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Institutional Deficit or Institutional Failure?

SDG Driven Governance of MNCs

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Abstract

The paper rests on the premise of *a priori* rationale for the sustainable development goals- SDG-driven governance of multinational corporations- MNCs -as these are the foremost non-state actors in the world economy.

The research question it addresses is whether there has been an institutional deficit or institutional failure in directing the MNCs toward SDGs. The latter aspect, institutional failure, gained prominence in view of the Indian Prime Minister's address at the G20 Ministers' Meet on Thursday, the 2nd of March 2023.

The paper draws on the institutional theory of multinational corporations to delve into the research question it addresses.

It notes that institutional theory de-emphasizes the role of individual actors (MNCs), focusing instead on the influences or rules of the game external to and transcending the organisational boundaries.

The paper argues that multilateral institutions in the era of economic liberalisation, privatisation and globalisation did not envisage the challenge of climate change. These rather myopically focused on growth in trade and investment. Thus, whereas trade and investment did grow under the extant institutional regime, their ecological sustainability was compromised.

The ability of the MNCs to wrestle national policy regimes in their favour only worsened things.

The paper argues that the debate about whether MNCs are a boon or bane for sustainable development anywhere has now outlived its utility. Instead, there is a need to contemplate institutional change that will foster the pro-planet behaviour of the MNCs. It then proceeds to elaborate on the contours of institutional changes for the SDG-driven governance of MNCs.

Keywords: SDGs; MNCs; Institutions; Institutional Theory

Introduction

Sustainable Development Goals (SDGs) or Global Goals (*Sustainable Development Goals*, n.d.) were unanimously adopted by 193 member-states at the 70th United Nations General Assembly held in 2015 (Martin, n.d.).

Recent literature in this regard suggests that the MNCs could play several roles in furthering the UN's SDGs (Eang et al., 2022; Narayanan, 2022) in the host countries and globally. The roles inhere in financing, community capacity building, product and service provision, partnerships, and innovation in the furtherance of the SDGs. Clearly, these roles represent a shift of expectations placed on MNCs and the foreign direct investment (FDI) in the development of lesser developed countries, viz., bridging the investment, technology, foreign exchange, entrepreneurship, management practices and thus developmental gaps.

Shift in the role expectations placed upon the MNCs, in our view, is attributable to a large extent to the institutional change that has brought sustainability as the dominant paradigm of development. The adoption of the SDGs by the sovereign states in 2015 represents a policy consensus. MNCs inarguably comprise quite powerful non-state actors (Lakhany, 2006). As such these can significantly influence the accomplishment of the SDGs.

Whether the state or the non-state actors act out of their own volition and or in response to the market signals or role expectations placed on them by the formal and informal social and political and economic institutions is a question whose answer depends upon the perspective one addresses.

The purpose of the present paper is to study SDG-driven governance of MNCs from an institutional perspective. Specifically, we intend to examine if the extant institutional framework governing MNC behaviour and FDI movement was deficient in or failed to incorporate sustainability concerns in promoting international flows of capital. Secondly, we intend to evaluate if the emerging institutional framework is adequate in fostering SDG governance of MNCs.

The immediate impetus for the study stemmed from the statement of the Indian Prime Minister during his address at the G20 Ministers' Meet on Thursday, the 2nd of March 2023. He drew the world's attention to the failure of the global institutions created after World War-II, namely the United Nations; the International Monetary Fund; and the International Bank for Reconstruction and Development- the World Bank and the General Agreement on Tariffs and Trade (GATT). These institutions were created to respectively ensure world peace; financial stability; equitable development of the world economy; and promotion of world trade (and investment). The latter, that is, GATT later paved the way for the setting up of the World Trade Organisation (WTO) that presently may be regarded as the overarching institution for facilitation of global trade and investment activities of the MNCs.

The rationale for the focus on institutional perspective lies also in the fact that non institutional theories of firm provide little promise in the furtherance of sustainability agenda. The rational, self-interest driven economic theories of international investment and thereby MNC behaviour emphasising comparative and competitive advantages preclude such apparently non-rational considerations as sustainability as the purpose of MNC activity. Even the behavioural theories of firm/ MNCs - that emphasise bounded rationality and political decision-making sans institutional context do not seem adequate in shaping SDG driven governance of the MNCs.

