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Domestic drug prohibition as a source of foreign institutional instability: an analysis of the multinational extralegal enterprise

Ram Mudambi[a,b,*], Chris Paul II[c]

[a] *Temple University, Philadelphia, PA, USA*
[b] *University of Reading, Reading, UK*
[c] *Georgia Southern University, Statesboro, GA, USA*

Abstract

The unintended consequences of prohibition on domestic markets are well documented [J. Econ. Perspectives 9 (1995) 175]. The enforcement of these prohibitions denies the extralegal enterprise (XLE) access to property rights and contract enforcement from the state. Consequently, XLEs must provide their own enforcement through the application of coercion and violence [J. Legal Stud. 18 (1989) 403; Public Choice 68 (1994) 185]. In this paper we focus on multinational activity by multinational XLEs in the illegal drug trade, examining the applicability of Dunning's ownership, location or internalization (OLI) paradigm [J. Int. Bus. Stud. 11 (1980) 9]. We find that the location and internalization aspects of the paradigm apply well, while the ownership aspect does not. Furthermore, we argue that wherever XLEs operate, their coercive powers distort the incentives in resource and goods markets, increase corruption and reduce institutional stability. Their activities substantially reduce the size of the productive exchange economy and the attractiveness of the location for investment by legitimate businesses. These distortions are amplified by the enforcement of prohibition by governments in target market countries.

Keywords: Prohibition; Domestic market; Extralegal enterprise; Multinational enterprise

* Corresponding author. Institute of Global Management Studies, Fox School of Business and Management, Temple University, Philadelphia, PA 19122, USA. Tel.: +1-215-204-2099; fax: +1-215-204-8029.

E-mail address: rmudambi@sbm.temple.edu (R. Mudambi).

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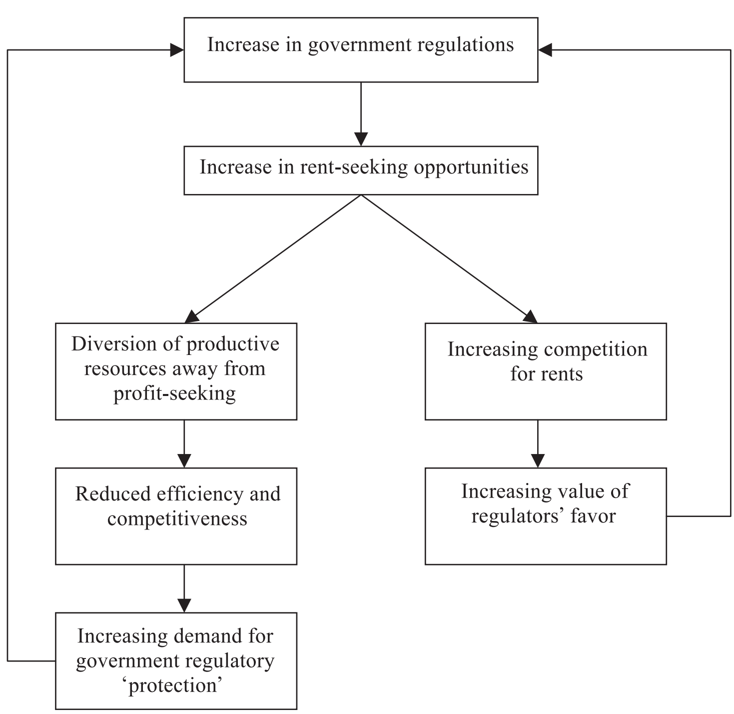
1. Introduction

The study of location choice by multinational enterprises (MNEs) identifies host country characteristics that advantage the firm. The decision to locate operations is made on the basis of cost savings and/or revenue enhancement resulting from ownership, location or internalization (OLI) advantages. Previous applications of this eclectic paradigm have considered only enterprises operating legally. We apply the OLI framework to identify the country characteristics that provide advantages to extralegal enterprises (XLEs). After identifying the advantages that direct XLE location choices, the consequences of the XLE locating in Latin American and Caribbean countries is analyzed by applying research findings on prohibition and resulting rent-seeking behaviors.

Stigler (1971) proposed that all businesses attempt to use the power of government to further their competitive advantage. This theory implies that government regulation emerges as the result of the interaction of the supply side (political agents) and demand side (business firms and other economic agents). We propose that allowing the Stiglerian model to evolve dynamically through time creates systems where the regulatory burden naturally increases (see Fig. 1).

A DYNAMIC MODEL OF REGULATION*



** Regulations can include prohibitions.*

Fig. 1.