Global Business: Oversight without Inhibiting Enterprise

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This article is focused on the role of international business in wealth creation. It discusses the issue of what regulations should be imposed, country by country, to encourage legal and ethical conduct by international firms. In a libertarian view, many excesses are self-correcting because businesses wish to operate in individual countries on a long-term basis. Serious abuses are rare but take place nonetheless, sometimes with disastrous consequences. The only effective way to control abuses is through tighter scrutiny of foreign direct investment (FDI) at a local level. Abuses affect individual countries and must therefore be policed in those countries, despite sometimes endemic corruption. Local politicians and bureaucrats—who issue FDI licenses—must be motivated by concern for public welfare and nothing else.

Keywords: global business; capitalism; foreign investment; foreign subsidiaries; corporate social responsibility

In this article, global business means two things: first, the export of goods and services, mostly from large countries to small ones; and second, the establishment of separate enterprises in foreign countries, with capital from (and therefore much control exercised by) private companies in the home market. I am mainly concerned with the latter. This article does not discuss the transfer of capital sums as loans and grants through public aid programs run by governments and United Nations agencies. These

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have a very patchy history and have been subject to great abuse.[1] Private investment is evaluated by the criteria of the marketplace. In other words, foreign investments are made on the basis of their perceived economic soundness.

Politicians, journalists, academics, and members of the public at large form themselves into two separate and opposing groups when they think about global business. The libertarians see global business as an extension into the international sphere of the principle of the division of labor: something that provides unquestioned benefits in terms of economic efficiency.[2] Opposing them are people who see global business as an expression of economic and social (and perhaps even political) imperialism.[3] It is sometimes known as the "McDonaldization" of the world: an epithet hardly characterized by subtle understatement.

I believe that the weight of evidence supports the libertarian position, and some of the facts will be briefly reviewed. The background arguments in favor of global business are (1) that it provides work in overseas markets at wage rates usually above those ruling in those markets (although not in the United States). This means (2) that wealth is created, and (3) goods are produced relatively cheaply, which is something of great value to everybody, including American consumers. At the same time, (4) the United States demonstrates its usual adaptability through the willingness of American workers to move from declining industries to expanding ones and to move home from the "rust belt" to the "sun belt." This is a process not without pain. But American workers, with their accustomed resilience, accept it in large numbers. They are after all mostly the descendents of immigrants who made longer journeys before they caught their first glimpse of the Statue of Liberty.

As a result of these processes, China does things that it does best because of the structure of the Chinese economy; and the United States does what it does best because of the different structure of its own economy. This is Adam Smith's Invisible Hand at work.

The libertarian argument does not claim that the path of global business is strewn with orchids, and it certainly does not mean that it will inevitably lead to a situation (familiar to readers of *Candide*) that can be described as the best possible of all conceivable worlds. On the contrary, global business needs to be scrutinized in such a way that its potential excesses (which can have dangerous consequences) are detected and corrected, without at the same time inhibiting the enterprise of the system: the enterprise that is its basic raison d'être.

The Positive Side

Substantial batteries of data exist to demonstrate the overall benefits of global business. I shall merely quote one series of robust estimates published by *The Economist*.[4] The data compare two years, 1980 and 1997; and they cover twenty-four "more globalized" countries (carefully defined) and forty-nine "less globalized" ones. The 1997 populations of the first group were 2.9 billion and of the second group 1.1 billion.

- In the more globalized countries, gross domestic product (GDP) advanced by 3.1 percent per annum; in the less globalized, it grew by 0.5 percent per annum.
- The average number of years of primary schooling in the more globalized countries advanced from 2.4 to 3.8 and in the less globalized from 2.5 to 3.1.
- In the majority of countries, the productivity per worker and the wage per worker are closely correlated. The economic benefit is therefore shared by the labor force as well as by the owners of capital.

Different tranches of data demonstrate that the idea that globalization is to the exclusive benefit of rich countries is a total fallacy.

Global business has a long history. Exporting has taken place for centuries. Separately established organizations funded by foreign direct investment (FDI) have existed for a hundred years. I have direct personal knowledge of such "daughter companies" that were established well before World War II. In all cases, they have developed a strong local culture that has been impregnated into the American (or British or Japanese or other) culture of the firms that established them.

In the majority of cases, problems correct themselves. The reason for this is that firms are in business for the long term, and they are fully aware that they must show themselves to be good citizens. But good citizenship can be interpreted in a number of different ways.

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The most fashionable concept at the moment is corporate social responsibility (CSR).[5] This has a wonderfully ethical ring to it, and as a result it is discussed and widely applauded by academics and social commentators who have an optimistic disposition. Have we arrived finally at "capitalism with a conscience"?

