Edexcel Economics A-level

Unit 3: Business Behaviour

Topic 4: Government Intervention to Promote Competition

4.4 Government policy towards transnational companies (TNCs)

Notes

Measures to attract foreign direct investment (FDI)

FDI is the flow of capital from one country to another, in order to gain a lasting interest in an enterprise in the foreign country.

A depreciation in the currency means the country's wages and production costs have fallen relative to other countries. This makes the country more internationally competitive and it is likely to attract more FDI.

Measures to control TNC operations:

Political influence

The activities of TNCs could be regulated or controlled. Regulation could be used to try and raise the costs of firms. Firms which fail to follow regulations could face heavy fines, which acts as a disincentive to break the rule.

Larger, more economically powerful countries, such as China or the US, are likely to have a much greater influence on TNCs than smaller, less economically developed countries. Moreover, some developing nations may not want to attempt to control TNCs, since they could be a useful source of FDI. They might fear that if they control them, they will lose this source of FDI. This could mean they lose out on an opportunity to develop economically.

Legal control

A legal system of control is likely to be much more effective in a developed, rather than developing, economy. The government is less likely to be corrupt and consequently, may be able to have a bigger influence.

The government might set standards for labour rights, for example, to ensure that workers have acceptable working conditions.

Self-regulation

Self-regulation is when a firm monitors its own behaviour, especially in relation to ethical or legal standards.

It could be in the interest of the firm to act ethically, especially in the short run, in order to preserve a good public reputation. A limit of this is that it could encourage firms to behave unethically, but simply hide their unethical behaviour from the public, rather than actually behave ethically.

Self-regulation is likely to be more effective where the mechanisms to enforce laws are weak or missing. This is especially true in developing countries, where control over the activities of TNCs is limited. Some governments, especially those in developing countries, might be unwilling to regulate an TNC, since they see the benefits of leaving the firm unregulated. A potential cost of regulating the firm is the possibility of losing FDI.

Self-regulation could be complementary to government regulation of TNCs. Some examples of self-regulation include the OECD Guidelines on Multinational Enterprises, UNCTAD's Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, and the UN's Global Compact.

The OECD Guidelines encourages firms to adhere to principles of human rights and to practice good conduct for the environment. They are encouraged to regulate their own behaviour against international standards. This, arguably, leads to a more efficient process for policy making, since firms can use their knowledge and access to information to control their behaviour, rather than relying on a, perhaps less efficient, external body.

The standards of human rights and environmental conduct could become norms in the environment in which the firm operates. This removes the necessity to have any form of regulation, since good conduct will become habitual for firms.

However, a limitation of self-regulation is that firms which are overly concerned with adhering to global standards might lose out in a competitive market. Ultimately, the firm's goal will be to maximise their profits, so actions in the firm's self-interest are more likely to be taken. Therefore, unless there are economic incentives to adhere to certain standards, self-regulation could be ineffective.