Development of institutions in resource industries of the Global South – The Role of Internationalised Businesses

Selection of ideas, work in progress, comments welcome (November 2022)

Johannes Stephan (Johannes.Stephan@vwl.tu-freiberg.de)
TU Bergakademie Freiberg

Content

1 Motivation of the research

The resource curse hypothesis is too general and lacks a consistent theoretical foundation. Where the right kind of institutions are in place and are effectively enforced, natural resources can in fact play an important part in economic development even in a resource-rich, less developed country. Alas, in most such economies, this is not the case; here, an institutional gap eliminates the benefit that could otherwise arise from the economic use of natural resources. And here, it is often foreign investments who reap business opportunities ahead of local firms. They, however, often play an inglorious role by abusing the institutional gap, leading to a bad reputation and in some countries to a rejection to consider them as a vital ingredient to their development policies. The analysis draws from two strands of research, development economics (which supplies the insights into what institutions are development friendly and how institutions emerge) and International Business (which analyses the motivations that multinational firms and their host and home countries have to contribute to the emergence of development-friendly institutions).

2 Overarching research questions

What are the commonalities of resource-curse cases, and what was the role of institutions (or the lack thereof)? Under want conditions do internationalised firms contribute positively to the emergence of development-friendly institutions in natural resource industries of less developed countries? Under what conditions are law-makers misguided by foreign investors (state capture) and institutional gaps in the host country used to the detriment of conditions of economic development? What role can home countries play to set the incentives right for their outward investors to contribute to the building of development-friendly institutions in host countries?

3 Relevant institutions and institutional gaps

In the first step, analysis has to determine, what kind of institutions are relevant for the natural resource industries in the global South? And how institutions development-friendly look like, where gaps prevail according to this development-criterion?

- Ownership titles over the extraction and use of natural resources and the land, etc.
  - The role of the civil society
  - The non-solution of legally undefined partisan artisanal mining
- Intellectual property rights over mining and refining/processing and recycling production technology
- Competition policy regulating the relationship between large firms and between small and large firms
  - Fair competition; free trade; free contracting
- Industrial policy: foreign direct investment and innovation policy
  - Inward foreign direct investment policy
    - knowledge and technology transfer and spillovers (Stephan, 2013)
    - local competence-creating efforts (Cantwell, 2014)
    - relationship between foreign invested firms and domestic firms
    - consideration of danger of technological lock-in (Narula, 2002)
  - Outward foreign direct investment policy
    - knowledge and technology transfer and spillovers
  - Innovation policy for the upgrading of technology and productivity in mining and refining/processing and recycling
    - commercial research and development: support and location-decisions
    - innovation systems of resource-based industries (Fagerberg et al., 2009) and embeddedness of FIEs into host economy
- Contracts between domestic state and foreign investors and national rules governing (foreign) investors
  - Technical legal expertise (legal studies)
- Bi- and Multilateral organisations (like WTO) and NGOs and local grassroot organisations and financers
  - (Investor-state) Dispute Settlement System (ISDP in bi-lateralism), WTO dispute settlement
  - United Nations Guiding Principles on Business and Human Rights

    - ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy
    - OECD Guidelines for Multinational Enterprises
- SDG for an environment-friendly and social community-responsible extraction and use of natural resources (Otto, 2022)
    - environmental, social, and corporate governance (ESG), corporate social responsibility (CSR), socially responsible investing/sustainable and responsible investing (SRI), and community development assistance (CDA)
        - enforced through costs (rules&regulations, standards, etc.)
        - enforced by host countries; home countries; global financial markets; global value chain-regulations
        - voluntary self-regulation and industry initiatives: branding and marketing-instrument or is there more to it?
- Investment Facilitation for Development (IFD) (Sauvent, 2022; Berger et al., 2022)
    - improve the transparency and predictability of investment measures; streamline and speed up administrative procedures and requirements; and enhance international cooperation, information sharing, the exchange of best practices, and relations with relevant stakeholders, including dispute prevention
    - offering a credible reform commitment on behalf of the signing parties, also less developed countries (plus progressivity and flexibility: special and differential treatment; plus technical assistance, but I don't believe in best practise)
- Natural resource revenues: use and transparency against corruption
    - mandatory redistribution to citizens (Arellano-Yanguas, 2011)
    - local citizens participating directly in decisions about use of resource-revenues (Arellano-Yanguas, 2011)
- State system: democracy and autocracy (political studies)
- Economic systems: state-governed, state-owned firms, Private Public Partnerships, and private firms
- Overarching: strong agency and fight against corruption, for compliance
    - Strong enforcement of all above institutions

This step can be done in desk-top research work. The theoretical foundations of IB, new institutional economics, and innovation systems have to be analysed from the perspective of making the natural resource industry a positive contributor to conditions of economic development in resource-rich, less developed economies. A literature review can analyse publications on (i) IB in resource industry, (ii) co-evolution in institution-building involving IB, (iii) institutions in resource-rich countries, and (iv) innovation systems in resource industry.