I am not enthusiastic about CSR. I see it as a dangerous fallacy, for two separate reasons. First, it has little real influence on the operating policy of major companies. From a large sample of such companies, it was found for instance that their donations to charity account for *less than 1 percent* of their pretax profits. To such companies, CSR may have benefits from the public relations standpoint, but that is about all. A perhaps more serious point is that the real purpose of capitalistic enterprise is for firms to make things that people will buy and thereby earn a profit. If they concentrate on this process while maintaining their respect for the letter and spirit of the law, they can compete most efficiently in a vigorously competitive marketplace. And from this the real benefits of capitalism flow. This is really what global business is all about.

We nevertheless need to remind ourselves of the problems.

The Negative Side

We now come to an examination of specific widely known examples, supplemented by my personal experience of the field of international business. There are two broad groups of problems: those derived from different (and less stringent) controls over foreign than over home operations and those stemming from investment and financial policies.

Consider these three notorious examples in which the controls over foreign subsidiaries have been less rigorous than over domestic ones:

- The shockingly lax way in which Union Carbide operated its plant in Bhopal, India, which led to the leakage of lethal gas in 1984, causing the death of twenty thousand people.
- The long-established policy of Altria (the company that markets Philip Morris cigarettes) in marketing cigarettes in vast quantities to third world countries, especially to China and (most recently) to Indonesia, which have few legal controls over such operations. At the same time, the company has advertised widely in the United States to try to persuade people not to start smoking: a preemptive strategy pursued for fear of stricter legal sanctions. By operating so differently in the Pacific countries and in the United States, the company is saying explicitly that Asian lives are less valuable than American ones.
- During the 1970s and 1980s, Nestlé, the largest food company in the world, generated enormous business through selling its Infant Formula milk products in third world countries. This was, prima facie, perfectly ethical, except that many such countries lack plentiful supplies of pure drinking water. The result of mixing the Nestlé product with contaminated water was a series of major health crises. Should Nestlé have been held responsible? Many observers think so, and I share their view.

Next consider these two examples of problems relating to investment and financial controls:

- A number of major companies, especially those in the oil sector, pump large quantities of capital into third world countries that are run by savagely autocratic and corrupt political regimes. The profit made locally from this investment is in effect used to curtail the liberty and prosperity of the population of those countries.
- Cases in which individual companies transfer profits from countries that levy high corporate taxes to those that levy lower ones. This practice may be legal (or on the fringe of legality). But it strikes many people as unethical, and it is certainly not an admirable example of good citizenship.

Overcoming Abuses

Citizens are fairly aware of the problems; these are not just the concern of the antiglobalist factions. The worries are shared by the better global firms themselves. The traditional response to the problems, however, has taken the form of either (1) (generally weak) legal regulations within the individual countries where global businesses are established; or (2) sanctions imposed by the companies themselves: in the home countries, in the outlying countries, or (most commonly) in both. I shall call these sanctions "self-regulation," and they will be discussed first.

My own experience of the local affiliates of major global companies has been very favorable. These include Unilever, Pepsi-Cola, Ford, Gillette, Nestlé (despite the problem just mentioned), and a number of slightly less important companies. Over time, these firms have developed a strong local culture in the individual countries where they operate. They invest in education and training of their local staff. Much of their success has been due to the importation of knowledge and expertise that has been exploited by the local companies.

Unilever, a joint British/Dutch enterprise, is run by a board of directors from these two countries. It is significant that the first director who was neither British nor Dutch was an Indian executive, who had been chairman of Unilever's highly successful subsidiary, Hindustan Lever (which has been established for almost eighty years). He was one of the most respected business leaders in India, and Unilever was perfectly aware of what he could contribute to its business as a whole.

[International corporate scandals] dramatically highlight the need for the government of a receiving country to act rigorously and proactively.

But with the investment and financial policies of less scrupulous organizations, the potential abuses need to be more strictly investigated than they are at present. Where they are open (e.g., investment in countries with undesirable political regimes), the system is *not* self-correcting. Questions raised by individual stockholders at company annual general meetings usually have no effect whatsoever. And the problems of accounting practice remain *sub rosa* and are never put on the table.

The logical forum where such problems should be addressed is the United Nations. This raises serious questions, however, discussed below. Assuming that the problem can be handed to an organization set up by one of the established United Nations agencies, how will it do its work, remembering that its deliberations need to be carried out with full transparency and publicity?

