

Multinational Corporations in Transnational Networks: Theoretical and Regulatory Challenges in Historical Perspective

Michèle Rioux

Département de Science Politique, Université du Québec à Montréal, Montréal, Canada
Email: rioux.michele@ugam.ca

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Abstract

Multinational corporations (MNCs) have become the most powerful drivers of integration and structural changes in today's global economy. MNCs have not completely subordinated States and markets in shaping the global economy, but they have transformed the world and given rise to a new set of economic, political, social, cultural and legal problems. Yet, quite ironically, MNCs are now facing a *recombination* that tends to subordinate them to transnational networks of corporate economic power. The thorny issue of regulating the global economy is, in this context, even more complex as regulatory systems of global governance must be built to fit those transnational networks superseding States and firms. This article presents an overview of the most important theories in international political economy on MNCs in order to situate the new theoretical challenges pertaining to the understanding of contemporary structural changes in the world economy and their incidences on global governance. The first section presents three configurations of globalization and concludes on the theoretical challenges of explaining and understanding the emergence and development of transnational economic networks. A second section discusses some current issues of regulation. The overall statement of this article is that globalization has, during the last decades, transformed international political economy in ways that now require new theoretical paradigms and new modes of global regulation that are adapted to a truly global economy made of networks rather than nations or firms.

Keywords

Multinational Corporations, Transnational Networks, Cooperation, Regulation, Governance, Theory

1. Introduction

Multinational corporations (MNCs) have become the most powerful drivers of integration and structural changes in today's global economy¹. They now dominate the market and economic flows. In a sense, they can be considered one of the greatest innovations of the 20th century in terms of organizational and institutional pillars of economic life. As technostuctures², MNCs have not completely subordinated States and markets in shaping the global economy, but they have transformed the world and given rise to a new set of economic, political, social, cultural and legal problems. Yet, quite ironically, MNCs are now facing a *recombination* that tends to subordinate them to transnational networks of corporate economic power. The thorny issue of regulating the global economy is, in this context, even more complex as regulatory systems of global governance must be built to fit those transnational networks superseding States and firms.

In this article, we present an overview of the most important theories in international political economy on MNCs in order to situate the new theoretical challenges pertaining to the understanding of structural changes in the world economy. The first three sections present three distinct configurations of globalization coinciding with three different theoretical debates. In the last section, we discuss the theoretical challenges of understanding the emergence and development of transnational economic networks and their implications for global economic governance. The overall statement of this article is that globalization has, during the last decades, transformed international political economy in ways that now require new theoretical paradigms and new models of global regulation that are adapted to a global economy made of networks superseding States and MNCs.

2. International Configuration—Emergence of the MNCs

Since the late 19th century, MNCs have emerged and developed. First, it was a result of the phenomenal expansion of US MNCs and thereafter it accelerated as the result of subsequent catching-up of European and Asian MNCs in the 1970s and 1980s. We are now currently witnessing the rise of several MNCs in emerging southern countries, including India, Brazil, and China. The emergence of these MNCs has challenged international trade theory based on territorially defined national spaces to which business corporations are confined, and within which perfect competition is assumed—i.e. competition that prevents any actor from influencing the prices, structures and functioning of markets. Economics has mostly threatened firms as “black boxes” and FDI as a substitute to trade used to circumvent barriers to trade erected by States for protectionist motives. The process of globalization of business is inherent in the dynamics of capitalism. The first theoretical challenge was to recognize the existence of firms and then to understand their international and even global dimension.

The Hudson's Bay, General Electric and the Standard Oil are examples of early stage international expansion through foreign direct investment (FDI). Pioneers like Byé (1958), with his study of large inter-territorial units, Vernon (1966), and Hymer (1976) have emphasized that MNCs are large planning organizations and vectors of global economic integration. Since the late 1960s, the literature on MNCs has grown considerably. We can first conceptualize an “international” configuration (Michalet, 2002) to refer to a world divided into national economies linked by flows between independent firms. International expansion occurs through trade (e.g. strictly considered as imports and exports). The firm exists in the background of an international economic order characterized by the separation between domestic and international markets. Yet, MNCs are emerging, as is a first set of explanations with articulate trade and investment interactions. Vernon (1966) contributed a very original theory articulating international trade and investment flows. Developed at the time MNCs were primarily US firms investing in Europe, his “product cycle model” revolves around two concepts; at the micro-level, the product cycle³, and, at the macro-level, the technological gap between national systems. He explains that US MNCs held an absolute advantage vis-à-vis foreign firms that is first reflected in the trade surpluses of the United States

