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## ECLIPSE OF THE STATE: MULTINATIONAL CORPORATIONS IN THE

### THIRD WORLD

by Rajeev M. Patel CC '03

The late twentieth century has seen the rapid growth of international trade and cooperation. This phenomenon, dubbed "globalization," has resulted in the rise of large multinational corporations whose power and influence extends beyond one nation or one trading bloc. Today, names like Coca-Cola, Exxon, and IBM are recognized in the most distant, least industrialized corners of the world. With corporations holding such influence, many have wondered what role the state will play in this new economic system. There are some who claim that the state will maintain its leadership in shaping economic policy. Nevertheless, the high popularity and high growth of multinational corporations in the world economy is a testament to the fact that the corporation is becoming the dominant power in conducting and shaping economic policy. This phenomenon is most evident in developing nations, where multinational corporations have surpassed the state in influence and power.

#### THE POTENTIAL POWER OF THE STATES

Those who assert that states are still dominant in the shaping of economic policy often refer to measures through which states can attempt to regulate large, multinational corporations (MNCs). This is essentially a mercantilist stance on international political economy in that they believe that states should control their own economies. Through regulations, it is argued, states are able to retain their influential position in the international system. For instance, there is a trend toward tougher laws in host nations to improve the tax system so that states can profit from the activities of the MNCs. International competition and the desire for economic growth also serve as incentives to host nations to improve their administrative procedures and methods of negotiating with the MNCs themselves (Tarzi 156). Likewise, the competition among MNCs for foreign markets potentially affects the bargaining power of host countries in their favor. For example, Saudi Arabia benefited when the Pacific Western Oil Company agreed to pay larger tax payments in order to gain access to Saudi oil fields that were desired by a number of corporations (157). States can also implement antitrust laws, enforce quotas, and control pricing as tools to curb corporate influence (Fieldhouse 177).

Another method in which states maintain control over MNCs, and thus, their own economic policy, is by the implementation of protectionist strategies. States can levy taxes on goods leaving the host country that are

produced by corporations not domestically controlled. Similarly, subsidies can be offered to domestic companies that could be potential competitors of MNCs (Coughlin, *et al.* 327). In this manner, a domestic corporation in its early growth stage can be placed on a near-equal playing field with a large multinational. The state controls production by supporting the growth of the domestic company and hindering in influence of the multinational.

States can use self-sufficiency as a way to diffuse the influence of MNCs. Policies such as import-substitution industrialization (ISI) have been attempted in many Third World countries to replace MNCs with state-subsidized industries. In Japan, the government effectively protected its electronic industry from any MNCs wishing to dictate the growth and direction of that industry.

Additionally, states retain a level of control over MNCs due to territoriality. That is, states have influence over MNCs because they have jurisdiction over the land and labor that corporations need for survival and growth (Strange 65). At an extreme level, such jurisdiction can allow states to nationalize MNCs that might be gaining too powerful a grip on state policies. For example, the assets of MNCs were seized by states when Iran took control over the Anglo-Iranian Oil Company and when the Congo seized the Katanga copper mines (Tarzi 161).

#### LIMITATIONS TO STATE POWER

Such are the arguments that many use to show that, despite the rapid growth of MNCs, states still have the leading role in the international system; states still have the advantage in state-firm diplomacy and can still lay down regulations to shape their economic policies. However, many of these arguments have flaws. In addition, recent developments in the international system show that MNCs are at least gaining the upper hand, if they have not already achieved it.

First, even if states wish to pass laws and revamp their administrative systems to regulate multinationals, states will continue to find it difficult to enforce such new regulations. Many nations, especially those of the Third World, are still operating under inefficient governmental or administrative systems that do not have enough resources to manage multinationals (Tarzi 156). Also, the likelihood of such laws being passed is slim because of the "ideological predisposition" of politicians that MNCs are of major benefit to the state economy (160). Second, even though competition has allowed states to gain more control over MNCs, it is still limited when projects are capital intensive. Also, MNCs will have bargaining power due to the uncertainty of the success of many projects. Such uncertainty allows MNCs to negotiate better terms and fewer regulations (158).

Additionally, though many states have used nationalization to reduce the influence of MNCs, this strategy has numerous consequences. Often, states do not have the same access to resources as the MNCs. Therefore,

newly nationalized industries suffer from problems of inefficiency or inoperability. Likewise, many states need access to the global market - access that usually only comes with the presence of a multinational. Without MNCs, many of the world's poorest nations would be cut off from the global supply of materials, technology, capital and information (Tarzi 161). Moreover, a state that adopts a nationalization strategy will most definitely ruin its reputation in the international arena. Few corporations would be willing to make an investment due to the high risk of losing their assets. Such an increase in risk decreases a state's bargaining power in future negotiations.

States also face domestic constraints on their potential power over MNCs. Although rare, it is possible for MNCs to practice political intervention to achieve their goals. For example, the United Fruit Company organized a coup in Guatemala when the government there was showing signs of gaining power. In similar fashion, ITT helped overthrow the elected government of President Allende in Chile (Spar 11). These instances are clear demonstrations of how MNCs can overpower states. Corporations also utilize "political risk management strategies" when conducting their business abroad. This strategy involves the establishment of circumstances to ensure that the cost to the host state for altering the status quo is far too great. In this manner, MNCs are able to impair government power (Tarzi 162).

Even though states have control over the territory occupied by MNCs, they are not always in a position to use this advantage as a method of control. Usually, states need the benefits that MNCs provide (technology, employment and access to global resources and major markets) more than they need regulatory power. This scenario is especially true in Third World nations needing economic assistance and capital inflows to compete and even survive in the international system.

