The Future Role of Transnational Corporations in the World Economy

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An analysis of the continuing evolution in transnational corporation-developing country relations and projections about its important components in the 1990s.

Following the conflicts of the 1960s and 1970s, the relations between transnational corporations and host developing countries have over the past decade, been less strained. The new relationship is characterized by a mixture of growing confidence and need. Developing countries have learned how to negotiate with transnational corporations and have, generally, created better capacities to strike advantageous bargains. At the same time, with bank lending all but dried up, revolutionary advances occurring in production technology and new and more sophisticated methods emerging for organizing production and markets, countries more than ever look towards international firms as important agents to provide capital, technology, management and market access.

While these developments strengthen the confidence of transnational corporations, many firms also recognize the importance of the markets and resources of the developing countries for their own long-term prosperity—witness, for instance, the high interest in China, a decade ago, after it opened its borders to foreign investment. This new relationship is underpinned by a better understanding of the development needs and aspirations of developing countries on the part of transnational corporations, and the requirements for an appropriate investment climate for transnational corporations on the part of developing countries. It is indicative of this new relationship that the number of nationalizations has declined to almost zero since the peaks it had reached in the mid-1970s.1

But will this new phase of peaceful relations between transnational corporations and developing countries continue in the 1990s? Or will this peace, in retrospect, appear only as a temporary truce? The relations between transnational corporations and their hosts have always been dynamic, evolving relations, with both countries and companies shaping this evolution. What follows is a discussion of what are likely to be the most important components of this evolution in the years ahead.

Technological Change

The present period has seen the opening of a number of new technological frontiers. New materials, biotechnology and microelectronics are already having important im-

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pacts, and their cumulative effects may amount to a new industrial revolution. Developments in microelectronics have advanced the furthest. They have changed existing products and processes of production, have given rise to entirely new ones, and have changed the locational patterns of economic activities.

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Transnational corporations have been at the center of this rapid change. Technological innovations have frequently originated within these corporations and they have been applied, commercialized and disseminated largely through their competitive activities. But the changes that are transforming products and manufacturing processes have as much to do with the organization of production as with new technology per se. Accordingly, the very concept of technology is acquiring a new meaning: it encompasses increasingly not only the hard technologies of patentable inventions, but also the soft technologies of management and organization, with the two often being joined by the growing application of data technologies. An example is the use of just-in-time inventory systems, which represent a new approach to the management of production-utilizing data technologies. The use of this technology—best known from its large-scale application in Japanese automobile factories—is likely to spread to more industries. Just-in-time production encourages long-term relationships between suppliers and producers that are frequently based more on joint development and product quality, and less on price advantages. Most importantly, it also places a premium on suppliers being located in close proximity to final producers. Thus, to the extent that just-in-time technology finds wider application in the future, the importance of outsourcing in developing countries (be it through subcontracting or deliveries from foreign affiliates) would decline. As a consequence, the role of transnational corporations in supporting export-led development in developing countries may be reduced.

The growing use of microelectronics-based production systems in manufacturing industries could well further this trend. As islands of automation in individual firms are linked with each other, the production of capital goods—and, indeed, the industrialization process itself—will have to take into account this new electronic reality. At the same time, labor content in a number of final products will fall. With labor costs becoming smaller as a proportion of value-added, one of the key elements of comparative ad-

vantage held by many producers in developing countries loses importance. It was barely a decade ago that observers were describing the development of a new international division of labor in which many manufacturing operations would be moved to low labor-cost producers and simultaneously aid in the structural transformation of many developing countries. While there are examples of such transformations occurring, the rapid spread of new production technologies has made the new international division of labor far less prominent than it once promised to be. In fact, automation may lead to a deployment, back to home countries, of production capacities once located by transnational corporations in developing countries.

The new data technologies can also be expected to have a profound impact on the delivery of services to foreign markets. Given that most services are intangible and non-storable, they can normally be sold in foreign markets by foreign affiliates only. The application of data technologies is increasing the transportability (and hence tradability) of these services and, perhaps more than just-in-time technologies did in manufacturing, revolutionizing in the longer run the manner in which many services are produced and consumed. This creates vast opportunities for international trade in services, including such trade for those developing countries that develop the necessary infrastructure. At the same time, one important source for the growth of foreign direct investment in services (namely the non-storability of certain services) is declining in importance.

