

GLOBALIZATION AND INCOME DISTRIBUTION

A Strategy for a National State

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Abstract

Considerations of income distribution are an important part in the general discussion and the research of the process of globalization. Locations decisions by MNE's contribute substantially both to international income distribution, and to domestic income distribution in those countries where MNE locate economic activities. In this paper a negotiation model between a national state and a MNE is described and discussed. Given the imperfect competition nature of the negotiation between MNE's and national states, and the experience of research in what is called "New Trade Theory", the model is set up as an extensive game with perfect information and a subgame perfect equilibrium. The analysis provides important insights. (1) Location is more crucial to the state than to the MNE. (2) There is a first mover advantage. (3) It is the interest of the state to take the initiative. (4) It is the interest of the state to form a complete strategy and to publicize it. (5) FDI is likely to improve both the share of the country in world income and to contribute to a more equal domestic income distribution at a higher level of income.

Key words: Globalization and location, FDI and Political Economy, Application of Extensive Games with Subgame Perfect Equilibrium

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1. Introduction

The post WWII period was characterized by an unprecedented economic growth. The growth was facilitated by a number of major processes. The period begun with a rebuilding and industrialization, it continues with the twin processes of market liberalization and globalization. All along the period economic growth went hand in hand with technological changes, culminating with the information technology (IT) revolution at the end of the 20th century. Many believe, particularly but not just in the Western world, that free markets, global value maximization, and the disappearance of nationalism are the wave of the future. Information technology with its cyberspace seems to support this view.

Reality at the beginning of the 21st century is more complex. The terrorist attack on the US on September 11, 2001 was an extreme and painful reminder of the power of an ideology that does not yield to rational economic logic. Nationalism seems to be on the rise, and global considerations are replaced by taking care of those close to us. The economic success of liberalization and globalization is undeniable. But it is not free of difficulties. Testimonies to what can be called “failure of success” range from a statement by a Swiss scholar who views globalization as a part of modern society, but says that: “ economic growth, the aim of everyone involved (in the process of globalization) has indeed occurred – but far from bringing the ‘good life’, it has only increased inequality and marginalization”, (Rist, 1997, pp. 218-219), to a recent special issue of the Journal of International Business Studies titled “The Janus Face of Globalization”, (JIBS, Third Quarter, 2001).

One problem associated with globalization is income distribution, both national distribution among countries, and class distribution across people within countries and in the world as a whole. The multinational enterprise (MNE) is a unique economic organization. Its value maximization process affects both the distribution of income among countries, and among people within a country. Income distribution is discussed in economics in terms of functional shares of factors of production. (For a description and an analysis see Johnson, 1973). In terms of globalization another vector of factors of production is added, location. National states control the access to location factors. MNE’s are defined as corporations who maximize value by taking

advantage of location factors, (in addition to other factors of production). Therefore it is only natural to discuss income distribution as a dimension of globalization.

In the neo-classic economic analysis of income distribution the focus is on current income, or current functional shares. When the discussion is in terms of value maximization of MNE's the appropriate way to discuss income distribution is in terms of value. Current income is replaced by the present value of lifetime consumption (income). This is as value maximization of a corporation is done in NPV terms. It is also consistent with the dynamic nature of the process of globalization. For example, if a MNE invests in a certain country in building up production facility of microprocessors the investment generates today a certain number of jobs at a given pay. However, it is often the case that in the future the number and the nature of the jobs will change. Wages, and other elements of direct and indirect compensation may go up. Measuring the present value, where the present value is defined over all the current and future cash flows to be paid to the residents of the state where the facility is located, gives a better measure of income distribution, and it is consistent with the value maximization of the MNE.

Another change in the way that income distribution is measured in the context of globalization as opposed to the neo-classical analysis is the introduction of expectations. Globalization together with the IT revolution changed the way that people perceive inequality. Prior to globalization inequality was measured and perceived as a local, or regional phenomenon. Globalization coupled with the IT revolution makes it global and raised aspirations. This may be at least a part of the reason for the popular belief that globalization increases inequality and marginalization.

