Outline of the lecture

1. Corporate Social Responsibility
2. Impact of multinationals on local firms
3. World Technology Frontier
Corporate Social Responsibility

- The Economist survey of CSR
- OECD Guidelines for MNEs
- Communicating CSR to shareholders
What is CSR?

the notion that corporations have other responsibilities beyond making profit—such as contributing to the community, the environment and broader social welfare.
Stakeholders

- A corporation is responsible not only to shareholders but also to other “stakeholders” who give it a “social license to operate”

- These are workers, consumers, the broader society in which firms operate, future generations etc
Is it just PR?

- Charitable contributions of FTSE 100 companies < than 1% of their pre-tax profits

- The Economist reckons CSR is mostly a cosmetic treatment; but that this is OK as capitalism doesn’t need big fix
## Types of CSR

<table>
<thead>
<tr>
<th></th>
<th>Profit for firm</th>
<th>Broader social good</th>
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<tbody>
<tr>
<td>Win-win</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Borrowed virtue</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Pernicious</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>Delusional</td>
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Is it new?

- The social responsibility of business is to increase its profits so long as it stays within the rules of the game without fraud (Friedman 1970)

- In the 1990s the debate has moved to multinational corporations and their responsibilities in developing countries
OECD Guidelines for Multinationals

- Benchmark for corporate responsibility endorsed by 30+ governments
- More than business codes of conduct
- Voluntary principles and standards
- Human rights, disclosure of information, anti-corruption, taxation, labor regulations, environment, consumer protection
- Similar to United Nation’s Global Compact
The Guidelines in the Practice

- Resettlement in the Zambian copper belt (more time to avoid social disruptions)
- Child labor in India (an investigation revealed the multinational encouraged local partners to avoid child labor)
- Human rights in Myanmar (French contact point issued recommendations to fight against forced labor)
Implementing the Guidelines

National level

- Multinational Enterprises and National Business Federations
- National Contact Points
- Trade Unions and other Employee Associations
- NGOs

OECD level

- BIAC Business and Industry Advisory Committee
- ADHERING COUNTRIES
- TUAC Trade Union Advisory Committee
- CIME
Communicating CSR

- Hockerts and Moir (2003): Communicating Corporate Responsibility to Investors
- The investor relations function in corporations is moving from a mere “broadcasting” mode regarding CSR into a much more interactive mode of relationship management.
Types of investors

- Mainstream investors
- Socially responsible investors
  - Positive screening (think greater responsibility leads to higher value)
  - Negative screening (avoid investment in “irresponsible” firms/industries)
  - Shareholder engagement (try to be active shareholders that stimulate change)
Responsibility indices

- Dow Jones Group Sustainability Index
- FTSE4Good
- KLD Indices (DS 400, KLD BMS)
- KLD Research & Analytics – Social Investment Solutions

- [www.kld.com](http://www.kld.com) (Boston-based firm)
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Multinationals and linkages

- UNCTAD’s 2001 World Investment Report
- Empirical studies on MNEs and linkages
- Smarzynska (2002)
FDI highly concentrated internationally and within nations—calls for a new generation of investment promotion policies.

- Backward linkages from foreign to local firms can enhance benefits of FDI.
- Governments can play an important role—remove market failures and perhaps even create a special linkage promotion program.
Investment promotion policies

- First generation (market friendly policies)
- Second generation (marketing countries)
- Third generation (target foreign investors at the level of industries and firms, in light of a country’s developmental priorities)
Why government intervention?

- MNEs should have self-interest in strong linkages—if they don’t, why bother?

- Policy can reduce:
  - Information gap (linkage opportunities)
  - Capability gap (between requirements of buyers and supply capacity of locals)
Linkage promotion program

- Provision of market and business information
- Matchmaking
- Managerial and technical assistance
- Training
- Financial support and incentives (?)
- Coordination to prevent municipal fiscal wars over tax incentives
Empirical studies on MNEs and linkages

- Little evidence for positive “horizontal” spillovers (in the same sector), some evidence for negative “crowding out”
- Some evidence for positive long-run horizontal spillovers in high-skill industries; no short-run spillovers in low-skills sectors
- Increasing evidence on positive “vertical” spillovers through backward linkages to suppliers in different industries
They use the value of inputs bought domestically per unit of labor hired to measure linkage potential.

