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## Introduction

Daily, in countless ways, we are reminded of the growing interdependence of the world's six billion people—processes that have collectively become referred to as “globalization.” Globalization is in large part driven by the world's multinational corporations, two-thirds of which in 2005 were based in Western Europe and the United States, with the majority of the remainder headquartered in the Asia-Pacific region and Latin America. In possession of a dazzling array of new technologies, these MNCs have increased and accelerated the flows of trade, investment, and information across national borders, making themselves, for better or for worse, indispensable to human progress. Those whom they benefit have greater access to power, profits, and self-determination.

Because MNCs are at the heart of the processes that compose globalization, they have created an easy target for those who have watched globalization destroy cherished ways and erode the ability of states to control their territories. Enriching many, globalization has left many others behind, and its sometimes adverse effects on the world's life-sustaining environment cause widespread alarm. Of paramount concern to many is the failure of globalization to reduce poverty and lessen wealth inequality in developing countries. Indeed, many charge that globalization and the global corporations that drive it have made international poverty worse. Belligerence is escalating. For example, at a recent meeting of the World Economic Forum in Davos, Switzerland, antiglobalization protesters held up a sign that read, “Our resistance is as global as your oppression.”<sup>1</sup> And in the Islamic world, globalization and the wealth it creates carry the taint of blasphemy, materialism smothering spirituality. It is significant that it is not only the followers of Al Qaeda who resent the media giants that infect the young with what the West calls “culture.”

Nevertheless, even though it is and will remain deeply controversial and its progress may falter, globalization will continue. And MNCs will remain easy primary targets for those who focus on its negative consequences. This group comprises a growing band of NGOs, community groups, and even government leaders. Although the utility of MNCs is clear—they produce goods and services upon which we rely every day—their legitimacy is eroding in the face of such criticism. The more thoughtful and farsighted of their leaders are responding to the threat posed by this decline in legitimacy by searching for ways to meet expanded community expectations, provide environmental leadership, reduce global poverty, and make the world a better place, while still satisfying their shareholders. A successful strategy along these lines, especially one that works to reduce global poverty, will be the new source of MNCs' legitimacy.

Up to this point, as far as poverty reduction is concerned, the collective response of MNCs has been sporadic and frail, rich with rhetoric but poorly organized and inadequate. Furthermore, and despite obvious complementarities, their efforts have been inadequately supported by international institutions and national governments. The question, then, is how to coordinate the actions of the many interested parties and achieve the sought-after objectives.

## The Controversy

More than seventy years ago French paleontologist and theologian Pierre Teilhard de Chardin wrote, “Nothing, absolutely nothing—we may as well make up our minds to it—can arrest the progress of social Man towards ever greater interdependence and cohesion. . . . It would be easier, at the stage of development that we have reached, to prevent the earth from revolving than to prevent mankind from becoming totalized.”

Teilhard spoke of “the thinking layer of the earth,” “a thinking envelope,” “a collective global energy.” He called it “the Noosphere” (from the Greek *noos* meaning *mind*) and attributed this “phenomenon of growing consciousness on earth . . . to the increasingly advanced organization of more and more complicated elements.”<sup>2</sup>

Teilhard was an optimist: he saw virtue in convergence. Václav Havel, on the other hand, in his 1995 commencement speech at Harvard University, saw conflict. He spoke of globalization as a “thin veneer” forcing interdependence even as it exacerbated tensions in the world’s “underside,” among cultures, religions, tribes, traditions, and nations. “Every valley cries out for its own independence or will even fight for it.”

What has changed about globalization of late, especially over the last several decades, is its scale, extent, and intensity. (See box 1.1 for a definition and data and figures 1.1 to 1.5.) What makes globalization so controversial—easy to characterize in either the positive or the negative with equal ease and passion—is the uncertainty about the rules by which it is governed. So many questions are raised: Who is deciding its purposes and priorities? How are the decisions made? Who will benefit? At what cost?

