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Infrastructure or foreign direct investment? An examination of the implications of MNE strategy for economic development

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ABSTRACT

This paper explores the paradoxical relationship between MNE current strategies and economic development. There is evidence that positive developmental impacts of FDI flows are conditional on high levels of human capital and thus on the existence of 'good' infrastructure in recipient countries. In this paper we suggest that current MNE strategies have a negative impact on the development of infrastructure in LDCs. The justification for this argument arises from the low developmental impact of current FDI patterns and from rising costs of attracting increasingly footloose investment. The overall effect is to aggravate government financial constraints on the development of basic infrastructure. We develop propositions for future empirical research. We also consider implications for MNE strategy and argue that current MNE strategies are not only ineffective for delivering poverty reduction but that current strategies in developing countries do not necessarily serve the interest of MNEs either.

1. Introduction

In recent years, several international business (IB) scholars have explored the issues around impact of MNE activities on economic development and poverty reduction. This is a significant development in the IB literature, and constitutes an extension of the domain of international business as a field of study. In the past, international business scholarship was not particularly concerned with the development issue, probably reflecting the notion that inquiries beyond the firm as unit of analysis are not in the domain of international business (Nehrt, Truitt, & Wright, 1970; Ricks, 1985). The more engaged stance of international business scholarship with the development issue (see e.g. Meyer, 2004; Ramamurti, 2004) is in part a refection of the fact that the earlier optimism regarding FDI as 'an engine of development' (UNCTAD, 1992) has virtually evaporated and replaced with an arguably more realistic assessment. There is now a general realization that positive developmental impacts from FDI are not automatic. The realization of potential benefits from FDI is a challenging process at which relatively few countries have been successful (Dunning & Narula, 2004; Lall & Narula, 2004; Nunnenkamp, 2004; Nunnenkamp & Spatz, 2004; UNCTAD, 1999). The recent interest in poverty issues by a number of scholars can be seen in a broader context which is witnessing a more nuanced and critical evaluation of the development impact of MNEs in LDCs (Ghauri & Buckley, 2002, 2006; Ghauri & Cao, 2006; Kolk & van Tulder, 2006; London & Hart, 2004; O'Brien & Beamish, 2006; Yamin & Ghauri, 2004). The present paper seeks to add to this literature by focusing on the impact of current MNE strategies on the development of basic infrastructure in LDCs. The focus on infrastructure is

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highly apposite from a poverty reduction perspective (Datt & Ravallion, 1998; Fay, Leipziger, Wodon, & Yepes, 2005) and yet is neglected in the discussion of the MNE impacts on poverty reduction.

2. Research problem and motivation

There is a paradox in the relationship between MNE current strategies and economic development. On the one hand there is evidence that the positive developmental impact of FDI flows is strongly conditional on high levels of human capital and thus on the existence of 'good' infrastructure in recipient countries. Levels of human capital are a product of cumulative investment in basic infrastructure, such as health and education, over an extended period of time. On the other hand current MNE strategies have a negative impact on the development of infrastructure in LDCs. Specifically, MNE strategies are, inter alia, creating a pattern of FDI that has, except in a small number of 'catching up' countries (Dunning & Narula, 2004), a low developmental potential – aggravated by the rising costs of attracting increasingly footloose investment. This creates pressures on public revenue which, given that investment in basic infrastructure is largely dependent on public taxation and government revenue (Swaroop, 1994), translates into constraints on the development of infrastructure. In this paper we articulate this paradox more fully. This is a useful exercise for two reasons. First, it potentially enriches the emerging literature by enhancing understanding of the connection between MNE strategies and poverty reduction. Second, an important implication of the paradox we articulate is that current MNE strategies are not only failing in terms of poverty reduction but may not be in the best interest of MNEs themselves as they also benefit from the development of infrastructure in host countries, through, for example, better opportunities for subsidiary capability development.

The remainder of the paper is organized as follows. Section 3 provides an overview of changes in the strategy and structure of MNEs. A basic driver is that the relative decline is the imperative for national responsiveness on the one hand and the enhancement of the global integration imperative on the other. Section 4 focuses on the pattern of FDI flows to less-developed-countries (LDCs) associated with emerging MNE strategies. It highlights the low development potential (low domestic linkages and positive spillovers) of FDI. Section 5 discusses the methodology of our conceptual research, by providing an overview of the literatures linking infrastructure with, on the one hand, positive impact of FDI flows on economic development and, on the other, the positive effect of infrastructure on poverty reduction. Section 5.2 focuses on the reverse of the first relationship, namely, on the impact of MNE strategies on the development of infrastructure in LDCs. The key consideration is the rising cost of attracting FDI in terms of forgone expenditure on the development of infrastructure (public revenues and public administrative and related resources taken up in attracting FDI). Section 6 concludes the paper by considering implications for MNE strategies in LDCs.

3. Changing MNE strategies and structures

Traditionally IB scholarship assumed that the key strategic issue for the MNE was the handling of the tension between the imperative of global integration on the one hand and the need for national responsiveness on the other (Bartlett & Ghoshal, 1987). The need for national responsiveness, in part, reflected an environment in which national governments had significantly more bargaining power in their dealings with MNEs than they generally do nowadays. This dual imperative was reflected in the organization of the MNE. The seminal work of Ghoshal and Bartlett (1990) explained why multinationals would tend to be federative rather than unitary structures, although industry and other contingencies would also be influential in shaping the structure. In the federative structure, *national* subsidiaries (by which we mean a subsidiary whose focus is very much on the national environment and market of the host country) were an important part of the organization of MNE. Thus, Ghoshal and Bartlett (1990, p. 607) argued that one reason for the limit to the efficacy of headquarters *fiat* in MNEs was that (some) subsidiaries 'control critical linkages with the host governments'. The basis for the power of national governments was of course control over access to the national economy and in particular to their markets. Multinational expansion frequently took the form of establishing 'miniature replicas', i.e. subsidiaries which performed several value chain activities in an integrated way and whose main function was to adopt or adapt the products and technologies of the MNE to the market and customer environment of the host countries. Over time however, miniature replicas could become more powerful; focus on the national economy would lead to significant degrees of 'embeddedness' in the national market, meaning that the subsidiary would become rooted in a network of business, technological and institutional actors in the host country (Ghauri, 1992; Phene & Almeida, 2003). In the words of Phene and Almeida (2003), subsidiaries grow 'progressively closer to local host-country networks both in terms of sourcing and sharing knowledge' (Phene & Almeida, 2003, p. 363). It has also been found that subsidiary embeddedness in local business and technology networks is an important source of subsidiary strategic capabilities (Andersson, Forsgren, & Holm, 2002). From the perspective of economic development, this 'old model' of MNE expansion had a positive quality – compared to what has replaced it – in potentially encouraging linkages in the domestic economy and the development of industrialization, although in practice the models' implementation was often mired in excessively protectionist policies. Moreover the smaller markets and lower purchasing power of many LDCs constrained the scope for subsidiary development and linkage formation. However, the experience of MNE assisted import substitution is not wholly negative (Hirschman, 1968).