Most of these innovations have been pioneered by transnational corporations in developed countries. One of the major challenges for the 1990s is to ensure that developing countries participate in them as well, that is, acquire the capacity to generate and utilize the new technologies. If this does not occur, developing countries risk their international competitiveness in those industries in which they have entered international markets, and run the risk of falling even further behind in other industries.

Transnational corporations can play an important role in this respect. In the past, these firms were mainly important because they supplied capital, technology and access to markets. Given the revolutionary changes that are taking place in technology, the principal contribution of transnational corporations in the future may well occur in the area of the transfer of technology and, equally important, the organization of technology. And this technology is likely to be increasingly of a soft nature—if, in particular, foreign direct investment in services continues to grow in importance. The growing role of technology also suggests that intellectual property rights will become more important, and will be extended into new areas, such as biotechnology. In fact, intellectual property rights may routinely appear in the balance sheets of firms, transnational or domestic. It will be a challenge to devise acceptable con-
ventions for their measurement.

As these changes emerge, developing countries, and some transnational corporations, may have to rethink how they participate in the world economy. A greater emphasis on infrastructure, training and entrepreneurship as vehicles of growth may become necessary. But the impacts of the new technologies, the role of transnational corporations in them and the resulting patterns of world production and consumption are far from clear at this time and require considerable additional research to be understood in their entirety.

The Organization of Markets

The new technologies are very expensive. Developing a new telephone switching system, for example, costs upwards of a billion dollars. The costs of restructuring production systems in the automobile industry are similarly high. At the same time, heightened competition and shorter product life-cycles have made investment more risky.

In large part, as a response to the high costs and risks in the new economic environment, companies have been forming corporate alliances. Sometimes for specific projects, sometimes for a single product line, sometimes for marketing purposes, sometimes for research and product development, these alliances touch just about every area of corporate activity. Companies with a go-it-alone policy are being forced to reevaluate their stance. In the past, such alliances were formed mainly by firms in the primary sector and manufacturing. The 1990s are likely to see more of these alliances—increasingly so in the services sector—especially as fully integrated world markets (exemplified by 24-hour trading in financial instruments) emerge.

Many of the alliances involve transnational corporations of roughly equal size and market power. In other cases they consist of a clustering of firms, with a large company at the center and smaller transnational corporations and national firms linked via joint ventures, subcontracts, marketing agreements, and the like. These corporate alliances, which usually involve little or no transfer of equity, may increasingly evolve into corporate galaxies spanning countries and continents. They may represent the start of a phase of transnational expansion that is both quantitatively and qualitatively different from that seen so far.

One issue raised by the new patterns of transnationalization concerns whether they foster increasing concentration of economic activity, especially in the most technologically advanced industries. It is not yet clear how stable the various corporate alliances will prove to be. But they do raise the possibility that smaller transnational corporations and national firms may be able to survive only if they are linked to one alliance or another. If this should occur, concentration would, indeed, increase.

To the extent that they are integrated into the world economy, firms from developing countries and enterprises from Eastern Europe and the Soviet Union would have to join this trend as well, either by forming alliances of their own or by associating themselves with those of firms from developed market economies. Firms that wish to remain independent may find it more difficult to enter international markets on their own. In brief, markets may become more structured. This, in turn, raises issues related to the efficacy of traditional national policies. In a world of transnational corporate alliances or corporate galaxies, national antitrust policies, for instance, will lose effectiveness, monetary policies may have less impact, and industrial policies could become significantly weaker. The inadequacy of purely national policies will generate pressures for greater international cooperation in some instances, but they may rekindle nationalist pressures in others.