They compare multinationals’ linkage potential compared to the domestics.

In Brazil, Chile & Venezuela, MNEs have higher link. potential; Mexico inconclusive.
Smarzynska (2002)

- Firm-level data from Lithuania (’96-’00)
- Evidence for spillovers in upstream sectors (suppliers), no evidence in the same sector
- Local firms benefit from FDI in the same region and in other regions as well
- Greater productivity benefits are associated with market-seeking rather than export-oriented FDI
- No difference between fully-owned and JVs
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World Technology Frontier

- Caselli and Coleman (2004)
- Implications for sectoral productivity
- Acemoglu and Zilibotti (2001)
- The role of the multinationals
Caselli and Coleman (2004)

The authors challenge a traditional interpretation of the Solow model that countries just differ in a multiplicative “Total Factor Productivity (TFP)” level and that all that is needed is to transfer to them the technologies observed in rich countries.
New growth model

They extend the development-accounting framework to allow for:

- Skilled and unskilled labor
- Differences in technology
Old and new growth model

\[ y = k^\alpha (Ah)^{1-\alpha} \]

\[ y = k^\alpha [(A_u L_u)^\sigma + (A_s L_s)^\sigma]^{\frac{1-\alpha}{\sigma}} \]
Barriers to technology adoption

The barriers-to-technology-adoption idea is captured by allowing some countries to face richer menus of accessible technologies, i.e. to have “higher technology frontiers”
Appropriate technologies

2 key ideas:

- Poor countries face “barriers” to technology adoption

- Different countries choose “appropriate” technologies (labor-biased & capital-biased) that fit their factor endowments
Skilled vs unskilled tradeoff

- Each country faces a technology frontier, representing a tradeoff in which technologies that use skilled labor more efficiently also use unskilled labor less efficiently and vice versa.

- The empirical study shows poor countries turn out to be relatively—and perhaps even absolutely—better at using unskilled labor.
TFP in Development accounting
Efficiency of skilled labor
Efficiency of unskilled labor
Caselli & Coleman imply that poor countries are more efficient in using unskilled labor. Their technology frontier is too low to make them competitive in skilled production. Should thus the developing countries focus just on the unskilled production? Should multinational enterprises locate just low-skilled production in emerging markets?
Acemoglu & Zilibotti (2001)

- Technology-skill mismatch theory
- New technologies, mostly developed in skill-rich North, are skill-complementary
- The labor-rich South mostly needs labor-complementary technologies
- This mismatch btw skills of South and technologies imported from North is the main source of productivity differences
Policy implications

- Encourage development of technologies more appropriate for LDCs
- These should be labor-biased and preferably fit to climates, tastes, cultures and institutions of the South
- Raise the supply of skilled workers in the LDCs if you want to benefit from advanced technologies from the West
Implications for sectors?

1. TFP (productivity) gaps between US and LDCs should be largest in the skill-intensive sectors, which are high-tech

2. TFP (productivity) gaps between US and LDCs should be largest in the labor-intensive sectors, which are lower-tech
TFP Gap across industries
Implications for sectors

- Empirical analysis showed that average TFP in LDCs is 22% of the US level in the least skill-intensive sectors, whereas the same number is 30% in the skilled ones.
- If LDCs have access to the same set of technologies and are relatively scarce in skilled workers, their prices and value of production in the skill-intensive sectors will be relatively high.
Implications for industrial policy

- Well, so it looks like LDCs may not be more productive than the OECD in unskilled production, and their higher-skilled sectors may even be relatively more competitive compared to the low-skilled sectors!
- It remains a puzzle whether development strategies should focus on low- or high-tech
- Maybe Caselli & Coleman and Acemoglu & Zilibotti forgot to include FDI in their models
The role of multinationals

- Chen (1983) argues that MNEs investing in LDCs in textiles, garments, plastics, and electronics very often decided not to introduce advanced technologies because of skill shortages.

- Baranson (1969) reports that problems associated with mismatch between skills and technologies are especially severe in the automotive industry.
Thus it may be that FDI and a potential technology transfer associated with it may not be enough to raise the productivity; effect on low- and high-tech remains an empirical question.