¹In 2010, foreign direct investment (FDI) flows reached 1.24 trillion dollars, production from MNCs represented about 25% of world production, and it is estimated that affiliates operating abroad accounted for 10% of global gross domestic product (GDP) and one third of world exports. In 2010, there were over 103,000 MNCs holding almost 900,000 subsidiaries worldwide.

²We use this expression by Galbraith (1967), according to whom the concept of a market economy makes no sense, to the extent that it is companies, as technostuctures, that direct and organize markets.

³The product cycle has five successive stages: 1) Innovation: macroeconomic variables, such as the structure of demand, efforts in R&D and market structure, allow innovation on the domestic market; 2) Launching: production costs are irrelevant because of the low elasticity of demand and the high level of income; 3) Standardization: export is made possible by economies of scale; 4) Maturity: costs of production determine location, and relocation happens when export costs are higher than costs of production abroad; 5) Decline: the country innovating loses its edge and may even import the product from an “imitator” country.

vis-à-vis Europe's and, in a later stage of the cycle, in the development of FDI from the United States to Europe. The location (L) of firms is the key factor in the multinationalization of enterprises. During the cycle, exporting is replaced by a licensing agreement and later by FDI, when foreign demand is growing and the standardization of production permits.

The explanatory scope of this model was reduced during the 1960s and 1970s as of crossed intra-sectoral foreign direct investment developed between the US, Europe and Japan. The hypothesis of a technology gap no longer held. Vernon proposed a second version of his model, the "oligopolistic cycle", which gave importance to the structuring power of companies in order to explain the crossing of FDI and to consider the strategic factors that became increasingly important in the 1970s and 1980s. The United States having lost its competitive edge, US MNCs now relied on barriers to entry in marketing and distribution. Underlying this structural change is a shift from a world of nations to a world of firms. The increasing power of MNCs led to a paradigm shift that would leave less scope for the nation-states as structuring actors of the world economy.

3. Multinational Configuration—A World of Firms

A second period coincides with a multinational configuration of globalization in which MNCs exist because of market failures or imperfections that can be either structural or natural⁴. Hymer is the most important scholar to have developed a theory of MNCs, emphasizing the specific advantages of firms "O" (for oligopolistic) as the determining factor of multinationalization. A theoretical approach inspired by Hymer, [Kindleberger \(1973\)](#) and [Caves \(1982\)](#) thus emphasized the structural power of MNCs. [Hymer \(1968, 1976\)](#), frankly adopting a structuralist approach, had a considerable influence, often underestimated⁵. While the HKC tradition revolves around the concept of "O" benefits, Hymer tends to consider these benefits as "monopolistic"⁶. Although we tend to agree with Hymer, we will use O for "oligopolistic"⁷. Perhaps the best example of this period is illustrated by Ford who developed a type of business organization that had such a significant impact on society and the world economy that the concept of Fordism emerged to refer to a linkage between a regime of accumulation and a mode of regulation of the capitalist system.

The starting point for Hymer is a simple question: Given the fact that domestic firms have an advantage on their "national" market, and in the context of significant barriers to international trade, how can foreign firms compete abroad? [Hymer \(1976\)](#) finds an explanation based on the exploitation of monopolistic advantages. *Ex-ante*, firms increase their domestic market share through mergers or internal expansion and then develop their international operations and structures when limits are reached in the domestic market. MNCs are monopolistic as they exploit entry barriers such as product differentiation, exclusive access to certain factors, the presence of economies of scale, government aids, the ability to innovate, privileged access to financial capital or the increasingly needed ability to control the management of complex and diverse networks and technological trajectories. International investment is not a substitute for trade; it is a means to exercise direct control over production, and its use must be explained by the interest in exercising such control. Two concepts are central to Hymer's theory: market power and the dialectics of rivalry-collusion. Firms are rivals, but they also tend to collude and cooperate in order to prevent or avoid competition ([Pitelis, 2002](#)). Corporate integration is a process of concentration/monopolization of economic power in large companies involving the extension of private planning on a global scale as well as a process of underdevelopment or dependency⁸. The power of MNCs also creates problems for developed States, which are increasingly unable to regulate and manage their national economies, facing deficits, tax issues, and other problems even as traditional policy instruments become less and less effective. Hymer also perceived a mercantilist and oligopolistic rivalry between US, European and Japanese