#### DEMONSTRATIONS OF CORPORATE POWER

Multinational corporations also have the power to alter the viewpoints and policy-making of government officials in a host state (Strange 63). This has been evidenced by the about-face in economic policy taken by nations such as Turkey and Thailand in recent years. It appears as if MNCs now hold a position of power once reserved for state bureaucracies and, especially in the case of democracies, special interest groups such as environmental and labor organizations.

The rise in state-firm and firm-firm diplomacy is also proof that MNCs are now a dominant force in the international system. At a basic level, both forms of global interaction ignore the influence of at least one state government. This has two major implications. First, this puts states in a position to bargain for the presence of MNC operations and to keep domestic corporations at home (Strange 65). Second, and perhaps most importantly, firm-firm

diplomacy can greatly affect state-state relations. If two firms from different states form an alliance, it would greatly affect the relations those states have with one another. In essence, firms are the new diplomats in an economically interdependent world. The current economic system is such that firms now have the power to move markets, crush governments and upset balances of power (67).

In all, though states have potential methods of controlling MNCs and thereby retaining their dominant role in the international economic system, there are still restrictions on the exercise of that power. In addition to these restrictions, the influence of corporations on the system has also led to circumstances in which states lose control over monetary policy. For instance, if a state chose to raise interest rates so as to slow its economy, capital from MNCs would pour in due to those same high interest rates. The resultant increase in money supply would lead to lower interest rates, thus negating the state's policy change. The growth of MNCs has also resulted in a greater flow of currency within the international system. The resultant increase in the size of the international capital pool makes it difficult for central banks to manage exchange rates (Thomson and Krasner 326). For such reasons, Janice Thomson and Stephen Krasner acknowledge that, "Huge increases in the absolute volume of world trade, international capital movements, and multinational manufacturing are taken as indicators of declining state control" (323).

#### CORPORATE CONTROL OVER SOCIAL POLICY

Not only do MNCs have power in shaping the economic policy of sovereign nations, their power has grown so great in the international system that MNCs are the force most able to both prevent or exact social change in developing nations.

For instance, many nations are forced to retain poor labor conditions and to adhere to low minimum-wage policies so as to attract MNCs to their territories. These states are in such need of economic assistance that they are forced to compromise basic labor rights in the process.

On the other hand, the presence of multinationals often leads to the advancement of human rights. The presence of multinationals correlates with greater media attention upon the working conditions in host states. It is in the interest of firms such as Reebok or Disney to improve the working conditions in their operations overseas even if it is done only to salvage the corporation's reputation (Spar 7). In all, the fact that MNCs have the power to influence social policies such as child labor and minimum wage laws is an example of the increased power they have over states. States are nearly powerless to make such political changes. This demonstrates that there are instances when only MNCs have the power to alter social policy in host countries. In this area, the multinationals have surpassed the states in political leadership.

Though states have certain regulatory power over MNCs, there are many restrictions on that power. Moreover, firms have established themselves tantamount to states in the international system. They have power to negotiate with states, affect state-state relations, influence monetary policy and even bring about social change. It is evident, especially in regions dependent upon MNCs for their link to the global market, that these corporations are an equal or greater force than that of the state itself. ®

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#### TEL AVIV: A STUDY IN UNPLANNED DEVELOPMENT

by Greg Shill CC '02

Located on the coast of the Mediterranean, Tel Aviv-Jaffa<sup>1</sup> is Israel's largest city. It is the Jewish state's primary business, cultural and communications center. The metropolitan area boasts about two million residents, about one-third of Israel's entire population; Tel Aviv proper contains approximately 357,400 residents.<sup>2</sup> Though many cities experienced dramatic growth during the twentieth century, Tel Aviv provides a particularly impressive example of that phenomenon. It remains an example of a metropolis which defies central planning and government control, despite numerous attempts throughout the history of Israel and Palestine, to do so.

A century ago, Tel Aviv was, for practical purposes, non-existent. Jews from Czarist Russia in 1882 began the first large wave of immigration to Ottoman-controlled Palestine. The nascent Zionist institutions were located in Jaffa and many of the new immigrants settled in *moshavim* (semi-communal settlements based on private ownership and wage labor) outside Jaffa. But Tel Aviv itself still did not exist and would not until several decades later, when it would be founded as a suburb of Jaffa to house an expanding Jewish population that had come into increasing conflict with the Arab residents of Jaffa. Principal financing came from the World Zionist Organization, which "saw in the development of a modern Zionist settlement the establishment of a national Zionist society in Palestine."<sup>3</sup> The city began in 1909 with the construction of the Ahuzat Bayit neighborhood, planned by a German architect, A. Tiedel, on the British "garden suburb" model. The model called for lots surrounded by a garden.

The city grew at a rapid pace during its first decade. Private enterprise and unchecked development created a situation in which building speculation soared, causing the population of Tel Aviv to expand. But what cemented Tel Aviv's status as a separate city were the Arab-Jewish disturbances in Jaffa in 1921. "As a result of the clashes Tel Aviv became isolated and was forced to develop those services which up till then had been provided by Jaffa."<sup>4</sup> The British Mandatory Authorities, who took over from the Ottomans following the Porte's cession of Palestine to Britain in 1917, recognized Tel Aviv as an "autonomous township," following the request of Tel Aviv's leaders. Though it was still subordinate to Jaffa's Town Planning Committee and was included in Jaffa's development plan, Tel Aviv's newfound independence, rail link to Jerusalem and ideology—"the first Jewish city"—encouraged many Jews to move their offices from Jaffa to Tel Aviv. And another wave of immigrants began to arrive in Palestine, many of them settling in Tel Aviv. Thus the population nearly tripled in four years,