The literature on “absorptive capacity” stresses that only economies/sectors/firms with sufficient levels of human capital and R&D will benefit from FDI inflows.
Zamborsky (2004)

- Impact of FDI and R&D on productivity of “high-tech” and “low-tech” in Central Europe
- The Czech Rep., Poland, Hungary (‘94-'00)
- FDI had a significant productivity impact on the high-tech, but no impact on the low-tech sector
- FDI had a positive one-year impact on high-tech’s productivity, same-year impact negative
- Result implies FDI policy focus on high-tech
What next?

- I’m trying to extend my study to other OECD countries including emerging economies (Slovakia, South Korea, Turkey, Mexico)
- Need to extend development economics models for theory of multinationals and industrial dynamics
- Need to find an empirical methodology to analyze how FDI flows explain productivity differences in high-skilled and low-skilled sectors across OECD
Bonus case: Turkey
The possible dream

Index: labor productivity for best-practice country in each sector = 100

[Diagram showing labor productivity for different sectors in 2000, with bars representing potential productivity in absence of barriers and current productivity.]

- Potential productivity average\(^2\) = 70
- Current productivity average\(^2\) = 40

\(^1\)2002 data.
\(^2\)Estimate for total nonagricultural economy.
### Three fixable problems

Index: labor productivity in United States = 100 in 2000

#### Viable improvements

1. For informality of economy
2. For macroeconomic instability
3. For monopoly, government ownership, lack of liberalization

#### For other product/market barriers

(93% of gap)

#### Turkey’s labor productivity, 2000

<table>
<thead>
<tr>
<th></th>
<th>40</th>
<th>14</th>
<th>10</th>
<th>4</th>
<th>2</th>
</tr>
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</table>

#### Turkey’s potential labor productivity

<table>
<thead>
<tr>
<th></th>
<th>70</th>
<th>28</th>
<th>2</th>
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</table>

### Nonviable improvements

1. Low consumer income levels
2. Low labor costs

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1. For example, in sectors that require capital investment and labor inputs that are basically fixed regardless of output level, productivity improvements are principally a function of output and thus are driven by consumer income levels.

2. Low labor costs preclude labor-saving technology investments that are profitably made in a country with high labor costs—for example, automation of secondary packaging (boxing) and stacking in confectionery is not economically desirable, given Turkey’s low labor costs.
The curse of tradition

Index: labor productivity in United States = 100

**Fast-moving-consumer-goods retail**
Labor productivity, 2000

- **Share of employment**
  - Traditional segment: Sector average = 29
  - Modern segment

**Residential construction**
Labor productivity, 2000

- **Share of employment**
  - Traditional segment: Sector average = 41
  - Modern segment

**Dairy processing**
Labor productivity, 2000

- **Share of employment**
  - Traditional segment: Sector average = 50
  - Modern segment

**Auto parts**
Labor productivity, 2000

- **Share of employment**
  - Traditional segment: Sector average = 68
  - Modern segment

**Confectionery**
Labor productivity, 2000

- **Share of employment**
  - Traditional segment: Sector average = 35
  - Modern segment

**Steel**
Labor productivity, 2000

- **Share of employment**
  - Traditional segment: Sector average = 76
  - Modern segment
## Turkey’s investment gap

Share of foreign direct investment as a percentage of total revenues by sector, 2000

<table>
<thead>
<tr>
<th>Sector</th>
<th>Automotive parts</th>
<th>Cement</th>
<th>Dairy</th>
<th>Fast-moving-consumer-goods retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hungary</td>
<td>96</td>
<td>81</td>
<td>59</td>
<td>43</td>
</tr>
<tr>
<td>Malaysia</td>
<td>30</td>
<td>86</td>
<td>70</td>
<td>19</td>
</tr>
<tr>
<td>Poland</td>
<td>60</td>
<td>100</td>
<td>38</td>
<td>24</td>
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<tr>
<td>South Korea</td>
<td>26</td>
<td>81</td>
<td>83</td>
<td>13</td>
</tr>
<tr>
<td>Turkey</td>
<td>38</td>
<td>33</td>
<td>20–25</td>
<td>&lt;7</td>
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^Share of foreign direct investment as percentage of raw milk processed in sector.
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