11 Private Enterprise and Development

CHAPTER SUMMARY

This chapter introduced one of the most important and yet most misunderstood and under-analyzed actors in international development—private enterprise. After reading the chapter, the student should be able to differentiate between small and large firms, and the different roles they play in development. Entrepreneurs, especially those in the informal sector, face important challenges related to a lack of property rights and government support, which can hamper economic development. Multinationals also should be regarded as differentiated actors that apply a wide range of strategies with diverse effects on development.

However, the chapter also underlines the need to consider the role of the state as a mediator. How well the state regulates and bargains with firms has a significant effect on whether they have a good or bad effect on development. Some states are better at getting more from multinationals than others. However, the student should note that international investment agreements sometimes reduce the policy space available to governments. In recent years, multinationals have begun to act directly as development agents, through corporate social responsibility programs that engage communities and by forming partnerships with government agencies and civil society organizations to address development problems. In brief, the effects of private enterprise on development depend on the size of the company, the strategy it employs, mediation by the state, and the way the company engages other actors such as civil society. Companies, by themselves, are not entirely responsible for the successes or the failures of development.

VIDEO RESOURCES

The New Rulers of The World
http://johnpilger.com/videos/the-new-rulers-of-the-world
Time 53:54

The New Rulers Of The World (2001) analyzes the new global economy and reveals that the divisions between the rich and poor have never been greater—two-thirds of the world's children live in poverty—and the gulf is widening like never before. The film turns the spotlight on the new rulers of the world: the great multinationals and the governments and institutions that back them such as the IMF, the World Bank, and the World Trade Organization, under whose rules millions of people throughout the world lose their jobs and livelihood.

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David Harvey on the Contradictions of Capitalism
https://www.youtube.com/watch?v=f9dLcGJ5NI0
Time 18:54

One of the world's most respected public thinkers visits the RSA to explore the hidden workings of capital. David Harvey, Distinguished Professor of Anthropology at the City University of New York Graduate School, unravels the paradoxes at the heart of capitalism and offers a manifesto for a new way forward.

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The Biggest Scam In The History Of Mankind: Who Owns The Federal Reserve? Hidden Secrets of Money 4
https://www.youtube.com/watch?v=iFDe5kUUyT0
Time 29:34

Who owns the Federal Reserve? You are about to learn one of the biggest secrets in the history of the world. . . It's a secret that has huge effects for everyone who lives on this planet. Most people can feel deep down that something isn't quite right with the world economy, but few know what it is.

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Who are the US 1 per cent and what they do?
https://www.youtube.com/watch?v=HJOljjRbT1U
Time 26:05

The top 1 per cent of the world financial pyramid is protecting the one percent and they are causing major damage to the 99 per cent in the US. The US has been the scene of protests since 17 September 2011, when a group of people who have dubbed themselves the 99 per cent began rallying in New York's financial district to protest "corporate greed" and top-level corruption among other instances of social inequality in the United States. US police have used violent methods to disperse or arrest protesters. The movement has now spread to major US cities and other countries, including Australia, Britain, Germany, Italy, Spain, Ireland, and Portugal.

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Whose Democracy? Information Flows, NGOs and the Predicament of Developing States
http://future-nonstop.org/c/ab21aff7426a62fea8e789b4dcce5d73
Time 26:44

This talk considers the paradoxical role played by NGOs in developing civic infrastructures, and suggests that greater focus needs to be placed by NGOs on securing intellectual property rights for developing states as the condition of political and economic sovereignty within informational and biotech economies.

REVIEW QUESTIONS

1. What is the meaning of entrepreneurship? Explain briefly, but clearly.
2. What is the informal economy?
3. What is the meaning of micro-finance?
4. What is a multinational corporation?
5. Why is foreign direct investment more stable than foreign portfolio investment?
6. What is the "obsolescing bargaining model" approach to state/firm negotiations?
7. What strategies must multinational corporations adopt when they go abroad to seek location-specific assets?