It will probably be fruitful to include legal studies to analyse contracts between resource-rich countries and foreign investors: there is a database of many such contracts that is being analysed by experts with a variety of differing research questions. It may also be fruitful to analyse different forms of state systems of governance: democracy has its weaknesses in governing resource-industries with the necessary long-term perspective; autocracy may solve this, but raises its own concerns.

4 Process of emergence of institutions, evolution of institutions

Following the selection institutions and the description of conditions, under which such institutions can be development-friendly, research turns to analysing the governance of the process of institution-building: how do institutions evolve that are development-friendly for resource-rich less developed countries and how do institutions evolve that run counter the conditions of development of natural resource industries, counter the conditions of economic development in general? Both are needed due to heterogeneity between countries and time-periods: the malign path to find out what can go wrong and the benign path to highlight positive conditions (that will not all apply to all countries and times, but are general enough to assist translation into particular cases).

- Each case (country/time) has its own challenges & opportunities, so institutions differ and are in constant change
  - No one-size-fits-all, model solutions (Kronthaler and Stephan, 2017)
    - national priorities, diverging paradigms (Kronthaler and Stephan, 2017)
  - Process described by evolutionary theory (Nelson and Winter, 1982)
  - Role of internationalised business described by Cantwell's theory of technological accumulation (Cantwell et al., 2010)
- Institutions can only pass the test of time (evolution), if norms are compatible with values of society (Bromley, 1998)
  - the host state has to be actively involved (e.g. for CSR, see Arellano-Yanguas, 2011)
  - but the state must not be replaced by the investor
    - tax payments have the role to enable the state to fulfil its functions (pass and enforce law, policy-making) (e.g. for CSR, see Arellano-Yanguas, 2011)
- Emerging institutions can result in intended benign effects for the investor and possibly the host country
  - but this can also result in unintended adverse consequences (Khan, Munir and Willmott, 2007)
- **Why and how do inward foreign direct investors influence the process of evolutionary institution-building in natural resource industries?**
  - Locational decisions/strategies of international investors (Cantwell, 2008) determine whether their role leads to development-friendly institutions of not
    - business opportunity and profits/securing competitiveness
    - enabling institutional/regulatory framework
    - investment facilitation programmes (attracting "higher quality FDI", Sauvant, 2022)
  - Ambiguity between short-term (windfall, excess) profit seeking by exploitation versus Cantwell's idea of endogeneity of location advantages (interaction between L and O-advantages: Cantwell, 2014)
  - Adjacent fields of concepts/theories: institutional entrepreneurship; institutional work
  - TNCs co-evolution are actions that involve:
    - **creation:** reconstructing, changing norms and belief systems (values) (Lawrence and Suddaby, 2006, 220-221)
    - **maintaining:** strengthening compliance (ibid., 1230)

        - **disrupting, de-institutionalisation:** remove sanctions for noncompliance and rewards for compliance; discredit values as foundations of norms (235-237)
    - **How** do TNC engage in co-evolution, what institutions do they target? And why?
        - TNCs leverage their resources or competencies (their Os) (Maguire, Hardy, Lawrence, 2004)
        - if they have sufficient clout, e.g. social position (Battilana, 2006)
        - the larger the institutional void, the more opportunities to design emerging institutions to suit own interests (Khanna and Palepu, 1997)
    - **What** can be the content of TNCs co-evolutionary agency?
        - TNCs set or adapt (technical) standards they need in their own network (Garud, Jain and Kumaraswamy, 2002)
        - TNCs affect public policy environment (Hillman and Wan, 2005) e.g. in a race for subsidies
    - **Why** do TNCs engage in co-evolution?
        - TNCs aim at aligning their host location institutions with the ones the international network of the investor, they practise transfer of institutions, in order to reduce incompatibility in norms (Jepperson, 1991; Seo and Creed, 2002; Zilber, 2007); possibly also values (Thornton, Ocasio and Lounsbury, 2012)
            - but FIEs are also often sufficiently autonomous to allow for deviations in institutions
            - but local business opportunities may make is profitable to entertain local-specific norms and values
    - Foreign investors can only be active in co-evolution, if they are sufficiently autonomous to be allowed to experiment (Cantwell, Dunning and Lundan, 2010) to tailor host-specific institutions
- How do firms who invested outwards feed back their experience into their home industry?
    - Reverse technology transfer (I am not aware of much relevant literature here)

This step essentially includes two parts: a theoretical analysis of institutional evolution (lots of literature available) on the specific aspect of resource-industries, and case-studies analysing positive and negative aspects of experiences with institutional development in resource-rich, less developed economies.

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