National states and MNE's act as agents for people. All the people in the world reside in one of the states that comprised the world. A sub-group of people is employed by MNE's. In the general model presented and discussed in section 2 below, it is assumed that all corporations are MNE's, people are either employed by a MNE, or they receive cash flows from their government. Governments run national states and managements run MNE's. There is a plenty of literature on governments as agents and the issue of agency costs, and on managers as agents and the ensuing agency costs. In this paper it is assumed that the agents and the principals are at least in tacit agreements regarding the decisions that the agents make regarding FDI. There is an interesting dynamic of what happens when the geographical distribution of the stakeholders of a given MNE is changing as a result of the investment decisions made by its management, but this is not discussed in this paper.

The focus in this paper is on the role of the government as the initiator. This puts more weight on the international dimension of the income distribution following investments by MNE's. As it is shown later in the paper there is a connection between the international and the across classes income distribution. The connection is a part of the process of globalization.

The rest of the paper is comprised of the following four parts:

- A general model of the interface between national states and MNE's is defined and discussed in Section 2. This is not an operative model, although it contains a number of insights regarding globalization and income distribution.
- A specific case, a negotiation between one MNE and one state, is set up in Section 3. A game theoretic model of extensive games with perfect information is applied to the specific issue and the results of the model are discussed in terms of actual negotiations between national states and MNE's.
- The connection between international distribution of income within a country and the process of globalization is discussed in Section 4.
- A brief summary is provided in Section 5 of the paper.

2. The Interface between National States and MNE's – a General Model

The main assumptions of the general model are:

- a. The basic unit of utility maximization is the household.
- b. Every household resides in one of N countries. All households reside in all the countries. A country is a geopolitical unit with defined borders and a government that may exercise power within these borders. The government possesses a certain amount of monopoly power.
- c. All production is carried out through MNE's. They generate all cash flows. MNE's have some proprietary advantages therefore they possess a certain amount of monopoly power.
- d. Some households are employed (or otherwise receive cash flows) by MNE's; those households who do not receive cash flows directly from MNE's, receive cash flows from their governments. Governments receive cash flows either directly from MNE's that operate within their borders, or indirectly through taxes paid by residents who receive cash flows from MNE's.
- e. MNE's can locate economic activities like production, distribution, marketing, and R&D in more than one country. They decide on the location that maximizes the value of the MNE.
- f. Governments act to maximize the welfare of their residents following the same logic that combines politics and economics as in the case of trade policy.
- g. The management of the MNE's and the officials of the governments act as agents for the households in the utility maximization process.

Given the above assumptions and a maximization function for each type of agents, MNE's and governments, it is possible to derive an equilibrium solution regarding the international location of the production, marketing, R&D, and other economic activities of MNE's. It is clear that such an equilibrium exists *ex post* as in any given time all the economic activities of the MNE's are located in one or more of the N countries of the world. It is also clear that there is no unique equilibrium. According to assumptions (b) and (c) this is a world of monopolistic competition. It is also a world of incomplete markets. As both governments and corporations can negotiate the

terms of investment, there is a process of strategy on both sides. As it has been shown in the international trade literature this calls for a game theoretic approach.

In general the game theoretic solution is different than the equilibrium solution of a free and complete market. In a borderless world with no barriers the location of the economic activities of the MNEs can be regarded as the global solution. The global, free market, solution of the location problem maximizes the welfare of all the households as one group. The actual distribution of MNE's activities across countries that reflect the interface between two types of organizations, MNE and national state, where each possesses monopolistic power, is the outcome of globalization. Unlike the global solution globalization reflects imperfect market.

