing this book; graduate assistants Geoff Munger, Marina Kostova, Paula Ehlers, Yongping Jiao, and Mami Nishimune for a superb job of library research and organization of notes; and Jung-Eun Graham and Kelli Francis for clerical work and typing.

My wife, Sadhna, encouraged me to undertake this project and provided a valuable critical and rational view of controversial topics. Most of all, I dedicate this book to my children, Aarti and Amit, who, it is hoped, will do a better job of defending good causes than I might have done in this book.

I sincerely thank Pam Wilkinson for the fine work of editing the manuscript. I owe a special word of gratitude to Hilary D. Claggett, senior editor at Praeger Publishers, for her excellent advice on the structure of the book and, Senior Editor Nicholas Philipson, for seeing it to completion.

CONTENTS

Preface vii

1. The Evolution of Multinational Enterprises 1
2. Forces at Work 29
3. The Rise of Business Globalization 53
4. The Myth of Globalization 75
5. The Future of Globalization 93
6. A Global Business Confederation 155
7. The Nation-State 187
8. A Manifesto for the Future 209

Bibliography 229

Index 239

Chapter 1

THE EVOLUTION OF MULTINATIONAL ENTERPRISES

The development of companies with interests and activities located outside their home countries has played a significant role in the early evolution of international business. This development has been particularly noticeable since World War II, although companies doing business across national borders emerged considerably earlier. Beginning in the fifteenth century, a number of chartered trading companies appeared in Europe to establish and encourage trade links between a country and its colonies. For example, the East India Company, the Hudson's Bay Company, and others were created in those years and were later transformed into vast trading entities. But for the most part, these early companies were trading houses. Firms that engaged in foreign production emerged only in the second half of the nineteenth century. At the time of World War I, a number of U.S., British, and continental European companies with overseas manufacturing operations existed. Among them, the British firms were the dominant ones, a fact that reflected the nation's imperial position. The growth of U.S. companies with overseas operations revealed the country's emergence as the world's major industrial power.

Multinational corporations (MNCs) are a product of capitalism, with its inherent goal of yielding more from less. With managerial skills and entrepreneurship, MNCs strive to produce more goods with less investment of capital, labor, and raw materials. If markets are stable, the productivity gains increase the profit per unit, which gets distributed as return on capital or as low prices for consumers. If the productivity gains continue, at

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some point production output cannot be disposed of within the national borders, making it necessary for MNCs to seek markets overseas. In this way, MNCs distribute the world's industrial structure among many new nations, sharing not only jobs and incomes but also capitalism's power of wealth creation. Thus, MNCs have a great role in economic justice. The ultimate measure of success of an MNC is shareholder value. Although there are competing claims, the fundamental principle of capitalism is that a company's first and last duty is to its shareholders.

CURRENT PERSPECTIVES

Today, the MNC is the principal instrument in the expansion of business on an international scale. In barely five decades it has become, by all accounts, the most formidable single factor in world trade and investment. The MNC plays a decisive role in the allocation and use of the world's resources by conceiving new products and services, by creating or stimulating demand for them, and by developing new modes of manufacturing and distribution. Current rates of energy consumption would be unthinkable without the involvement of MNCs in the development and expansion of the automobile and electrical appliance industries. Indeed, MNCs largely set the patterns and pace of industrial activity worldwide.

The MNC is the most dynamic institution of our time. It develops, manufactures, and markets products and services worldwide. It is able to do so because of the following characteristics:

1. It controls economic activity in more than one country.
2. It takes advantage of geographic differences among countries and regions in factor endowments.
3. It has the flexibility to shift resources and operations among locations globally.

Dimensions of MNCs

According to a UN study, some sixty thousand companies worldwide qualify as multinational, and they have about five hundred thousand foreign affiliates.[1] Most of these firms have their headquarters in developed countries.