While there are no easy, one-sided answers to these questions, there is considerable evidence that those who manage the world’s giant corporations lie at the heart of the issue. Government policies do, of course, shape globalization, at least in countries with strong, capable governments, but even there corporate managers have found ingenious ways to use the power of their respective governments for their own corporate ends.<sup>3</sup> In the developing world, governments are not only fragile and often corrupt, but also invariably so eager for the benefits of corporate investment that they are not overly fussy about attendant negative consequences. Multinational corporations create jobs, bring access to credit and markets, introduce new technologies, often reduce the prices of goods and services, and increase the wealth of the host economy through payments of taxes and wage income. MNCs also, on average, pay higher wages than domestic companies. Perhaps this explains why, in 2002, 70 national governments adopted a record 248 investment-friendly legal and regulatory changes in order to attract them.<sup>4</sup> For example, in the 1980s Malaysia attracted several multinational semiconductor manufacturers by promising no taxation on earnings for five to ten years and guaranteeing that electronics workers would be prevented from forming an independent union.<sup>5</sup>

In light of the criticism of their activities, it is easy to lose sight of the undeniable benefits investment by MNCs brings to developing countries. A recent report by the McKinsey Global Institute found that

Box 1.1

**Globalization: Definition and Data**

A recent review of the copious literature on globalization defines it as “the gradual integration of economies and societies driven by new technologies, new economic relationships, and the national and international policies of a wide range of actors, including governments, international organizations, business, labor and civil society (NGOs).” Here are some measures of the recent phase of globalization and its effects.

*Trade and Economic Growth*

World trade, measured by world exports of goods and services, between 1985 and 2002 tripled from \$2.3 trillion to \$7.8 trillion. During the same period, world nominal gross domestic product (GDP) increased by two and a half from \$12.8 trillion to \$32 trillion. The ratio of exports to GDP, however, fell in about a third of the 174 countries surveyed. In low-income countries the ratio fell more than 20 percent. During the seventeen-year period the share of world trade of these countries (excluding China and India) actually decreased from 3.6 percent in 1985 to 2.7 percent in 2002, implying a marginalization of poor countries. These countries’ share of world GDP decreased even more drastically from 4.5 percent to 2 percent.

*International Capital*

Global inflows of foreign direct investment (FDI) increased more than ten times between 1985 and 2002 (from \$58 billion to \$633 billion). But the share of FDI going to low-income countries fell from an already marginal 3.3 percent to 1.1 percent. Their share of world portfolio investment (short-term capital flows into equity and bonds) decreased from 0.04 to less than 0.01 percent.

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Thus it seems quite clear that globalization has exacerbated the inequalities among the world's countries. The rich, and China and India, have become richer, while the poor countries where 30 percent of the world's population live have drifted to the margins of the world economy, their employment and labor standards declining.

SOURCE: Bernhard G. Gunter and Rolph van der Hoeven, "The Social Dimension of Globalization: A Review of the Literature," *International Labour Review* 143 (Geneva: International Labour Organization, 2004), pp. 7–19.

the overall economic impact of such investment has been "overwhelmingly positive despite the persistence of policies that lead to negative, unintended consequences."<sup>6</sup> Besides improving developing countries' standards of living, the report identified other benefits including lower prices, higher quality and broader selection of goods, and increased productivity and output among suppliers. Concluded the report: "Compared to its potential . . . it's just a drop in the bucket."

Their vulnerability to attack is in many ways a function of MNCs' efficiency. In his recent study, Brian Roach of Tufts University wrote, "What especially differentiates the modern MNC from earlier large firms is its great mobility to seek low-cost inputs to production. This transnational mobility implies that firms may be able to set nations against one another in an effort to obtain a favorable regulatory environment. Even further, recent international trade agreements may enable corporations to circumvent national sovereignty entirely."<sup>7</sup>

MNCs can shop the world seeking the lowest cost suppliers. Nike, the world's largest apparel retailer, contracts with foreign suppliers mostly in China, Indonesia, and Vietnam. Not a single Nike employee makes shoes. Thus, the company can move with remarkable speed to take advantage of lower costs and friendly regulation.<sup>8</sup> This mobility of capital, which is commonly found in the garment and apparel industries, can cause some economic dislocations in host economies but does