The loss of total welfare that is the difference between the total welfare of the global solution to that of globalization can be attributed to two sources; agency costs and geopolitical utility differentials. Agency costs are the result of political economy considerations at the level of the government, and of self-interest of hired management at the corporate level. Geopolitical utility differentials reflect the assumption that people care more about their fellow countrymen than about foreigners, particularly those who are culturally and geographically far away.

In this paper the focus is on the actions of governments. Once government is introduced to an economic model as an active agent, there is no escape from the question of mixing politics and economics. This issue, known also as political economy has been discussed in the literature of economics. A particularly appropriate example is trade policy. First, by its very name the issue of trade policy involves government actions that in general reduce total welfare. Government intervention reduces total welfare. This is so as it is a well-known fact that in almost all cases free trade maximizes total welfare. Still, governments do conduct trade policy. Second, to a great extent FDI and the process of globalization are an extension of trade where factors of production are traded rather than goods and services. Therefore, it is reasonable to extend the analysis of trade policy to FDI. Third, "New Trade Theory" provides one of the better applications of game theoretic models to a situation of imperfect and incomplete markets.

In an invited paper to the Seventh World Congress of the Econometrics Society Helpman (1997) discusses Political Economy in general and the politics of trade policy in particular. Models of Political Economy like Direct Democracy, Political Support Function, and Tariff Formation Function, are all based on the idea that the interests of a subgroup out of the total population of the world dictate a policy that benefits this subgroup at the expense of others. The others can be within the same national state, like consumers vs. industry interests, or they may reside in far away countries like in the North-South debate.

FDI, the location of economic activities across national states, and the process of globalization in general are rooted in Political Economy. As Kobrin (2001) argued MNE's came into being as a result of the national state and its power. The economic added value of MNE's depends to some extent on the power of the national state to exercise its monopolistic power, as well as by the proprietary advantages, the monopolistic power, of the MNE. It is a well-known result in economics that there is only a negotiated solution to such a case.

The issue of MNE-national state relations is a central issue in the International Business literature. Very early in the development of the literature of International Business Vernon's "Sovereignty at Bay" (1971) set the tone of focusing on the MNE as the active player. In their classic work Buckley and Casson (1976) view the MNE as a profit-maximizing corporation in a complex, and imperfect, world comprised of many national states. Internalization is the process by which the MNE maximizes its value subject to the national states constraints. More recent examples for a similar attitude are in Braunerhjelm and Ekholm (1999), and in Eden and Lenway (2001). This, however, is not the only view. Stopford and Strange (1991) presented a view where states are competing to create value within their borders, and where MNE's are instruments to arrive at this goal. A more recent contribution to the active role of the government in the process of globalization is found in Vernon's last paper (2001) where he discusses the changes in US trade policy as an indication for a more active role for the national state in the process of creating value within its borders, or to use Helpman's terms, promoting the interests of a certain subgroup of people in the world like stakeholders of a certain industry in a given country.

If globalization is the outcome of an interactive process of many agents representing many MNE's and many national states each of which is trying to negotiate a better deal, what can be said about the solution? In this paper a first step is taken towards a general solution. Setting up a simple case of one national state and one MNE negotiating over one project does this. A game theoretic model is utilized to analyze the issue at hand and gain a better understanding of the process as a whole. It is shown that although this is a very simple case, some important insights are gained.

3. A Game Theoretic Model of the Interaction between a National State and a MNE

3.1. Extensive Games with Perfect Information – An Interactive Model

The general interactive model is based on adopting a game theoretic model of an extensive game with perfect information. This is a very restrictive model compared to the actual situation. Yet, it is sufficient to provide useful insights.

An extensive game with perfect information is a game that has the following components:

1. A set of N players.
2. A set of finite, or infinite sequences that include the empty set. This is the history or the actions taken by the players in different circumstances. It is assumed that all players have perfect information.
3. There is a function $P(h)$ being the player who takes an action after the history h . $P(h) = i$, $i = 1, \dots, N$.
4. For each player i in the group, $i = 1, \dots, N$, there is a preference relation with regard to the outcome of the game.