ANSWER KEY: REVIEW QUESTIONS

1. Entrepreneurship refers to the private sectors in capitalist economic development. Entrepreneurs have a kind of special ability to see new ways to put economic factors together to cause economic growth, such as new products, new productive processes, or accessing new markets. As an approach to explaining what pushes capitalism forward one must be agent-focused, rather than relying on abstract categories like "accumulation of capital" or "investment." Someone does something with capital. In this regard, the focus must be on the leadership of special individuals, innovation, and economic growth and development. However, it fell to later theorists to address what conditions facilitated the emergence of entrepreneurs. (p. 201)
2. The micro-enterprises and independent entrepreneurs operating businesses that are not legally registered, can't get bank financing, don't pay taxes, and don't follow labour or health and safety regulation. The informal economy is of principal interest for this discussion because in developing countries, most entrepreneurial activity (in terms of employment) takes place in this sector, and it is often a survival strategy for the very poor that is precarious and with little potential for growth. (pp. 201–202)
3. One of the most widely used tools to promote entrepreneurship in developing countries is micro-finance: the granting of small nominal loans to would-be entrepreneurs. Micro-finance came to worldwide attention through the work of Muhammad Yunus, who established the Grameen Bank in Bangladesh and won the Nobel Peace Prize for his work in 2006. Yunus established a system in which small loans would be granted to individual women organized within a larger group under the principle of collective responsibility (if one failed to repay, they would all lose access to the loans). Repayment of the loan was a gateway to more loans, and failure to pay resulted in exclusion from the system. The system also involved compulsory savings by participants and intensive surveillance by caseworkers. This model of micro-finance used collective responsibility to substitute for a lack of collateral or property rights. It also promoted the empowerment of women in patriarchal societies by giving them access to loans and promoting solidarity and friendships with other women. (p. 202)
4. Various terms are used to describe multinational corporations (MNCs) and their activities, including transnational corporations (TNCs), multinational enterprises (MNEs), and foreign direct investment (FDI). Overall, these terms can be and are used interchangeably. Differences between them stem principally from disciplinary and institutional divides and practices: MNC is the most widely used term, employed by political scientists, sociologists, and the media; TNC is the preferred terminology of the United Nations system; and MNE is used in international business studies. FDI is a catch-all phrase, often preferred by economists, which refers to investment that is made across borders. The word "direct" in "foreign direct investment" indicates that the investment has a physical presence or corporate form (such as a branch plant) and differentiates this mode of investment from indirect investment, also known as "foreign portfolio investment" or colloquially as "hot capital" flows, which include the purchase of foreign debt, loans, and stock market investments. Foreign direct investment is much more stable than portfolio investment, since it involves an investment in physical and productive assets such as buildings, technology, and labour, which are more costly to abandon. (p. 203)
5. In contrast to foreign portfolio investment, FDI involves an investment in physical and productive assets such as buildings, technology, and labour, which are costly to abandon making FDI more stable than foreign portfolio investment. Foreign portfolio investment, a form of indirect investment also known as a 'hot capital' flow involves the purchase of foreign debt, loans, and

stock market investments, allowing investments to flow rapidly in and out of the host country, often leading to financial instability and balance-of-payments crises. (p. 203)

6. The "obsolescing bargaining model," also called the "eccentric" model, is a dynamic and flexible approach to understanding state–firm relations. This model assumes that both states and firms want to maximize their benefit from FDI, firms seeing benefit as profits and states seeing benefits as positive spillover effects. Three factors are considered in the model: relative bargaining power (resources controlled by each party desired by the other), strategy (how the specific investment fits into each party's overall economic strategy), and constraints (existence of alternatives and pressure from domestic or international actors). This model generally assumes that the firm initially has the upper hand as states are eager to attract investment. However, once the initial investment has been made and costs are "sunk" into fixed capital in the country, the state gains the upper hand and may change the rules of the game in the form of implementing regulations. (pp. 209–210)

7. These are four strategies MNCs need to take into account:
    i. Resource-seeking strategy: MNCs require specific resources that are only available abroad. Typically, these resources may include natural resources or agricultural goods, desirable services that can only be accessed locally, and specific managerial or technical skills.
    ii. Efficiency-seeking (or cost-reducing) strategy: MNCs plan to make their global operations more efficient through exploiting differences in the availability and cost of labour, capital, and resources. The location of light manufacturing and assembly plants in low-wage countries is an example of this strategy.
    iii. Market-seeking strategy: MNCs establish a subsidiary to serve the consumer demand of a local market directly instead of by trade. FDI is chosen over trade because it is required by law to enter the new markets, permits the product to be adapted to local conditions, is less expensive, or is a strategic response to competing firms. Direct investment in small market-seeking factories was a common response to import substituting industrialization (ISI) policies, which tended to restrict trade through high tariff barriers.
    iv. Strategic asset-seeking strategy: MNCs buy up assets of other corporations as part of a global strategy to improve their competitiveness. Such a strategy may generate benefits such as "opening up new markets, creating R&D synergies or production economies, buying market power, lowering transaction costs, spreading administrative overheads, advancing strategic flexibility, and enabling risks to be better spread." (p. 209)