The value of the output under the governance of MNCs (parent firms and foreign affiliates) amounts to about 25 percent of global output, with one-third of it in host countries. Foreign affiliates' sales in domestic and

international markets were about $11 trillion in 1998, compared with almost $7 trillion of world exports in the same year. Year after year, both global output and sales of foreign affiliates have grown faster than world gross domestic product (GDP) and exports.[2]

Exhibit 1.1 shows the distribution of MNCs between developed and developing countries and among different nations in each group. An important dimension of MNCs is the predominance of large firms. Virtually one hundred MNCs have annual sales of more than $10 billion. The economic significance of these corporations as compared with other economic entities, including the economies of many nations, suggests that they are an important source of global power. Exhibit 1.2 shows that many MNCs have higher annual revenues than the gross national products (GNPs) of some countries. Approximately 70 percent of world trade is controlled by 500 corporations.[3] The largest 200 MNCs control almost one-third of the world's GDP.

Many MNCs derive a substantial portion of their net income and sales from overseas operations. About one-third of the top 100 U.S. companies generate over 50 percent of their annual sales in foreign markets. Put together, the world's 1,000 largest companies produce 80 percent of the global industrial output. MNCs play a dominant role in the economies of specific countries. Foreign firms account for almost half of Ireland's employment and two-thirds of that country's output. In Australia, each of the 10 biggest MNCs has annual sales larger than its government's tax revenue. As shown in Exhibit 1.3, the nondomestic earnings of many U.S. companies, such as ExxonMobil, Hewlett-Packard, Dow Chemical, Motorola, McDonald's, Gillette, Rohm & Haas, Avon Products, and others, exceed 50 percent of the total earnings.

Another important feature of MNCs is their predominantly oligopolistic character; that is, they operate in markets that are dominated by a few sellers. Their technological leads, special skills, and ability to differentiate their products through advertising are all factors that help sustain or reinforce their oligopolistic nature. Four companies—ConAgra, ADM Milling, Cargill, and Pillsbury—mill nearly 60 percent of all flour produced in the United States, and two of them—ConAgra and Cargill—control 50 percent of grain exports.[4]

An important aspect of the operations of MNCs is the business activity that is generated within the multinational companies themselves as they export and import among their own foreign-based subsidiaries. About 50 percent of U.S. exports and imports are goods that constitute intrafirm transactions.[5] A U.S. computer company ships design components to its

Exhibit 1.1
Number of Parent Corporations and Foreign Affiliates, by Area and Economy, Latest Available Year

Area/Economy	Year	Parent Corporations Based in Economy	Foreign Affiliates Located in Economy
DEVELOPED ECONOMIES		49 806	94 623
Western Europe		39 415	62 226
European Union		33 939	53 373
Austria	1996	897	2 362
Belgium	1997	988	1 504
Denmark	1998	9 356	2 035
Finland	1997	1 963	1 200
France	1996	2 078	9 351
Germany	1996	7 569	11 445
Greece	1991	--	798
Ireland	1994	39	1 040
Italy	1995	966	1 630
Netherlands	1993	1 608	2 259
Portugal	1997	1 350	5 809
Spain	1998	857	7 465
Sweden	1998	5 183	3 950
United Kingdom	1997	1 085	2 525
Other Western Europe		5 476	8 853
Iceland	1998	70	79
Norway	1997	900	3 000
Switzerland	1995	4 506	5 774
Japan	1998	4 334	3 321
United States	1996	3 382	18 711
Other developed		2 675	10 365
Australia	1998		2 550
Canada	1997		4 562
New Zealand	1998		1 106
South Africa	1997		2 147
DEVELOPING ECONOMIES			
Africa		43	429
Ethiopia	1998	--	21
Mali	1999	3	33
Seychelles	1998	--	30
Swaziland	1996	30	134
Zambia	1997	2	175
Zimbabwe	1998	8	36
Latin America and the Caribbean		2 594	26 577
Bolivia	1996	--	257
Brazil	1998	1 225	8 050
Chile	1998	478	3 173
Colombia	1998	877	4 468
El Salvador	1990	--	225
Guatemala	1985	--	287

Exhibit 1.1
(continued)