⁴Pursuant to the debate between the Harvard school (under the influence of [Bain, 1956](#)), which focuses on entry barriers and the theory of internalization (based on the work of Coase and Williamson on transaction costs), debates on MNCs oppose a structural conception, in which flaws pertain to entry barriers, with one in which natural imperfections are inherent to markets.

⁵[Polanyi-Levitt, Kari \(1982\)](#) wrote after the sudden and untimely death of Hymer that it was 10 years after the completion of his thesis (The International Operations of National Firms: A Study of Direct Foreign Investment, directed by Kindleberger) that it was finally published following many rejections. The thesis had circulated widely even before its publication in 1976.

⁶Hymer is considered a marxist and is notably recognized for his influence on world-system theories. As such, he is probably the most widely read Marxist author, cited in most business schools, though his contribution is still underestimated.

⁷Subsequent developments would lead to a paradigm called OLI. Hence, keeping the O is further justified in helping us to understand the evolution of debates surrounding this theme.

⁸Hymer also develops the idea of a trend towards the emergence of a community of corporate interests on a global scale. According to him, the world economy would evolve into a global structure of economic power free from national constraints and state regulatory powers.

groups but an equilibrium would be achieved when MNCs would have completed the deployment of their activities on a global scale, thereby nullifying the importance of firm location for market division and ensuring economic integration and cooperation between States. Indeed, from the 1990s onwards, states have increasingly cooperated in removing bottlenecks to economic globalization and to the multinationalization of enterprises. Hymer recognized the efficiency gains of MNCs. Yet, he argued horizontal integration, through which a firm increases its market power, is not automatically compatible with economic efficiency at the macro-economic or the general economic level. Some authors opposed this view and founded what has been labeled the *internalization* school.

The second approach to the understanding of the multinational configuration emphasizes efficiency gains derived from MNCs. According to them, internalization (I) of market transactions allows the firm to reduce uncertainties and avoid problems caused by opportunism and by the limited rationality of actors⁹. If MNCs are replacing international markets and increasing their market power, it is firstly by reducing the costs of cross-border operations by exerting hierarchical control over them. Corporate integration and the internalization of transactions thus improve organizational and economic performance. Accordingly, the MNC turns out to be an effective institution for the hierarchical coordination of international production networks. Using various types of institutional arrangements (internalization vs. market/externalization and all the variations possible such as outsourcing, alliances and agreements for specific elements of the value chain), the MNC can appear to be effective in determining the location and mode of coordination or control of economic activities, by making comparisons and experimenting with options to reduce costs. In coordinating the firms' transactions, the notion of preference between external markets and internal hierarchies is crucial. Industrial concentration, resulting from an internalization of transactions, allows for gains in economic efficiency. Establishing a strong link between economic efficiency and corporate integration justify economic liberalization, but this link still remains questionable. The circularity of the argument should be noted: "I" benefits are supposed to derive from market imperfections while the existence of the latter is confirmed by the act of internalization. There is no empirical evidence demonstrating the superiority of large firms. Yet, States have increasingly sought to attract MNCs in order to promote efficiency and innovation.

In attempts to reconcile or articulate the two types of advantages (O and I), Dunning (1991) suggested that the benefits of multinationalization must be related to the benefits that the firm (O) has before internalization (I). Others have argued that the internalization of transaction costs is not only compatible but also necessary for the exercise of a firm's market power. As a result of these discussions, most came to recognize the unlikelihood that any single theory could capture the phenomenon of multinationalization in its entirety. Since the late 1980s, it has seemed appropriate to address the phenomenon of multinationalization with some eclecticism, taking a number of variables into account¹⁰. More fundamentally, the question of the determinants of MNC location arose; and this issue has become more central as States have sought to improve the attractiveness of their national spaces and promote the international activities of MNCs leading to new strategic instruments for competitive integration in transnational economic networks (Cowling & Sugden, 1998).