The Pattern of Transnational Expansion

The recent growth of transnational corporations is, in important respects, different from previous periods of expansion. Small- and medium-sized companies, including some from developing countries, appear to be expanding more rapidly than large firms. Transnational corporations from Japan and Western Europe are rapidly expanding their transnational activities, and corporations are growing more rapidly in the tertiary sector than in the secondary and primary sectors. At the same time, the forms of transnationalization are changing with various non-equity arrangements replacing or supplementing equity foreign direct investment. Thus, it can be expected that the amount of worldwide economic activity falling within the scope of these corporations will continue to expand in the 1990s. What could be the geographic pattern of this expansion? The following possibilities deserve special attention:

- The United States used to be the single largest home country. It is likely to retain this position, especially as far as accumulated stock value is concerned. In terms of outward flows of foreign direct investment, the United States has been joined by Japan and the United Kingdom, and will likely be joined by a more unified European Community after 1992, as major sources of foreign investment. The relative decline of the importance of United States transnational corporations is partly the result of a realignment based on the relative macroeconomic position of other home countries, and partly a result of the more dynamic strategies of non-United States firms, combined in particular with exchange-rate changes and the distorting impact of protectionism.

- Some impetus can also be expected to come from
firms in developing countries and in Eastern Europe and the Soviet Union, as they seek to gain immediate access to technology, circumvent trade barriers, secure their export markets and capitalize on their own competitive investment advantages. But given the small share of firms from these countries in the total of international direct investment, even a major expansion of their activities would not bring about significant changes in the overall pattern of foreign investment.

- The developed market economies will remain the most powerful magnets for foreign direct investment. The United States, due to its large and dynamic internal market in particular, will continue to be the single most attractive host country for transnational corporations. However, this position could be jeopardized if the current debate in the U.S. (with arguments familiar from debates in other countries during the 1970s) on the desirability of a rise of foreign influence in the economy should lead to a less hospitable environment for foreign direct investment. In such an environment, transnational corporations undertaking greenfield investments or adding substantial capital to acquisitions may be less vulnerable to restrictive policies, since they are visibly adding to employment and income, not just shuffling assets. But sometimes even such a strategy does not prevent criticism, in the United States and elsewhere. The integration of Japanese foreign affiliates into host countries, in particular, appears to engender the most heated concern, despite the visibility of those affiliates as greenfield investors. This reaction appears to be similar to the response to United States transnational corporations a generation ago, and may reflect the problems traditionally faced by nationals from the country widely perceived as the international pacemaker. It may also reflect, however, the difficulties of integrating Japanese management practices, with their cultural distinctiveness, into a variety of different social environments.

- Western Europe will become an increasingly attractive host area as the reduction of trade barriers within the European Community promises to create a large internal market in the 1990s. Transnational corporations from Japan are investing in European Community countries, while European-based firms are expanding across their borders via mergers and acquisitions, greenfield investments and alliances, in order to position themselves for the completion of the single internal European market by the end of 1992 and the expected growth associated with it. Increasing cross-border linkages among Western European companies are not only anticipating future European integration, they are also advancing it at the production level. At the same time, the increase of foreign participation may be resisted once it becomes too high in the perception of important domestic groups.

- The host country with the highest potential to attract foreign direct investment is Japan. The share of the developing countries as a group is likely to continue to decline or stagnate, although some countries, such as China and the newly industrializing countries, may succeed in attracting larger investment flows in the 1990s. Even though the worldwide pool of capital available for investment abroad is not a fixed one, flows to developing countries may be affected as the Western European integration process absorbs foreign investment—if Japan and the countries of Eastern Europe become more important host areas, and if the application of new technologies leads to a shifting of production facilities back to home countries. The distribution of investment flows among developing countries will remain highly uneven. As in the past, the least developed of the developing countries will largely be bypassed, while those with large markets will absorb the lion’s share. Because the debt burden continues to throw its shadow over economic growth, Latin America may well lose its position to Asia as the host region with the highest share of foreign direct investment in the developing world. Here much will depend on the performance of China and India.