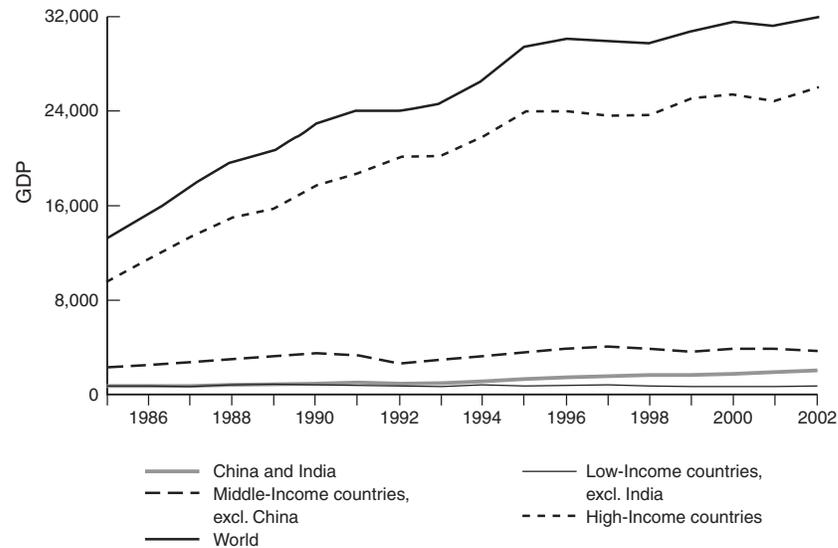


Figure 1.1. Evolution of GDP (billions of current US\$). Source: Gunter and van der Hoeven, “The Social Dimension of Globalization,” 2004.

not otherwise detract from the strong case for the benefits of foreign direct investment flowing into developing countries.<sup>9</sup> Similarly, Coca-Cola, which sells an enormous volume of products in Bangladesh, employs fewer than ten people there directly, as subcontracted firms handle most of its production and distribution.

In addition to the greater mobility of capital these days, the sheer size and reach of MNCs, which are extremely large and enormously powerful, appear to their critics to be beyond the effective control of political authority. Comparing corporate revenues with national gross domestic products, one study found that fifty-one of the world’s one hundred largest economies are companies.<sup>10</sup> Using value-added as a measure (defined as the sum of salaries, pretax profits, and depreciation and amortization), twenty-nine of the world’s largest economies are companies. In 2000, ExxonMobil, the world’s largest corporation, was bigger than 180 of the world’s 220 national economies and certainly much larger in economic size than most of the countries in which it operated.<sup>11</sup> The world’s largest private corporate employer is Wal-Mart, with 1.3 million workers.<sup>12</sup> And these corporate giants are growing:

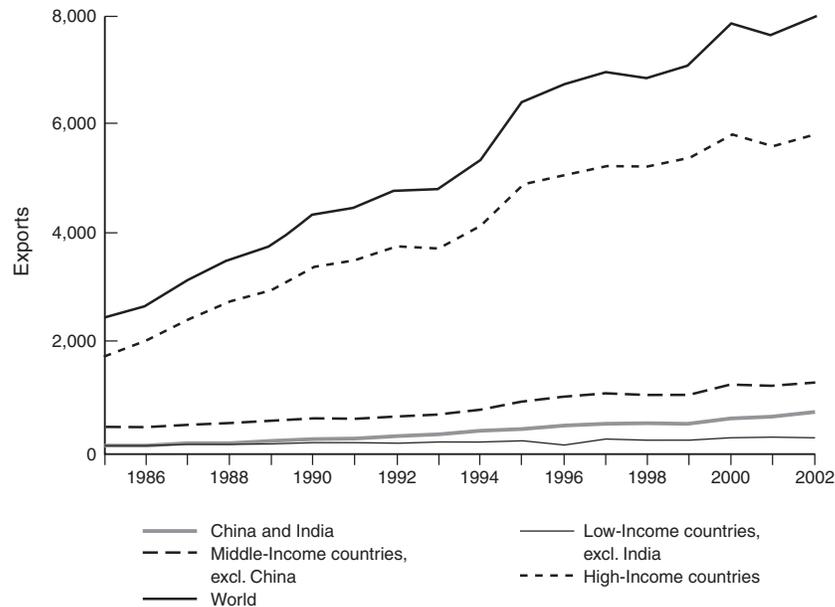


Figure 1.2. Evolution of exports (billions of current US\$). Source: Gunter and van der Hoeven, "The Social Dimension of Globalization," 2004.