4. Global Configuration of Transnational Networks: Rival Firms, Rival States in a Race for Competitive Integration in Transnational Networks

Economic globalization now implies the emergence of global corporate strategies that deploy institutional networks on this entire new market area. With this global configuration, we enter an era of deep integration that goes beyond increasing the flow between national spaces towards recognizing that new spaces overlook these national spaces. This captures a significant change in the organization of the global economy and in the integration process¹¹. Trade routes have become "transnational", and increasingly "electronic". The best illustrations of the new MNCs are Google, Apple, Facebook and all the new MNCs that are linked to a transnational networked economy and a networked society.

Dunning is one of the most influential authors in the literature introducing what he calls an eclectic paradigm (OLI), which integrates international trade, structural imperfections and transactional imperfections and strategic

⁹The important contributions are notably those of Rugman (1981 and 1982), Buckley and Casson (1976 and 1985), and Teece (1980).

¹⁰Meso-economic approaches focusing on the emergence of global industries stress the importance of international exchange and meso-economic aspects (industry-sectors).

¹¹On the distinction between shallow integration and deep integration resulting from the development of a structure of international production by firms, see UNCTAD (1993).

variables that we have discussed above. His paradigm integrates four conditions for multinational activity: A firm must have oligopolistic (O) advantages over national firms located in the target market; there must be benefits to internalization (I) (control of certain inputs, reduction of uncertainties, or quality control); some factors of localization (L) and the decision to go abroad must comply with the strategy of the firm. Interestingly, according to Dunning, internalization (I) advantages were critical before the 1990s, while O advantages are more important now because in order to promote technological innovation, MNCs rely on strategic alliances, on cooperation between firms and on the outsourcing of their activities. Those new relationships between firms initiated the transition from *hierarchical capitalism* to *alliance capitalism* (Dunning, 1997).

This trajectory of capitalism is based on an organizational model that emphasizes the networking of economic units, each possessing a degree of independent decision-making. Knowledge is a core determinant of this reconfiguration. Information and communications technology (ICT) plays a significant role in the emergence of these new forms of economic integration. Having helped to overcome national telecommunications networks in order to create a global infrastructure, MNCs have set up systems to facilitate the coordination of activities in a space where geographical boundaries are virtually eliminated, falling increasingly into the category of transnational corporate networks. This connectivity allowed by new technologies reveals network firms leading the way towards a new trajectory of digital capitalism characterized by the increased importance of cooperation between companies¹².

Thus appears the *networked firm* or *virtual firm*, which significantly broadens the horizons of research as it is no longer enough to consider the MNC as a space defined by the boundaries of a firm; one has to go beyond—to capture the wide variety of horizontal and vertical linkages forging such transnational corporate networks, and to identify their value chains¹³. Focusing on changes in the organization of production and on the financialization of the global economy, authors speak of de-territorialization (Andreff, 1996). The links between companies and their home markets do not disappear completely but are modified by the creation of global systems of production and global value chains.

Gereffi et al. (2005) analyze global value chains and argue that technological innovations have enabled the creation of transnational networks, which combine, paradoxically, concentration and decentralization. Some refer to global production networks combining the dispersion of the value chain throughout the enterprise and across national borders, with a parallel process of integration of levels of participants in the network. Networks now surpass MNCs, and appear as the dominant form of emerging industrial re-organization, arising from the combined effects of FDI policies for promotion and attraction, generalization of the principle of competition, and, foremost, ICT developments. Some have suggested that the impacts of these new production networks affect the international division of labor, and some, such as Gereffi et al. (1995) articulate a theory of “world-systems” based on the deployment of transnational flows of production and their effects on economic development. These networks create value based on the organization of the firms that compose them (their ability to organize work and make productivity gains while taking social and institutional contexts into account), on the exploitation of rent situations arising from monopolistic advantages (technological rents, organizational and relational rents from strategic alliances); and on cooperation, economies of scale, brand, policies and regulations at the national, international and global levels.