- Another area with a potentially very high absorption capacity for foreign direct investment is Eastern Europe and especially the Soviet Union. The markets exist, and their attractiveness is a main incentive for transnational corporations to engage themselves here. The key variables are the regulatory environment, institutional flexibility and experience. The recent, dramatic moves towards opening these economies
may be creating the precondition for such a development. But changes are, of necessity, slow, and great expectations at the beginning can easily fall victim to day-to-day operational problems. To the extent that the involvement of transnational corporations in Eastern Europe and the Soviet Union increases (either through traditional forms, or through new forms of cooperation), and to the extent that at least part of this investment is export-oriented, these countries may become competitors for developing countries in some international export markets linked to transnational corporations: all of these countries have a skilled workforce and all of them are very close to one principal market, Western Europe. Expanding demand worldwide, however, may be able to absorb these additional exports without any major disruptions.

Future patterns of foreign direct investment will also be affected by changes in key economic sectors. Most notably:

- The development of new materials and the growth of sea-bed mining will reduce the importance of a number of traditional raw materials and their suppliers. The increased use of optical fibres and ceramic materials, for instance, will be felt in the demand for copper, iron and bauxite.

- In manufacturing, the technological and organizational changes mentioned earlier may decrease certain locational advantages of developing countries as production sites. But new technologies also create opportunities, for instance, when some traditional products such as the coarse ramie fiber can be upgraded and become the basis for wider use in the textile industry. Subcontracting to developing countries will continue in those manufacturing processes in which labor saving innovations and just-in-time inventory systems are less important. And the growth of non-equity forms of transnationalization, as they allow for greater flexibility than equity participations and reduce risks for the firms involved, is also likely to benefit developing countries.

- The growing share of the services sector in national economies, the below-average degree of transnationalization of service transnational corporations and the non-tradability of many services will ensure that foreign direct investment in services will continue to grow at above-average growth rates in the years to come. Host countries will therefore have to consider carefully which policies they should adopt to increase the contribution that this investment can make to their economic development.

To what extent these various possibilities will actually materialize, of course, unclear, as is the interaction between them. But one thing appears to be clear: at a time when developing countries are becoming less antagonistic to transnational corporations—and perhaps more than ever need foreign capital, technology and know-how—technological developments and investment opportunities elsewhere have made investment resources increasingly scarce to the developing world. Or, to put it differently, transnational corporations have more to offer, but they may offer it less to developing countries. This paradox poses a challenge to the international community. New policy approaches may change this to a certain extent; but even new policies can change little, at least in the short run, in the underlying economic determinants of foreign investment flows.

National Policies

The 1970s saw developing countries adopt a series of policy measures aimed at controlling or even restricting the activities of transnational corporations. The 1980s, in contrast, was a decade of liberalization, with many restrictions removed and often replaced by incentives designed to encourage a greater involvement by transnational corporations.10

All indications are that the trend towards liberalization will continue, if not accelerate and spread, in both developed and developing countries, in a quest to make economies more efficient or attractive. Competing investment opportunities, the debt burden and the slow growth experienced by many developing countries contribute to this trend, as countries seek to attract more capital and technology. Liberalization in one major country, furthermore, puts pressure on other countries to liberalize, lest they be prepared to accept a disadvantage in the global competition for foreign direct investment. This process has been accompanied by changing attitudes towards the role of the private sector in developing countries, developed market economies and in the Soviet Union and Eastern Europe. Indeed, privatization has become a more important policy trend in many countries. Thus, liberalization may well be the single most important characteristic of the policy environment for transnational corporations in the early 1990s, combined perhaps with heightened competition for foreign direct investment.

Liberalization will not, however, go unchallenged: a number of counterforces will maintain checks and balances. For one, the spread of liberalization does not necessarily mean that economies will become wide open for transnational corporations. Instead, regulatory mechanisms may become more fine-tuned and geared towards channelling foreign investment into priority areas while curtailing it elsewhere. Liberalization could even be accompanied by the strengthening of certain regulatory mechanisms, for example, prudential control in various indus-
tries. A number of countries, furthermore, may find that increased liberalization is either not necessary in order to obtain the desired resources or not effective to doing so. Both Japan and the Republic of Korea, for instance, have achieved high growth rates and maintained high levels of investment and rapid rates of technological progress, while simultaneously closely regulating or even restricting inflows of foreign investment and the role of foreign corporations in their domestic economies. At the same time, countries that have put a liberal policy in place and have offered generous incentives have experienced less than satisfactory inflows of foreign direct investment, especially in industries in which they desire foreign capital. This highlights that the nature of the policy framework is not only one element defining a favorable investment climate and only one determinant for foreign investment flows; economic conditions, and especially the promises of scarce natural resources and growing markets, are, as a rule, more important.