(For a formal and precise definition see Osborn and Rubinstein, 1998, pp.89-90).

A critical feature of the game is that it depends on the histories of the players. The general rule of the play is that after any nonterminal history h player $P(h)$ chooses an action from the set:

$$A(h) = \{a; (h,a) \in H\}$$

To apply the model to the case discussed in section 2 above assume the following:

There are two players. One is an agent for the national state (G), the other is an agent for the MNE (M). The set of histories H consists of the past decisions and the current policies, laws, regulations and procedures of both the state and the MNE. It is assumed that there is a perfect information regarding H . It is assumed also that the two agents have well defined preference functions regarding all possible outcomes of the game. The preference function of agent M relates to the value of the MNE. The preference function of agent G relates to the amount of additional income generated by residents of the country in question. (This relates to the discussion of Political Economy, see Helpman, 1997).

Following the structure of the game it is assumed that the agents act and respond in a sequential manner. It is assumed here that G acts first, then both G and M are making their decisions. The assumption that G begins the process is not trivial. It is shown later that gaining the initiative is an important component in the strategy of both the MNE and the state. Initiative gives advantage in this model.

To see how the model operates assumed the following simple example. There is a potential investment project that M the agent for the MNE can locate in the country of G. Given the cost function and the demand function for the output of project there is a positive net present value, an added value over the life of the project, of 3 units. The NPV can go either to the shareholders of the MNE, all of them are assumed to reside outside the country of G, or to the residents of G via taxes and other payments paid to the government of G, or the NPV can be shared between the two parties, the state and the MNE. The project needs to be agreed upon by both parties. In a case of disagreement the project is not executed and the NPV is zero. There is only one project and it can be located by M only at G. Obviously, each party (player) can block an agreement and created a zero NPV for both parties.

In its simplest form such a situation can be formulated as the well-known "Bach or Stravinsky" (BoS) game. (The description of this game dates back to Luce and Raiffa, 1957, pp. 90-91. The example given here is taken from Osborn and Rubinstein, 1998, pp.15-16). In this basic game situation two people like to go together to a classical music concert. There are two concerts; one consists of music by Bach, and the other of music by Stravinsky. One person prefers Bach the other prefers Stravinsky. Both prefer to go out than to stay at home. One has to give up her or his preferences, or both will be worse off.

In the case of G and M the two agents have to cooperate and to agree on how to divide the NPV of the project between the shareholders of the corporation represented by agent M, and the constituency of agent G. Assume further that there are only two ways to divide the NPV between the two agents; 2,1 and 1,2 where the first is the share of G and the second is the share of M. A division of 2,1 means that both

production and marketing are located in country G. This division is denoted PM. A division of 1,2 means that only production is located in country G and that marketing is located elsewhere. This division is denoted P.

This version of the simple BoS game is presented in Table One below.

M \ G	MP	P
MP	2,1	0,0
P	0,0	1,2

Table One

There are two Nash equilibria to this game, 2,1 and 1,2 but there is no way to tell which Nash equilibria will take place, or if the players will not end in disagreement. This is why there is a need for a strategy that will insure that the players will end up with one non-zero equilibrium.

Following the “rules of the game” each agent formulates a strategy. The strategy of both agents depends only on the form of the game $\{N,H,P\}$. That is the strategy depends on the number of players, the history until now, and the rational behavior of each player given a history. The term history includes what the other players have done until now. It also includes actions that the other players may have taken, but did not, and that given a certain strategy by other players may never occur. (This is an important feature of this game. It is discussed further in the context of FDI in the next part of this section).

In terms of extensive games strategy is not a plan of action. It is a description of contingent actions depending on prior possible histories, including possibilities that may be ruled out by prior choices of one of the players. Strategy, in this model, also depends on belief regarding what the other players will do given nonterminal histories, that is all the histories prior to the current decision by the player whose turn is to act now.