A model for this type of organization is the way in which the Better Business Bureaus in the United States have set up a voluntary mechanism to handle complaints (from all sources) about advertising claims. The bodies in question are called the National Advertising Division and National Advertising Review Board (NAD/NARB). These systems are run by a small but highly qualified staff supplemented by experienced volunteers from the advertising industry, and the findings of specific investigations are published monthly. In this way, self-policing can be made to work because it is generally recognized that high ethical standards are to the benefit of all.[6]

I must, however, return to my doubts about the ability of the United Nations to address abuses such as those described in this article. This body seems to me to be sinking into the ocean beneath the weight of its own bureaucracy plus the added weight of the large number of separate parties with conflicting self-interests. I believe that it is absolutely necessary to devise a system that is likely to be implemented more rigorously and with stronger sanctions than the United Nations is at present capable of providing. This is certainly true of the types of problems that carry safety and health hazards.

Foreign Direct Investment

FDI is in the interest of both the investing organizations and the receiving countries. Investors are keen to make it because they will only put up the money if the proposal meets commercial criteria. Receiving countries—specifically politicians in those countries—are in favor of it because they know that it is good for employment, income, and tax revenues. The only opposition that makes itself heard comes from local politicians who are either xenophobic or proponents of economic self-sufficiency or both. For this reason, in some countries, for example, India and Norway, foreign owners are only allowed to hold a minority stake in the equity of their subsidiary companies.

FDI plans should be subject to tough negotiation between the two parties. Conditions should be required. Leverage can be applied. All details should be scrutinized.

FDI is always regulated by the receiving countries, and licenses are granted by politicians and bureaucrats. These provide obvious opportunities for corruption, although direct evidence is difficult to find. But it has certainly been prevalent and may indeed be endemic. A highly informed analyst once described investment decision making in third world countries as the transfer of money from poor people in rich countries to rich people in poor countries.[7]

FDI is enormously important and can make an almost immediate difference to the economic health of developing countries. As an illustration of this, the different rules in India and China regarding FDI have had strikingly contrasting effects in the retail field. In China, retail FDI has been liberalized, and as a result the retail sector has developed rapidly, with a significant reduction in margins that has been of great benefit to the Chinese buying public. In contrast, retail FDI is still rigidly restricted in India. As a result, retailing remains atomized, with high margins and vast wastage (estimated at $11 billion per annum) because food stores are small and lack air-conditioning. This is strikingly evident to visitors to the subcontinent.

Even more important, the Union Carbide, Altria, and Nestlé scandals should have been addressed by legal regulations, yet they were not. They dramatically highlight the need for the government of a receiving country to act rigorously and proactively. It must only agree to accept FDI on condition that there will be a tough and formal evaluation of how the global company intends to conduct its business in the new country. At this stage, it should be made quite clear that matters as important as safety standards and marketing policy should be applied uniformly across all parts of the company: the home country and the foreign subsidiaries. There should be no holes in the net.

If receiving countries are to avoid disasters like the ones described in this article, politicians must think exclusively of the economic and social welfare of their people. I wish I knew how to achieve this wonderfully utopian objective. I am nevertheless convinced that this is the only way in which excesses can be avoided.

Analysts can advise. It is up to politicians to take action. Can the first group influence the second? We might remember the wise words of a Harvard economist who is now in his nineties but who thinks as clearly and trenchantly as ever: "Conservatives worry about universities being centers of disquieting innovation. Their worries may be exaggerated, but it has occurred."[8]

Notes

1. Peter T. Bauer, *Dissent on Development* (London: Weidenfeld & Nicolson, 1976), 34-36. Also see Peter T. Bauer, *Reality and Logic* (Cambridge, MA: Harvard University Press, 1984), 38-62.

2. See for instance Martin Wolf, *Why Globalization Works* (New Haven, CT: Yale University Press, 2004).

3. See for instance Naomi Klein, *No Logo* (New York: Picador USA, 1999). This book's strongest feature is tendentious argument rather than empirical demonstration.

4. Wolf, *Why Globalization Works*, 138-72.

5. See for instance "The Good Company. A Survey of Corporate Social Responsibility," *The Economist*, January 22, 2005.

6. Rana Said, "The National Advertising Division, National Advertising Review Board, and the Self-Regulation of Advertising," in *Advertising Organizations and Publications. A Resource Guide*, ed. John Philip Jones (Thousand Oaks, CA: Sage, 2000), 203-16.

7. Bauer, personal communication.

8. John Kenneth Galbraith, "How Keynes Came to America," *Economics, Peace and Laughter* (Harmondsworth, UK: Penguin, 1979), 40.