Finally, whenever the openness of an economy leads to the perception of undue foreign influence, governments may react with the imposition of restrictive controls. In a number of countries, perceptions of this sort could be fueled by large-scale debt-equity conversions, if these are seen to lead to a denationalization of domestic industries. National resentment of foreign ownership, although dominant in only a few situations, is present in many. Even in the United States, traditionally a champion of an open foreign direct investment environment, the growth of inward investment may increasingly be regarded with suspicion as the share of foreign ownership in the country’s total assets increases. Similarly, the reaction of some European Community countries to certain types of foreign direct investment (especially assembly-type investment which is often meant to circumvent trade restrictions) suggests that protectionism, which is increasingly plaguing international flows of goods and services, may spread to international flows of investment. A policy change by the United States towards greater control of foreign direct investment flows could herald a worldwide backlash to the liberalization trend.

Thus, the policy environment for transnational corporations in the early 1990s will be shaped by conflicting forces. Further liberalization will be embedded in a more differentiated and fine-tuned overall policy and regulatory framework. Strong administrative structures and stronger capacities to deal with transnational corporations will facilitate this trend in developing countries. In such a mixed policy environment, more emphasis will be placed on the quality rather than the quantity of investment flows.

A review of policies will be further encouraged by technological developments. Technological advances in some industries, such as financial services and telecommunications, have changed the parameters of these industries to such an extent that traditional national regulatory mechanisms lose their efficiency or even become obsolete. For example, the emergence of global financial markets has made some policies towards foreign direct investment in banking at least partially obsolete, as banks can use transborder data flows to deliver their services to foreign markets and need not necessarily establish foreign affiliates. Indeed, the number of foreign affiliates in banking has not increased since 1980, although international banking activities have expanded considerably. Such developments pose a challenge to governments in developed and developing countries alike, namely, how to adapt their policy and regulatory framework to the fast pace of technological change.

The Challenge of Governance

An increasingly integrated world economy at the level of the production and distribution of goods and services is evolving without a similar degree of integration at the social, cultural and political levels. In other words, the growth of global values and governance capacity is outpaced by the growth of the world production system. Indeed, national values are being eroded and national capabilities to deal with economic matters are declining, as more and more countries are finding that international movements of trade and capital are affecting their domestic economies. But while countries want to benefit from the international division of labor, they find it difficult to accept that part of their economic destiny is being determined by decisions taken outside their borders. These developments increase the fragility of the international system as a whole: in a highly integrated economic system, disturbances in one part are passed rapidly to other parts; this certainly seems to have happened in the October 1987 stock market crash, or, over a longer period of time, in the influence of domestic imbalances between savings and investment on international capital and trade flows.

In the developed economies, attempts to deal with this divergence are seen in the increased attention being paid to international policy coordination and in the move by the European Community to remove most of the governmentally-imposed barriers to the movement of resources among the member countries. Both developments are a recognition of the increasingly international character of the world economy and, in the case of the EC, a boost to the expansion of transnational corporations. What is not yet clear is whether the drive to create a unified internal market within the EC will conflict with national and regional cultural and political differences, and whether the acceptance of a single European economy will lead to greater tensions with, and higher barriers against, trade and investment from the United States, Japan and other non-EC countries.
With respect to developing countries, the key issue is whether the "truce" between transnational corporations and their hosts will remain in force. We observed at the beginning of this article that relations between transnational corporations and host developing countries have become less strained. There is, of course, no certainty that this situation is permanent, especially at a time of rapid changes which can generate frictions, disturbances and dislocations. For example, if foreign investment flows to developing countries fail to expand in any significant manner, some developing countries may be less willing to accommodate the expressed needs of transnational corporations. At present, however, the mood of cooperation appears firm and is likely to stimulate further moves in the same direction.