Firms on their own tend to be self-centred and myopic in their decision-making. Thus, despite resources and capabilities, they may not be invested in addressing the big questions of life such as world peace, climate change, global hunger, poverty & inequality.

Institutions are needed to exert persuasive as well as compulsive influence on the MNCs to conduct their operations in sync with the big questions of life. Evidence of the performance and impact of the MNCs on sustainability agenda has been rather mixed to say the least ("Multinationals and Renewable Energy: Boosting Innovation through Foreign Direct Investments," 2022). Since their operations transcend national boundaries, a system of global governance obtained by articulation of decision-making via upward delegation (Holesovsky, 1977) by the national states is imminent.

Institutions, Institutionalism and Institutional Theory of MNCs

Institutions refer to formal and informal arrangements that govern behaviour of the individual actors- be it natural or corporate persons. Institutional theory de-emphasizes the importance of individual actors [corporations] and focuses instead on influences or rules of the game external to and transcending the personal/ organisational boundary (Hoffman, 1999). These institutions may be social, political or economic (Rodrik, 2008; Polanyi, 2001; Aoki, M. 2001; North, 1990; Granovetter, 1985).

These institutions might operate at macro, meso and micro / point-of-contact (POC) level. With reference to the MNC governance the successive layers of institutions may be illustrated with the help of concentric circles (Figure-1).

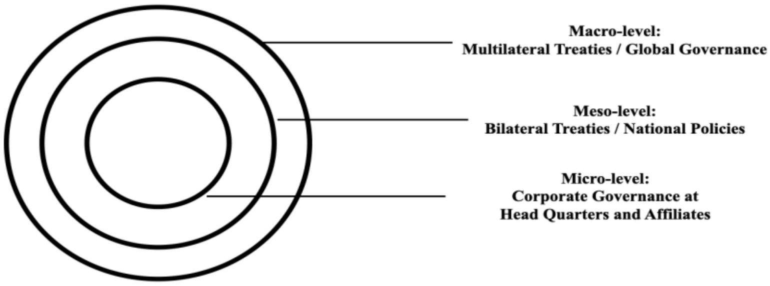

Figure-1: Levels of Institutions

Level of institutions notwithstanding, institutionalism or institutionalisation refers to the emergence of orderly, stable, socially integrating patterns of unstable, loosely organised, or narrowly interpreted technical and economic activities and behaviours (Broom & Selznick, 1963). With reference to the theory of firm, it represents a voice of resistance to the dominant culture of selfish shortsightedness, guides the firm toward corporate responsibility, and brings into question the goal of maximising profits or returns on capital (Selznick, 1994).

We draw on this context-inherent and context-defining idea of institutions and institutionalism and apply it to the theory of multinational corporations.

It may be noted that institutional theory has been variously applied to multinational corporations (Kostova et al., 2008). The distinct themes of the extant application of institutional theory in respect of MNCs comprise (i) conceptualization of national environments in terms of regulatory, cultural & cognitive profiles of the countries; (ii) transformation of national systems through the notions of institutional voids, transition, upheaval, and imperfection; (iii) comparative studies of national business systems; (iv) similarities in features of organisations within a culture; (v) constraints and the enablers of the diffusion of technological and managerial practices across borders and units of MNCs; and (vi) the relationship between MNCs and their host environments based on e.g. the notions of legitimacy and liability of foreignness.

We note the comparative yet conspicuous absence of discussion on the role of global institutions in shaping the conduct of the operations of the MNCs. Thus, in this paper our focus is on global institutions only.

Institutional Deficit and Failure

The term institutional deficit is coined here to refer to the situation where an institution regulating an individual actor's behaviour is either missing or omits regulating a particular behaviour. It is closer to the idea of institutional void, a term that is frequently used in the emerging markets context (Khanna & Palepu, 2010). Institutional deficit is a feature of institutional design. The term institutional failure implies the inability of the institutions to prevent the mishappenings they were supposed to oversee. Thus, although the institutions exist yet they are not effective in accomplishing the purpose for which they were envisaged to serve. It is thus a feature of institutional performance. See Figure-2.