Guyana	1998	4	56
Jamaica	1997	--	156
Mexico	1993	--	8 420
Paraguay	1995	--	109
Peru	1997	10	1 183
Trinidad & Tobago	1998	--	70
Uruguay	1997	--	123
South, East, and Southeast Asia		6 067	206 148
Bangladesh	1997	143	288
China	1997	379	145 000
Hong Kong, China	1998	500	5 312
India	1995	187	1 416
Indonesia	1995	313	3 472
Korea, Republic of	1998	4 488	5 137
Malaysia	1998	--	3 787
Mongolia	1998	--	1 100
Pakistan	1993	57	758
Philippines	1995	--	14 802
Singapore	1995	--	18 154
Sri Lanka	1995	--	139
Taiwan Province of China	1990	--	5 733
Thailand	1992	--	1 050
West Asia		449	1 948
Oman	1995	92	351
Saudi Arabia	1989	--	1 461
Turkey	1995	357	136
Central Asia		9	1 041
Kyrgyzstan	1997	9	1 041
The Pacific		84	2 763
Fiji	1997	--	151
Papua New Guinea	1999	--	2 342
Tonga	1998	84	270
Central and Eastern Europe		850	174 710
Albania	1998	--	1 239
Armenia	1998	--	157
Belarus	1994	--	393
Bulgaria	1994	26	918
Croatia	1997	70	353
Czech Republic	1999	660	71 385
Estonia	1999	--	3 066
Hungary	1998	--	28 772
Lithuania	1998	16	1 778
Poland	1998	58	35 840
Romania	1998	20	9 195
Russian Federation	1994	--	7 793
Slovakia	1997	--	5 560
Slovenia	1997	--	1 195
Ukraine	1998	--	7 066
WORLD		**59 902**	**508 239**

Source: UN Conference on Trade and Development estimates.

Exhibit 1.2
GNPs of Various Countries Ranked with Sales of Selected Corporations, 2002

Country/Company	Billions of U.S. Dollars
Switzerland	284
Sweden	227
Austria	217
ExxonMobil	206
Turkey	201
Wal-Mart	191
General Electric	185
General Motors	184
Denmark	175
Ford Motor	170
Norway	152
Poland	151
Saudi Arabia	143
South Africa	137
Thailand	132
Indonesia	130
Finland	125
Greece	123
Citigroup	112
Portugal	106
Iran	102
Colombia	100

Source: World Bank and company annual reports.

subsidiary in Malaysia for assembly and then imports the finished machines back to the United States and exports them to other buyers around the world.

MNCs are mainly the product of developed countries. However, the relative importance of different home countries has changed in the last 15 years. The MNCs of Japan and the European countries have increased in significance, whereas the significance of MNCs of the United States has declined. The available evidence suggests that these shifts are due primarily to changes in the international competitiveness of companies based in different countries.

Foreign Direct Investment Patterns

The establishment of foreign affiliates involves costs in either cash or kind. Often these costs comprise a package of equity participation in the new venture, technology transfer, and sharing of managerial expertise. In addition, loans may be made to the affiliate with an agreement to reinvest

Exhibit 1.3
Nondomestic Earnings, Sales, and Assets of Selected U.S. Firms, 2002

Company	Percentage of Net Profit	Percentage of Sales	Percentage of Assets
ExxonMobil	60	69	63
IBM	48	60	40
Texaco	40	72	50
Hewlett-Packard	61	56	50
Compaq Computers	36	55	35
Procter & Gamble	42	50	50
Intel	34	59	26
Motorola	78	53	40
Dow Chemical	73	62	46
Xerox	Deficit	55	41
Coca-Cola	36	61	37
Caterpillar	27	50	37
McDonald's	62	63	54
3M	47	53	37
Texas Instruments	13	73	30
Manpower	77	78	85
Aflac	73	82	86
Halliburton	62	66	39
Lear	71	50	43
Agilent Technologies	105	56	47
Crown Cork & Seal	Deficit	59	63
SCI Systems	45	51	73
AES	51	63	72
Unisys	Deficit	58	37
Gillette	56	60	52
Rohm & Haas	63	57	26
Avon Products	69	67	56
Baxter International	62	54	45

Source: Company annual reports.

the earnings for a specified duration. Together, all these elements of costs are defined as *foreign direct investment (FDI).* In 1998, FDI outflows amounted to $649 billion in world trade. The inflows in the same year reached $644 billion.[6]

A major portion of FDI outflows and inflows is among developed countries. In 1998, FDI inflows to and outflows from developed countries reached $460 billion and $595 billion, respectively. FDI inflows to developing countries for the same year amounted to $166 billion. The pattern of FDI inflows and outflows by absolute value, as shown in Exhibit 1.4, does not provide a full picture of the significance of these flows in different countries. If the size of the economies is taken into consideration, a differ-

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