To illustrate this point in the context of the problem at hand consider the following. The strategy of the government depends on the beliefs of agent G regarding the question how agent M will respond to a certain decision, or an action by G. These beliefs may be based on past experience, on a declared policy by the MNE, or on the perception of G what makes M decide in a certain way. Moreover, the strategy depends also on the beliefs of G about the steps that M would have taken if G would take certain decisions that he did not take.

As was stated at the beginning of this section this is an interactive rather than a negotiation model. In the simple game presented in Table One there is no time dimension. All decisions by the agents are made ahead of time given the histories. In this simple case there is no agreed upon solution. To arrive at a solution there is a need for a time dimension. Introducing the concept of a subgame perfect equilibrium does this.

A subgame perfect equilibrium means that there are at least two stages to the game. In stage 1 the first player makes a choice and based on that the two players formulate an optimal strategy given the other agent's strategy that is based on every possible history, (including those that are never attained). The importance of the subgame perfect equilibrium is that it eliminates all the irrelevant Nash equilibria and leads to one agreed upon equilibrium solution. (A formal definition of subgame perfect equilibrium is provided at Osborn and Rubinstein, 1998, pp.97-101).

An immediate insight in this stage is that it is necessary for both MNE and the government to specify ahead of time their complete strategy. The strategy should include steps that the government or the MNE may take although there is very small likelihood that they actually do that. All this information should be made public as it does figure in the decisions of the two agents respectively. If this is not done, it is likely that the two parties end up in disagreement where both are worse off.

Arriving at a subgame perfect equilibrium requires a procedure of eliminating various "irrelevant" choices. This is done by what is defined as "iterated elimination of weakly dominated actions". An action is defined as weakly dominated "if a player has another action at least as good no matter what the other player does and better for at least some vectors of actions of the other players". (Osborn and Rubinstein, 1998, p. 62). It is important in the process of the elimination who begins the action. In general, it is beneficial to be the first player. In terms of our illustration, if the government is the initiator of the process, it is more likely to succeed. Success is measured in getting more of the NPV of the project. Countries that are interested in FDI should take the initiative and spell out a complete strategy.

3.2. Subgames and Government Strategies in Negotiating with a MNE: An Illustration

As was stated earlier the focus in this paper is on the role of the government as an initiator of a negotiation with a MNE. The following is a description of two specific extensive games with perfect information and their solution, (subgame perfect equilibrium). The games were chosen because they are described and analyzed in the literature of game theory, and because they yield themselves to a useful interpretation in the context of a government-MNE negotiation regarding the location of an economic activity of the MNE. The analysis also provides additional insights into the questions discussed earlier.

Game 1: Assume that the NPV of the project in question is 4 units. Otherwise all assumptions regarding the process of negotiation remain as before. Now, however, agent G let it be known that the government has two alternatives; it can purchase a license from the MNE and develops the project domestically, or, as before, negotiates with the MNE for an investment of the nature PM or P. In the case of a license and a domestic investment the total NPV of the project is divided 2,2. This game is described in Table Two below:

License	FDI		
2,2			
M \ G	MP	P	
MP	3,1	0,0	
P	0,0	1,3	

Table Two

Strategy: As before the first number represents the payoff of agent G, player 1, and the second number represents the payoff of agent M, player 2. According to the rules of the game decisions are made simultaneously once agent G decides whether it goes for license or for FDI. Once G has made a decision to go for FDI, M has to decide on its choice. If G decides to go for FDI, M knows that G will choose PM. This is so because the strategy of license yields 2,2 which is greater for G than either P,P = 1,3, or PM,P = 0,0. Therefore the best strategy for G is to decide on FDI, and then choose PM. There is only one subgame perfect equilibrium in this game, PM,PM = 3,1. M will invest in both marketing and production. The complete strategy for G is: Announce FDI over License and then choose PM.