between 1983 and 2001, "the value of capital assets owned by the world's fifty largest corporations increased by an astonishing 696 percent."<sup>13</sup> Further, by the early 1990s MNCs accounted for more than two-thirds of global trade in goods and services.<sup>14</sup>

With all this economic power, say their critics, MNCs have achieved political power as well and so, to use the phrase Raymond Vernon applied in the United States some years ago, they are like "rogue elephants in the forest."<sup>15</sup> They pollute. They exploit low-cost labor. They bribe officials. They find themselves in cahoots with unsavory governments. They subvert traditional cultures. And, especially in the poor world, the states in which they operate will not or cannot control their behavior. "Corporations have invested billions to shape public and political opinion," the critics charge. "When they own everything, who will stand up for the public good?"<sup>16</sup>

Furthermore, despite their growth and success (there are more than 63,000 MNCs, nine times the number 30 years ago), they have failed

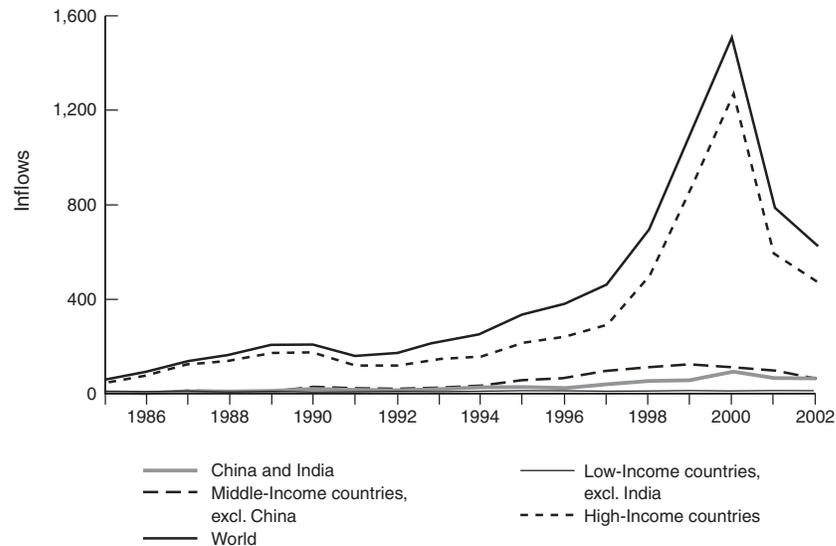


Figure 1.3. Evolution of inflows of FDI (billions of current US\$). Source: Gunter and van der Hoeven, “The Social Dimension of Globalization,” 2004.

to bring prosperity to much of the world.<sup>17</sup> Indeed, in the last twenty years, with the notable exceptions of China and India, poverty in developing countries as well as the gap between rich and poor has worsened.<sup>18</sup> (Issues related to poverty and wealth inequality are covered more fully in chapter 6.)

Yet, many defensibly argue that the problem with globalization is that it isn't global enough. Corporate foreign direct investment in the developing world has been concentrated in just a few countries, especially in China in recent years, with the least developed countries, where poverty is normally greatest and the process of investing most risky, receiving little. In fact, the World Bank reports that some two billion people live in countries that are becoming less globalized, among them Pakistan, Indonesia, and much of Africa and Latin America. In those regions, trade has diminished in relation to national income, economic growth has stagnated, and poverty has risen. Most Africans were better off forty years ago. The average per capita income of Muslims—from Morocco to Bangladesh and beyond to Indonesia and the Philippines—is one-half the world average. Other countries such as Botswana and Thailand have in a relatively short time been able to double average per