It has been suggested, for example, that transnational corporations might be more willing to accept input, perhaps of a consultative nature, from local interest groups in areas that are considered of particular importance. Such areas include the impact of transnational corporations on the physical environment, impacts on local employment and on the social and cultural environment, and locational decisions. Corporations have also shown some willingness to devote a portion of their net revenues to local projects, such as the subsidization of housing, schools and medical facilities. Such activities may be extended, along the lines of the corporate social responsibility actions that have become more widespread in the United States. 14

The gap between the steadily integrating world production system and the fragmented national policy systems may be bridged to some extent by strengthening global governance capacities through greater international cooperation related to transnational corporations. The need to strengthen mechanisms of global governance has been recognized by the international community, the trade-union movement and the business sector. Developments underway at the end of the 1980s suggest some movement in this respect in the 1990s. With the growth of foreign direct investment in the United States, and perhaps soon in Japan, these two major countries will add a host-country perspective to their present home-country perspective. The growth of transnational corporations from developing countries could lead some of these nations towards acquiring elements of a home-country perspective. And as the Soviet Union and the countries of Eastern Europe become more involved in both inward and outward investment, their perspectives, also, may change. In other words, as more countries find themselves in mixed interest situations, circumstances become more conducive to international agreements relating to transnational corporations.

Efforts in this direction will certainly continue in the 1990s. The Uruguay Round of Multilateral Trade Negotiations, although not concerned with foreign direct investment as such, has a bearing on some important foreign direct investment-related issues, most notably in the negotiations on trade-related investment measures and certain types of equity and non-equity forms of foreign direct investment in services. The outcome of these negotiations, which are scheduled to be concluded in the early 1990s, could add important elements to the emerging international framework for transnational corporations. Part of this framework is of a mandatory nature and consists primarily of bilateral investment treaties. The number of such instruments will grow in the years to come. Increasingly, they will not only be concluded between developed market economies and developing countries, but also between the former and the countries of Eastern Europe (including the USSR), and between developing countries. But much of the international framework for transnational corporations is likely to remain soft law, consisting mostly of codes of conduct of a nonmandatory nature; the comprehensive Code of Conduct on Transnational Corporations being negotiated by the United Nations Commission on Transnational Corporations would be part of it. Through the processes of state practice, these codes will acquire at least the status of customary international law and, therefore, become an important part of the body of international obligations defining the rights and responsibilities of transnational corporations and states.

This body of obligations is likely to grow slowly, perhaps primarily through specialized agreements in such areas as transnational banking, airline computer reservation systems, accounting and reporting, and the like. Continuing transnationalization will, if only to avoid an increase in jurisdictional conflicts which would disrupt interstate relations, underline the importance of international cooperation concerning the activities of transnational corporations. More generally, more intensive international cooperation may be required to manage the strains of interdependence that are an unavoidable by-product of growing transnationalization.

No issue requires more international cooperation than the need to ensure that the developing countries, and especially the least developed among them, receive the capital, technology and managerial resources they require to advance their development process. If bank lending to developing countries does not recover, and if official development assistance does not expand considerably, alternative avenues will have to be explored. One suggestion, building on the interest some corporations have shown in extending their social responsibility activities to developing countries, is to encourage firms to make available voluntarily a small percentage of their global income for large-scale agricultural, training or infrastructure-development projects in those areas of the developing world where the need is the greatest. Such an approach would be of direct benefit to the recipient economies. At the same time, it would also benefit transnational corporations by encour-
aging the growth of markets, improving access to resources and helping to build more harmonious relations between transnational corporations and host developing countries.

At the bottom, however, the factors determining the flow of resources through transnational corporations are mostly of an economic nature. Efforts at combining public and private capital flows to the least developed countries are likely to be promoted. Infrastructure investment combined with private production and sale of basic consumer goods could yield a significant multiplier effect. New initiatives involving the joint efforts of governments, international agencies, and transnational corporations may be the best hope in the near term for promoting economic development in these countries.

Notes

6. UNCTC, op. cit., chap. 4.
12. UNCTC, Economic Integration and Transnational Corporations in the 1990s.
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