Institutional Performance	Strong	-1 Institutional Overkill	-2 Institutional Effectiveness
	Weak	-3 Institutional Void	-4 Institutional Failure
		Deficient	Sufficient
		Institutional Design	

Figure2:Institutional Design-and-Performance Matrix

The term institutional failure has been variously used in academic research. It has been used in the wake of social, political, military, and economic crises in different contexts ("Institutional and Political Failure: Privatisation in Malaysia," 2007; Fischer, J. R. (2008); Vaughn, 2012; Mathur & Marcelin, 2015.) In his address at the G20 Ministers' Meet on Thursday, the 2nd of March 2023, India's Prime Minister used the term to denote the failure of global governance in the wake of financial crisis, climate change, pandemic, terrorism and wars experienced by the world in recent history. We focus here on the state of global governance of MNCs vis-a-vis SDGs.

Global Institutions for SDG Driven Governance of MNCs

The idea of sustainable development dates back to Brundtland Report in 1987 (Development, World Commission on Environment and Development, 1987). However, when we look at the charters of the global institutions comprising the architecture of MNC governance we find that reference to this idea was conspicuous by its absence. Our findings on a survey of the charters of a representative array of global institutions for MNC governance are contained in Table-1.

Table-1: Global Architecture of SDG Driven MNC Governance

(1) **Institution and Year of Founding**	(2) **Whether the Original Charter Provided for Sustainability or SDGs**	(3) **Recent Amendments or Directions of Change**	(4) **Time Lag Between Brundtland Report in 1987 and Year of Founding** Number of Years	(4) **Time Lag Between (3) and Adoption of SDGs in 2015** Number of Years
World Trade Organisation- WTO, 1995	No	Trade Policy for Climate Change, 30 November-12 December 2023	8 Years	8 Years
Trade Related Investment Matters- TRIMs, 1995	No	None	8 Years	Not yet
The Organization for Economic Cooperation and Development- OECD Principles of Corporate Governance, 1999	No	OECD 2023 Edition includes sustainability and resilience as one of the principles of governance	12 Years	8 Years

A representative snapshot of the global architecture of SDG Governance evident from Table-1 suggests that the global institutions of economic governance were either oblivious of the idea of sustainable development at the design stage? Else they had a myopic understanding of their role and functions that deterred the member states from pushing the sustainability agenda in trade and investment agreements. Could this be referred to as an institutional deficit at birth? That it took nearly a decade for these organisations to adopt sustainability agenda even since the SDGs is also perplexing.

If we presume that this should augur well then we need also to ask the question how things would have been if sustainability concerns were embedded in multilateral negotiations on trade and investment liberalisation right from the beginning?

Institutional Change

The relationship between institutional change and economic growth [development] is quite well entrenched. We briefly address here the broader question of feasibility and directions of institutional change as well as the specific question of institutional change for SDG governance of MNCs.

First, the broader question of feasibility and directions of institutional change. Institutions as mechanisms to stabilise behaviours although are slow to change yet these are not immutable entities. These can certainly be, to borrow from the terminology of organisational transformation, reframed, renewed, restructured and revitalised and thus reformed and made more effective (Gouillart & Kelly, 1996). In his address to the same audience eight months later on Wednesday, the 22nd of November 2023, the Prime Minister of India underlined the need for reform in global governance. The institutional design-and-performance matrix of Figure-2 could be interpreted in a dynamic sense too. We could consider quadrant (2) as the aspirational quadrant and thus set forth the directions of institutional change from quadrants (1), (3) and (4).

Second, the institutional change for SDG driven governance of MNCs. In a thought provoking paper entitled 'Sustainability through institutional failure and decline? Archetypes of productive pathways,' the authors (Newig et al., 2019) identified five pragmatic pathways for pushing the sustainability agenda, that include, **institutional reform** and adaptation toward sustainability triggered by some environmental disaster; **institutional improvement** through learning from failure and breakdown; **purposeful destabilisation** of unsustainable institutions; making a virtue of **inevitable decline**; and, **active management** of decline instead of leaving it to chance.

Conclusion

Strong institutions alone may not be sufficient for SDG driven governance of MNCs more so in view of the power of the MNCs. Weak institutions, however, are a sure recipe for social and climate precipice. In our endeavours we need also to resolve certain inherent tensions: whether to follow the American approach of voluntarism or the European approach of mandatorism or some space in between; do we provide for independence and superiority of the global institutions of governance over the sovereign states and the MNCs themselves who wield more economic and thus political and diplomatic power than the sovereigns; how do we create and sustain value forming institutions that reinforce the idea and ideals of the larger ethos of *vausdhaiva kutumbakam* or "One Earth · One Family · One Future" enshrined beautifully in the G20 logo a la India's presidency.

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