Interpretation of the strategy: note that in the simple version of the game, presented in Table One above, there are two Nash equilibria, P,P and PM,PM and there is no real strategy and real solution. Once there is a time dimension in which agent G introduces another policy alternative, that he does not intend to use, there is a subgame perfect equilibrium, PM,PM, that favors agent G. As in the general case the strategy covers all histories, including those not used, and in order for the strategy of G to be successful M has to have perfect information. In this respect, perfect information is a part of the strategy of G and not a technical assumption. It is possible to construct a game where M is the first player with a strategy that will result in a subgame perfect equilibrium of P,P. However, in this paper the focus is on the strategy of G.

Game 2: Consider now a similar situation but where the government represented by agent G has two options. The first option is to invest in stage 1, prior to the negotiation with the MNE, 1 unit in a marketing infrastructure for the project under discussion. The second option is not to invest prior to the decision of M. This game is described in Table Three below:

No Marketing Infrastructure (NI)				Marketing Infrastructure (I)			
M \ G	MP	P		M \ G	MP	P	
MP	3,1	0,0		MP	2,1	-1,0	
P	0,0	1,3		P	-1,0	0,3	

Table Three

Again, agent G begins the process by deciding whether to invest 1 unit in marketing infrastructure or not. After agent G has made the choice known, both G and M decide on their actions.

Strategy: Informing M that the alternative of an investment in marketing infrastructure exists makes the game one of an extensive form. It has two subgames. The first is where agent G decides whether to invest 1 unit in marketing infrastructure. The second consists of M and G decisions, given G decision in subgame 1. For G choosing NI in stage 1 and then PM is the best strategy. Once G chooses NI, M realizes that he should choose PM for a similar reasoning as in game 1 above. The subgame perfect equilibrium is NI, PM, PM with result 3, 1. (For a discussion of the applications to economics of this type of games see Gardner, 1995, pp. 148-157).

Interpretation of the strategy: without introducing the first subgame, investment in marketing structure, there is no solution to the game. By considering an investment in marketing infrastructure and making it known to M the government attains its goal of PM without making the investment. Credibility is vital in these games. M should really believe that G would choose PM even if M decides to choose P.

There are two important caveats; first, as was pointed out before it is extremely important who is the first player. (This is similar to the well-known first mover advantage of Cournot-Stackelberg equilibrium of a credible quantity competition). The second caveat is more general. The general class of extensive games with perfect information is based on assumptions of rational behavior, risk neutrality, and a deductive approach. The deductive approach means that the two agents focus only on the single situation at hand. There is no attempt to reach at a general market-wide equilibrium, and there are no considerations of signaling regarding future decisions.

4. FDI, International, and Domestic Income Distribution – The Role of the Government

The analysis presented in Section Three above is very limited. It deals with a restricted form of negotiation between one national state and one MNE regarding one project. Yet, as was pointed out before, even this limited analysis contributes to a better understanding of some desirable aspects of government policy and strategy regarding FDI. The discussion presented in Section 3 can be extended in two ways; first, more complex game theoretic models can be explored. Games with incomplete information, signaling games and bargaining games may provide more realistic examples. (For potential applications see Gardner, 1995, pp.327-410). Second, the issue of income distribution can be extended to include not only international income distribution, but domestic as well.

This last point is of a particular relevance to the process of globalization and it is briefly presented in this section. A major source of criticism against the process of globalization is that it has contributed to more inequality in income distribution. (See Rist, 1997). Yet, the process of globalization can contribute to a more equal income distribution not only across countries, but within countries as well. This becomes

clearer where one uses the value terms of income distribution discusses in Section 1 above, and allows for the dynamics of globalization.