Corporate power now lies in the relative ability of MNCs to control/influence networks and their components. It is expressed less in terms of domination, and more in the creation of sustainable relationships throughout the transnational network involving the MNCs and its partners. Conversely, small and medium enterprises may also have strategic influence in transnational production networks. To some extent, one can apply the same analysis to States. In global production networks or value chains, firms and states are positioning themselves and their relative power, or performance, is increasingly determined by their capacity to adjust to new emerging structures of transnational networks. Finally, these new transnational corporate networks overlap different MNCs, small firms, national territorial spaces, thereby redefining economic “borders” and policy issues/frameworks.

5. Policy and Regulatory Challenges

States today are increasingly obsessed with competitiveness as Krugman (1996) correctly pointed out, so much

¹²This alliance capitalism is distinguished from hierarchical capitalism based on internal coordination within the firm Dunning (1995).

¹³An important dimension of economic globalization is obviously financial. Unfortunately, we cannot discuss it here due to space constraints but we will highlight it in discussing the work of the regulation school.

that the keyword for the new realities of integration is competitiveness driving strategies of States and MNC. The state becomes “competitive”, but with a view to fostering a competitive integration of the national economic space (as an attractive area or an incubator for competitive firms) in transnational economic networks (Cerny, 1990, 1997; Stopford & Strange, 1991). The national, physical and institutional environments (infrastructure, values, culture, history and institutions) have become a strategic factor in the economic success of MNCs and the deployment of transnational networks. Dunning sees the State as a venture partner creating competitive advantages for business by influencing the development of each OLI advantage¹⁴. According to Porter (1990), this alliance or interface between States and the MNCs is beneficial and justified since it is not oriented towards protectionist policies but towards the development of competitive advantages. Yet, Dunning takes seriously the risk of a neo-mercantilist rivalry where States and MNCs can play on two levels, sometimes on that of rivalry-competition, sometimes on that of collusion-cooperation, and often both at the same time with hybrid strategies of *coopetition* (Nalebuff & Brandenburger, 1996)¹⁵.

If States and MNCs are engaged, each in their own way, in a dynamic of global competition, one can doubt the ability of either to provide policies or codes of conduct capable of regulating the global economy. One of the first to take the multinational enterprise seriously, Vernon (1977, 1981), very quickly and clearly raised the question of interface in terms of cooperation or rivalry of these two competing systems whose inherent friction, according to him, could be mitigated or eliminated only through the emergence and consolidation of a multilateral economic cooperation¹⁶. In other words, a global economy requires a global policy! The reconciliation of corporate (global) and political (national) systems can occur only through *transnational* cooperation regulating States and firms, and through measures that apply to the *networks* they are engaged in (Rosenau & Czempiel, 1992). As Rodrik (2002) suggested, any kind of *global federalism* will not be feasible, if at all, for another century, thereby sending the issue back to national political systems.

States and international organizations tend to embrace pro-MNC governance by enhancing their territory and by supporting their businesses through trade negotiations at different levels. Among existing international instruments oriented to discipline MNCs, one counts ILO's (International Labour Organization) *Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy*, the OECD (Organization for Economic Co-operation and Development) *Guidelines for Multinational Enterprises* and UNCTAD's (United Nations Conference on Trade and Development) *Set of Multilaterally Agreed Principles and Equitable Rules for the Control of Restrictive Business Practices*. These instruments of soft law rely on the voluntary compliance of States and MNCs, which is not always forthcoming. Thus, it is not surprising to see so much discussion around the concept of corporate social responsibility (CSR) and on codes of conduct that MNCs voluntarily undertake to respect. Many stakeholders capitalize on that path and foresee the possibility that CSR may lead to the emergence of more effective standards than those outlined in the declarations and resolutions of international organizations. Yet, collective action will remain difficult to emerge in a world where neither states, especially strong ones, nor companies, starting with MNCs, agree to some kind of system of rules to provide for an orderly global economy.

