The Theory and Practice of Regulation with Multinational Enterprises

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Abstract
The ability of firms to operate in several markets at the same time is changing regulators’ tasks. Regulatory bodies are now having to deal with multinational firms which spread their business activities all over the world. This paper analyzes the theory and practice of regulation in terms of the multinational dimensions of regulated firms. We show that the perceived theory of regulation is indeed affected, and that new issues arise both from a positive and normative point of view.

1. Introduction

The phenomenon of business internationalization is a main aspect of today’s economic systems. Firms may serve foreign markets by exporting goods or by turning into multinational enterprises (MNEs henceforth). In the former case they produce in one country and export abroad, while MNEs open production plants in different countries and provide markets with local production. An empirical comparison of these phenomena shows that in 1985, world sales of all MNEs’ foreign affiliates equaled 99% of total world exports; the same figure rose to 122% in 1991. Thus, from at least 1991 onwards international production has surpassed exports as the principal means of delivering goods and services to foreign markets, and more recent figures confirm this trend (U.N.C.T.A.D. 2000). Thus, the process of international expansion is now mainly taking place through the setting-up of foreign subsidiaries.

In this paper we analyze the recent involvement of public utilities in this process of multinationalization. Two events can be considered the main originating causes of this

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phenomenon, deregulation and privatization, both of which have favored the entry of new, often foreign, firms.

EDF, the former French electricity monopolist, has recently acquired London Electricity—an important energy distributor in the U.K.—and is planning to expand into the German electricity market. Similarly, United Utilities and Eastern Group control many of the former RECs (Regional Electricity Companies) in the U.K. In 1997, ENDESA, the Spanish national energy group, acquired a 29.2% majority stake in the Chilean ENERSIS Group, thus becoming the largest electricity provider in the region. In 1993 the group Aguas Argentinas, led by the French multinational Vivendi, received a 30-year regulated franchise to provide water and wastewater services to 9 million inhabitants of metropolitan Buenos Aires. An analogous story could be told regarding the telecommunications industry, where the process of liberalization and privatization which began in the late 1980s provided a strong impulse to internationalization and to the expansion of MNEs (see Bohlin and Granstrand 1994 and Antonelli 1995). For instance, the U.K. firm Cable & Wireless had a majority stake in Hong Kong Telecom, the main local telecom services provider until 1997, and still supplies regulated services in Australia, Russia, the Caribbean and Sweden.

Many other examples can be found in financial sectors. The French insurance firm AXA owns Equitable Life, one of North America’s biggest life insurers, together with Canada’s Boreal Assurances, the country’s fourth largest life insurer. As for the banking sector, the following quotation is particularly revealing: “... United Bank of Switzerland ... operate(s) in more than 100 countries. As banks have become more global, however, their regulators have remained national.” (The Economist December 13, 1997). (For the proliferation of MNEs in banking see also Williams 1997.)

These facts show that the theory and practice of regulation has to be re-analyzed in view of the fact that regulated firms are now deeply involved in the “globalization” process. Firms’ mobility and their ability to operate in several markets at the same time are changing regulators’ tasks. Regulatory bodies are now faced with firms that spread their business activities all over the world, and as a consequence they sometimes directly regulate foreign-owned firms. We will show that in this case the traditional theory of regulation is subject to certain important modifications, and that new interesting areas of analysis arise.

Despite the importance of these developments, existing theoretical literature on MNE regulation is very limited. The aim of this paper is threefold. First, we review the few existing papers on this topic. Second, we reinterpret some recent theoretical developments in contract theory within the present context. Finally, we present some further areas of research.

Both exports and international production are new subjects for Regulation, and as such require specific analysis. Brainard and Martimort (1996) and Combes et al. (1997) analyze regulation with regard to exporting firms. We will mainly focus on international production for at least three reasons. Firstly, economic theory argues that MNEs tend to prevail over purely national firms when production requires intermediate inputs of a

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1 At the same time there was a period of partial de-regulation in the sector. However, regulation is still required for a number of reasons, such as access pricing.