



Multinational firms and the extractive sectors in the 21st century: Can they drive development?



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ABSTRACT

Historically, extractive sector MNEs have been seen as an obstacle to sustainable development, because they operated in enclaves with limited local engagement. Import-substitution policies aimed to increase the local benefits of these resources, restricting FDI. Since liberalisation, extractive MNEs have re-engaged with developing countries through looser governance structures with greater potential for linkages. Despite the increased *potential*, few host countries have seen meaningful MNE-led development because of weak domestic firms and poor location advantages. New MNEs from emerging economies have also not shown a greater propensity to local linkages. Only countries that have continued to invest in location advantages have seen substantial benefits.

1. Introduction

It is a central characteristic of a developing country that natural resource sectors dominate its economic structure, and it is the gradual shift away from these activities (towards manufacturing and services) that is considered to be the hallmark of economic development. Indeed, subsistence societies rely almost entirely upon on unmodified ‘natural’ inputs associated with land (including subsoil resources, vegetation and animals) and unskilled human labour. Development implies an increasing utilization of capital, which I will use in the sense preferred by Adam Smith, as physical assets, machines and people, and not (only) in the narrow sense of capital as money.¹ In today’s parlance, this is what is known as knowledge capital, and refers to the capacity to add value to naturally occurring inputs. Natural assets are enhanced by transforming these natural assets into ‘created assets’ (Dunning, 1993) through the adding of value, either through organisational skills, or transforming them through production or processing. Economic development springs from reinforcing the efficacy of these transformations within the economy. The proof of a successful development strategy is often taken to be a natural resource sector that is no longer the *primary* sector. In this paper I emphasise the extractive sector, although the principles I look to are broadly applicable across all branches of the primary sector, except that extractive activities are resources that are non-renewable, and are therefore in fixed supply. They have the capacity to provide returns well in excess of their cost of production

(referred to as ‘rents’). Rents from extractive sectors have the potential to create the basis for further economic activity in other (renewable) industries, therefore acting as driver for sustainable development. I use the term ‘sustainable development’ in a narrower sense than the currently-popular UN Sustainable Development Goals (see Kolk, Kourula, & Pisani, 2017) to mean economic development that does not excessively depend upon natural resources or on volatile commodity prices, and is therefore not interrupted by the vagaries of commodities markets.

At the heart of the vitality (or its lack) of the extractive sector as an engine for sustainable development is the MNE. The MNE (or ‘foreign capital’ as it was referred to in the earlier development literature²) and the resource sector have a strange and convoluted history. The MNE has been much derided in the dependency theory literature as generating too few benefits for the host, and causing structural distortions in the local economy, as well negatively impacting its political processes (Moran, 1978). MNEs had a habit of internalising the complete value chain and creating enclaves around their facilities that had few linkages or spillovers locally (see Girvan, 1970, 1973; Prebisch, 1950). This buttressed the view that the MNE in the extractive sector was an obstacle to development.

As a response, many countries adopted an import substituting, inward-looking policy orientation. Where implemented diligently, this led to the growth in some countries of a variety of domestic firms that had the competences to extract resources without MNE intervention, a

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¹ Money is, arguably, a natural asset. Its possession *per se* provides no rents, it is through its astute use (buying a property or machinery, investing in stocks, that generates rents, but this requires knowledge.

² The term has its roots in the work of Karl Marx, but is best developed by Rosa Luxemburg (2003). See Rasiah (1995) for a useful discussion.

Table 1

Resource dependence, selected countries.

Source: CHELEM and The World Bank, various databases.

Sorted by GDP	1980		1990		2000		2010		2015	
	NR exports/total exports (%)	NR rents as % of GDP	NR exports/total exports	NR rents as % of GDP	NR exports/total exports (%)	NR rents as % of GDP	NR exports/total exports (%)	NR rents as % of GDP	NR exports/total exports	NR rents as % of GDP
Brazil	9	2.7	10	2.2	8%	2.5	26%	4.5	19%	2,9
Canada	10	9.0	10	3.1	11%	4.5	22%	2,8	19%	0,9
Australia	15	6.2	25	3,3	21%	2.6	50%	9.6	45%	4,8
Nigeria	83	34.6	93	50,4	94%	38.2	85%	13.8	87%	4,7
Norway	47	7.6	41	7,9	58%	11.5	56%	7.7	51%	5,4
South Africa	22	15.1	15	6,0	17%	2.9	24%	7.7	20%	4,2
Malaysia	25	37.1	18	25,7	7%	9.8	11%	8.4	9%	4,8
Colombia	0.5	4,5	29	7.3	35%	5.1	48%	6.3	52%	3,6
Chile	15	9,1	11	11.6	16%	6,9	24%	18,2	26%	12,2

Note: Total natural resources rents are the sum of oil rents, natural gas rents, coal rents (hard and soft), mineral rents, and forest rents. The estimates of natural resources rents are calculated as the difference between the price of a commodity and the average cost of producing it.

cohort of suppliers, and a variety of industries further upstream that utilised these extractive outputs. Brazil and India are good examples of countries which have succeeded in this regard, developing pockets of excellence in several sectors. This has led to a new breed of MNEs (often the progeny of import-substitution) competing with traditional MNEs. In Brazil, for example, a successful industrial network developed around Petrobras (Dantas & Bell, 2011), as well as in the mining sector around Vale (see Rodrigues & Dieleman, this issue). In the majority of developing countries, however, domestic sectors failed to reach critical mass.