A new diplomacy between increasingly diversified actors and other emerging forms of regulation are likely to grow alongside the more traditional means of economic regulation. Some see competition between the State and corporate worlds as the end of the Westphalian system and its replacement by a *lexmercatoria*—a sort of “neo-medievalism” characterized by a plurality of actors self-organized into decentralized global networks with voluntary standards. MNCs themselves and their private regulatory forums shape **private regulatory trajectories**. Without being based on “a treaty between two or more states”, MNCs are large organizations operating on many territories and playing an increasing role in the emergence of new standards, rules and norms of the global economy—as effectively structuring, probably, as those created by governmental and intergovernmental organizations (Haufler, 2006). Others see it as a process of transformation of international relationships and organizations—including Slaughter (2000) who points at the emergence of trans-governmentalism comprised of networking organizations.

¹⁴Dunning introduces the paradigm Environment/Systems/Policies to compare nations. The first category, Environment, deals with production factors, market size, transportation, distance and communications, distribution channels and relationships within a given locale. The second, Systems, deals with social and cultural elements. The Policies category pertains to policies of the country.

¹⁵The concept of *coopetition* is reminiscent of Hymer's dynamics of rivalry-collusion.

¹⁶Friction between these two systems was already the subject of *Sovereignty at Bay* (Vernon, 1971), which analyzes the sometimes conflicting rationalities of these systems: firms oriented toward profit maximization or shareholder interests, and States whose objectives are wider and more variable according to their national contexts and their specific political dynamics.

A central element is the transnational nature of emerging regulatory responses with a strong bias towards the disappearance of the boundary between the public and private spheres at various levels—local, national, international and global—where co-regulation develops (Enrst & Kim, 2001; Graz & Nolke, 2008). Global governance thus relies on a complex system of networks between authorities endowed with overlapping and competing skills (Friedrichs, 2004).

Globalization has highlighted the weaknesses in national and international regulatory frameworks while it is causing the emergence of new institutional and normative frameworks, much more elaborate than the previous ones since they deal with investment, competition, services, public procurement and intellectual property; all areas that played very little part in international negotiations in the past (Pitelis, 2005). This is one important dimension of deep integration since it is not simply a matter of eliminating barriers and obstacles, but rather of creating rules and standards—even policies—that, while supporting economic globalization, will oversee the new relationships and seek new balances, which, in times of crisis, are becoming harder to achieve. Firms, States and civil society will have to compose new types of cooperation and governance regulatory schemes in this world of transnational networks.

6. Conclusion

The historical transformations of capitalism, and the concentration process that accompanies it, imply that the firm is understood as an “organization of private planning” and as an actor whose strategies have a structural power over economic trajectories and regulatory activities (Moran, 2009). Throughout the 20th century, firms have grown in size and created bonds of control and cooperation with other entities in expanding geographic territories (Wilkins, 1996; Ruggie, 1994). This is the mark of a dynamic of rivalry-collusion, leading firms and States into increasingly complex strategic maneuvers aimed at more than the conquest of market shares since it is now a matter of positioning oneself at the heart of large transnational economic networks. Accordingly, we are faced today with a network of very large companies that control their markets and competition ever more closely—not only on the scale of national economic spaces, but also on a worldwide scale in some cases. These firms perform their activities and generate economic flows by crossing national borders ever more easily. Smaller companies do not remain on the sidelines of these networks since their competitive insertion into the latter determines their success and market performance more often than not.

Vectored by firms that have adopted strategies of multinationalization, combining vertical and horizontal integration as well as outsourcing or inter-firm cooperation agreements, the economy has become global. Not only have States failed to control the processes of globalization and economic integration, international organizations, but have been quickly overtaken by events. Juxtaposed with the pressures of MNCs and the rise of neo-liberalism (used to justify economic and institutional reforms that have lifted many constraints on businesses), this loss of control by States and international organizations has been a key factor in shattering a state-centered vision of the world and mechanisms of economic regulation. This does not mean the complete withdrawal of States, especially the strongest amongst them, which now intervene in new ways to earn points in a race that pits States, firms and even workers and societies against one another to increase competitiveness.

Institutions aiming to regulate the global economic system are currently inadequate to the realities of globalization. In general, they are also biased, favoring the interests of the most powerful actors. New ideas may sometimes provide answers, and may lead to new trajectories. Managing networks linking MNCs to national economies, markets and people might be the greatest challenge while providing the greatest pillar for the future governance of complex systems.

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