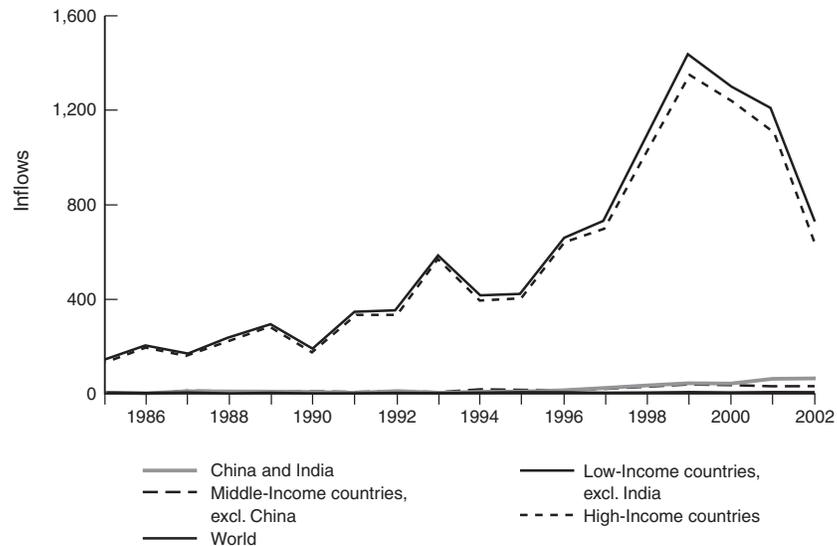


Figure 1.4. Inflows of portfolio investment (billions of current US\$). Source: Gunter and van der Hoeven, “The Social Dimension of Globalization,” 2004. As we explained in box 1.1, inflows to low-income countries were so low that they scarcely register on this chart.

capita income, mostly by accepting foreign investment and adopting new technologies. However, it is clear that the difference in the degree of openness around the world remains significant and is largely responsible for corresponding gaps in development, individual wealth, and the reduction of poverty. Those countries with the weakest links to the outside world are the poorest. As figure 1.6 shows, the countries that opened their economies and pursued the greatest economic openness since 1980 have vastly exceeded the economic growth rates of even the world’s richest countries.

Despite the roughly \$1 trillion that has been spent on grants and loans to fight poverty around the globe since the end of World War II, the World Bank reports that nearly half the world’s population still lives on less than \$2 a day, and one-sixth get by on less than \$1 a day.<sup>19</sup> To quote Joseph Stiglitz, one-time chief economist of the World Bank: “Despite repeated promises of poverty reduction made over the last decade of the twentieth century, the . . . number of people in poverty has actually increased by an average of 2.5 percent annually.”<sup>20</sup> During this

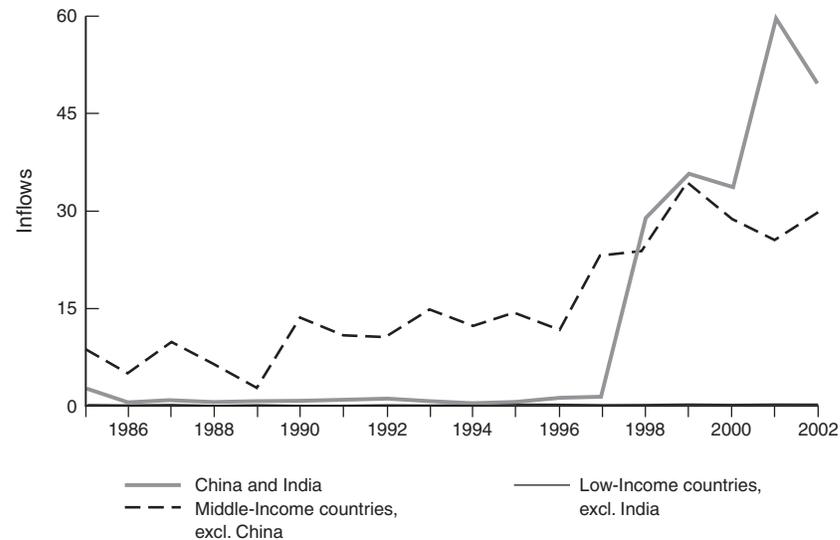


Figure 1.5. Inflows of portfolio investment in low- and middle-income countries (billions of current US\$), 1985–2002. Source: Gunter and van der Hoeven. Inflows to low-income countries were so low that they scarcely register on this chart.

same period, however, many of the world’s people have become much richer because of the activities of global corporations, but the inequality gap in the world has grown. “The central challenge we face today,” according to UN Secretary General Kofi Annan, “is to ensure that globalization becomes a positive force for all the world’s people, instead of leaving billions of them behind in squalor.”<sup>21</sup>

The resources of the world’s MNCs are central to solving this challenge. As Peter Woicke, former executive vice president of the International Finance Corporation, commented:

Our world faces huge challenges. About 20 percent of the global population owns 80 percent of the assets, 1.2 billion people live in deep poverty, and most of the population growth in the next 20 to 30 years—an additional two billion people—will take place in the poor countries. These are challenges that go beyond the capacity of the public sector. To help address these challenges, the private sector has to take some responsibility for economic and social development as well, leading to a better world where it will be able to develop and thrive.