Since the 1990s, a concatenated change in the organisation of economic activity due to globalisation has also seen a change in the organisation of extractive sector activity, and the attitude of host countries. Economic liberalisation and a new outward policy orientation has pushed states towards greater engagement, reducing MNE-government conflict (Mullner & Puck, this issue). At the firm level, extractive sector MNEs no longer seek to internalise all value-adding activities, which in principle has meant more opportunities for linkages with the domestic sector. There is also greater awareness in host countries of the opportunities the extractive sector can provide, and concurrently greater pressures for corporate social responsibility (CSR) from civil society, regulatory agencies and other stakeholders, in both developed and developing countries.

In principle, this new dispensation is supposed to increase the potential benefits through linkages with host country firms, as well as through competition and demonstration effects. But how much do developing countries really benefit (in development terms) from these new realities? I argue that much depends upon the strength of the domestic firm sector, and the capacity of local actors with whom to link. This is an extension of the vicious cycle of poverty: Domestic incapacity is a function of the weakness in the stock of location advantages. The more underdeveloped a country is, the weaker the location (L) advantages, and this normally implies a weak domestic firm sector (Crisuolo & Narula, 2008; Dunning & Narula, 1996). FDI-led development requires a certain minimum threshold of L advantages to ensure that domestic firms are able to survive and thrive. Ironically, when there is poor domestic firm capacity, MNEs are obliged to internalise activities that they would have preferred to outsource. Sustainable development also requires diversification beyond the immediate extractive sector MNE's value chain. A nascent domestic sector (both firms and the associated L advantages) outside the extractive sector is required. Without this, the likely outcome is again the overspecialisation that marked the pre-globalisation era.

2. Development and the extractive sector: the background

The limitations of natural resources as a driver of development, and

the consequent attention paid to upgrading the secondary and tertiary sectors was formally analysed by Prebisch (1950), Singer (1950) and Lewis (1954). To simplify a complex set of arguments, natural resource outputs are commodities whose prices are volatile, which means growth also becomes cyclical. An economy that diversifies away from the primary sector into the relatively more stable manufacturing and services sector acts as a 'valve' for surplus labour and ensures more stable incomes. Coercing a single-sector economy towards a more balanced one, forms the dogma upon which much of development strategy rests.

Resource wealth has not always proven to be a blessing. Auty (1993) introduced the term 'resource curse' to describe countries that underperform despite being resource-rich. Work by Sachs and Warner (1995, 1997) found that natural resource dependence had a significant negative effect on GDP per capita growth (controlling for initial income, investments in physical and human capital, trade openness, and rule of law).³ Failure to diversify away from extractive sectors, for example, by utilizing the rents for current consumption is equivalent to the liquidation of a country's capital stock (World Bank, 2011). The majority of the less developed countries have failed to benefit from resource rents.⁴ (Venables, 2016). Many of these countries show growth which is closely mirrors volatile commodity prices, and therefore, by its very definition, is unsustainable. Table 1 provides some data on a selection of resource-rich countries. These data indicate that in many cases they matter more than they did 25 years previously⁵ Table 1 also illustrates the volatility, with high rents in many extractive industries attributable to the commodity boom that peaked about 2010.

Resource abundance is also associated with the 'Dutch Disease', which describes the propensity for resource-rich countries to overspecialise in resource extraction while neglecting tradable activities from other sectors of the economy. Investments in location-specific assets (human capital, infrastructure) are diverted away from other value-adding activities to support the resource sector. Harding and Venables (2016) find that every \$1 of resource exports decreases non-resource exports by 74 cents, while also increasing imports by 23 cents. They also find that domestic manufacturing tends to be crowded-out by resource activity to a higher degree than agriculture or services. Given the time-constrained nature of subsoil assets, the shrinkage of the rest of the economy can have dire consequences for sustained development.

Our current understanding of the development benefits associated

³ More recent work has determined that the nature of the resource curse is much more nuanced. See).

⁴ Failure to benefit from resource abundance is not a *fait accompli*. Malaysia, Botswana and Chile are among the few developing countries that have avoided the resource curse.

⁵ It is as much a result of the collapse of the unsustainable manufacturing sectors, as about the improved competitiveness of the resource sector.

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