In the classic analysis of income distribution and functional shares, Johnson, 1973, points out that the traditional functional shares of factors of production in the income distribution were a representation of the three classic classes in society, land, capital, and labor. A somewhat similar paradigm that is more appropriate for the structure of society and the economy of today is the value balance sheet of a corporation. (For a discussion and the applications of the value-based balance sheet (VBB), see Agmon, 2002). A value based balance sheet is a list of all the future revenues of a given corporation discounted in the appropriate risk-adjusted discount rate (the assets side), and a list of all the future liabilities including wages and expected returns to shareholders, also discounted in the appropriate risk-adjusted discount rate (the liabilities and net worth side). Like any balance sheet the expected value of the assets side is identically equal to the expected value of the liabilities and net worth side. Unlike an accounting balance sheet, the total risk of the assets, discounted future revenues is identically equal to the total risk of the liabilities and net worth, discounted future payments to providers of factors of production. The liabilities and net worth describes also how the value generated by the corporation is distributed among different households (people) in different countries.

The liabilities of the MNE can be divided into categories according to the length of the contract and to the combination of the fixed and the conditional components in the value of the liability. On the one extreme there are the workers who have short-term contracts, sometimes daily, and all their value is based on a fixed hourly wage. On the other extreme there are the shareholders who have infinite contracts, or as long as the MNE exists, and all the value depends on the success of the MNE. Normally, the longer the contract and the larger is the conditional component the larger is the expected return on the investment, or the larger is the functional share of the factor of production represented by the liability on the balance sheet of the MNE.

Now consider the simple example discussed in Section Three above. If the MNE makes an investment in production and marketing, PM, compared to an investment in production, P, alone the income distribution in country G improves in two ways. First, a larger share of the income in the world is generated within country G, and the revenues of the residents of G go up. Second, as marketing involves more human capital than production, the investment by the MNE contributes to capital formation and a “better” income distribution within country G.

Adding a dynamic component where a FDI brings about an additional domestic development strengthens the potential contribution of MNE's to the functional shares of factors of production provided by residents in the target countries of the FDI. (See for example the concept of IDP (International Development Pattern) in Dunning and Narula, 1976).

The potential of the MNE in increasing the welfare of the residents in a given country puts the responsibility to do so on agent G. To see this consider the following example. Assume that there is a new technology developed by a certain MNE. The MNE can locate this technology in one of a number of locations. However, the nature of the technology is such that once it is located in a certain country, there is no room

for a second location. (Harris, 1998, presents a model of the introduction of the Internet in the context of the General Purpose Technology (GPT) that has this feature).

Agent M representing the MNE who owns the technology act as to maximize the value of the stakeholders of the MNE. Agent M is not concerned about issues of income distribution neither internationally nor domestically. Agent G representing a country where the Internet activity can be located is concerned about the total income accrued to residents of G, and how it will be distributed among different classes of residents. The interest of G may reflect considerations of Political Support Function, Electoral Competition, or any other of the factors expressed in Political Economy models. Agent M interest is in the best location in terms of value maximization. The government has the power to affect costs for M. This asymmetry leads to focusing on G as the initiator of the negotiation for location. It also creates an incentive for the government to create and publicize a strategy toward FDI.

5. Summary and Conclusions

Considerations of income distribution are an important aspect of the discussion and the research of the process of globalization. The imperfect market nature of the process of globalization and the dimension of politics suggest an approach following that of the “New Trade Theory” both in terms of using game theoretic models, and setting up the government as an active player.

A simple extensive game with perfect information and a subgame perfect equilibrium is utilized in this paper to begin an investigation of the process of negotiation between a national state and a MNE. The analysis provides the following insights:

- There is a first mover advantage.
- It is likely that the first mover will be agent G representing the government.
- Given this, it is necessary for agent G to develop a strategy and let everybody knows all of it, (perfect information).
- The strategy should include moves that agent G does not intend to take (as in Games 1 and 2 in Section 3).

A well-planned strategy towards FDI is beneficial both in terms of international and domestic income distribution. It can improve the share of the country that initiates the policy in world’s income, and helps in developing local human and other capital thus creating a “better” income distribution in the country.

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