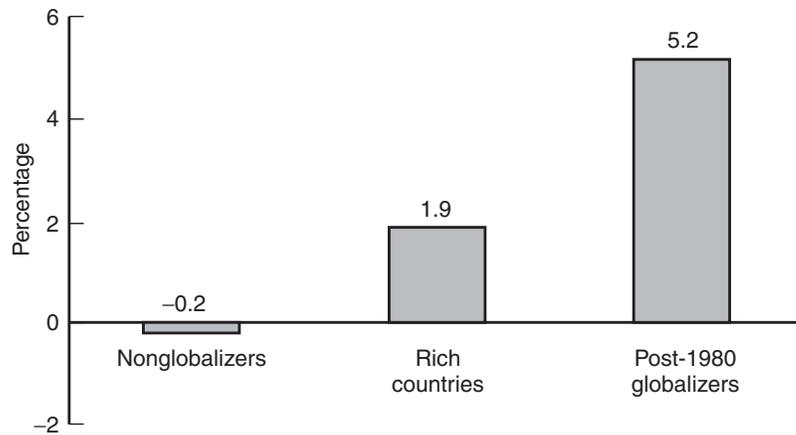


Figure 1.6. Convergence and divergence in the 1990s: Per capita GDP growth rates. Source: International Finance Corporation, May 2004 (Rapid Response Unit).

Woicke continued:

The private sector is at the heart of the changes that need to be made to ensure a better future for developing countries. In the years to come private companies will generate most if not all of the growth; they will demand most of the resources; they will gain more responsibility for development; and they will enjoy most of the opportunities. That is the new reality.<sup>22</sup>

This “new reality,” which includes MNCs (both in their role as targets for opponents of globalization and also in their role as part of the solution), also includes space for the swarm of vigilantes (6,000 at the last count) that has arisen to curb what they regard as corporate abuse and create new rules for the governance of globalization. These organizations are a subspecies of what are generally referred to as nongovernmental organizations or NGOs. They have enlisted the support of many governments—indeed, some 40 percent of their funding comes from governments—and have gained much influence in international organizations such as the United Nations, the World Bank, and even the International Monetary Fund.<sup>23</sup> Their record of achievement is impressive, ranging from producing an international treaty banning land

mines “over the opposition of the most powerful bureaucracy in the world’s most powerful state: the U.S. Pentagon,”<sup>24</sup> to pressuring giant pharmaceutical companies such as Merck and Bristol-Myers into cutting the price of HIV/AIDS drugs in poor countries. Recently the NGO, Forest Ethics, pressed Kinkos, the large American copying and printing chain, to commit to buying paper from sustainable sources, while the Rainforest Action Network extracted promises from the U.S. lumber company Boise Cascade to stop logging endangered forests.<sup>25</sup>

If there is such a thing as “the international community”—and we believe there is, even though it’s hard to define—it seems that this community has accepted, even welcomed, the NGOs: Amnesty International, Friends of the Earth, Oxfam International, the Sierra Club, Human Rights Watch, and the rest. They are doing what no other organizations or institutions seem to be capable of doing—forcing the world to observe certain minimum standards of humanity and behavior. Although their own legitimacy is questionable in that they are essentially self-appointed, the utility of NGOs is accepted, even, in many cases, by the very corporations they attack. At their best, they reflect a global consciousness akin to that foreseen by Teilhard, rooted in moral convictions about rights and duties that transcend cultures and boundaries, which, shared by human beings everywhere, also lie at the heart of the United Nations and its many agencies.

The NGOs’ emphasis on global rights and duties provides them abundant ammunition with which to attack multinationals. But given the importance of global corporations to the economy—and the polity—of the world, and their preeminent effectiveness at creating and storing wealth, developing technology, and managing resources, the continuing challenge posed to their legitimacy demands further consideration. In the next chapter we shall inspect the traditional assumptions from which managers derive their authority, their right to manage. We shall argue that the old assumptions are becoming less valid, less acceptable, and less consistent with what the managers themselves are actually doing. A “legitimacy gap” is emerging.