

What Insights Can IB Research Provide for Policy Decisions?

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Why Can IB Scholars Provide Insight?

- Division of labor
 - Scholars are not policymakers or managers
 - Scholars are not journalists
 - Scholars have the time and the training to look behind the phenomena and reveal underlying relationships
 - Scholars have the incentive to question conventional wisdom

The Big Lessons

- Correlation \neq causation
 - Just because two things occur together doesn't mean that one causes the other
- You can't change human nature, and people don't stand still
 - People find ways to optimize their personal positions, given the rules of the game
 - Incentives matter – so understanding incentives is crucial
- The status quo is hard to change
 - People who benefit from the status quo have strong incentive to perpetuate the status quo

Example 1: Exports and Productivity (these rankings are made up)

Company	Productivity rank	Exporter?
ATI	Very high	Yes
Alcan	Very high	Yes
Bombardier	Very high	Yes
Brascan	Very high	Yes
RIM	High	Yes
...		
Falconbridge	High	No
Inco	High	Yes
Abitibi-Price	Low	No
Tascot Ties	Low	No
Ballard Systems	Low	No
Silverman Motors	Very low	No

Example 1 continued

- A minister or lobbyist proposes a policy of encouraging non-exporting firms to export
 - Use tax revenue to subsidize exports of such firms
 - Since these firms will enjoy increased productivity as a result of exporting, this will ultimately create a public good through more jobs, better jobs, etc.

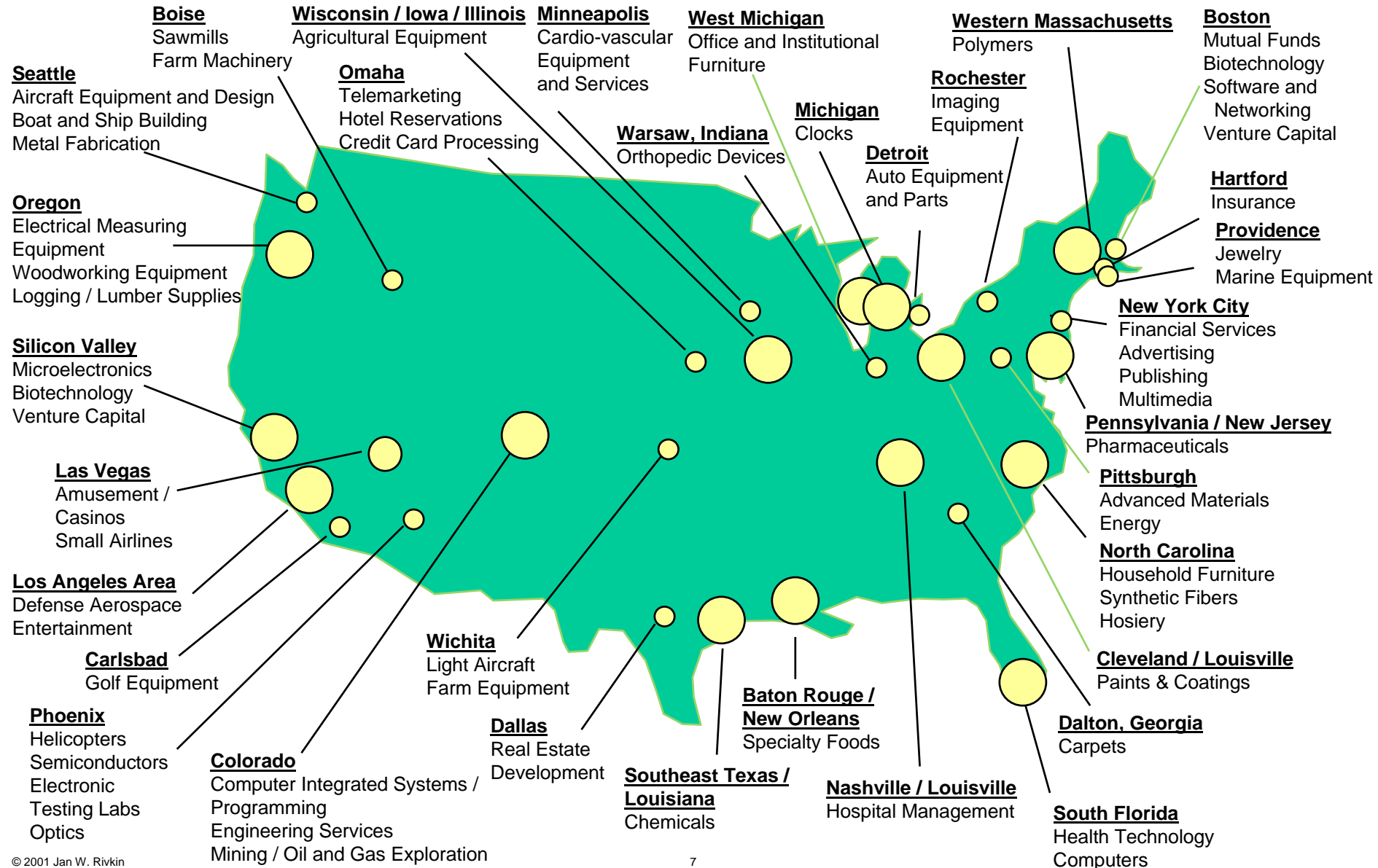
- Policymaker: Do you support it?

- Scholar: How can you help the policymaker decide?

Example 1 continued

- Scholar: correlation is not causation
 - It could be that exporting leads to improved productivity
 - But it could be that higher-productivity firms are the ones that choose to export
 - Either of these would explain the correlation between exports and productivity
- Result of debate in IB academic literature (i.e., Bernard and Jensen)
 - Look at firms over time
 - Identify relationship between productivity and the decision to begin exporting
 - Identify changes in productivity before and after beginning to export
- Bottom line: High-productivity firms begin to export; there is little evidence that firms improve their productivity by exporting

Example 2: Encouraging Clustering of FDI



Example 2 continued

- Clusters appear to be crucial to developing globally competitive industries
- It is desirable to attract great foreign firms to our cluster
- Policy proposal: provide tax-free zones or other favorable policies to encourage foreign firm FDI into our clusters
 - This will attract great foreign firms to our cluster
 - This will help our workers get good jobs and will help our local firms to access spillovers from these foreign firms
- Policymaker: Do you support it?
- Scholar: How can you help the policymaker decide?

Example 2 continued

- Scholar: you can't change human nature
 - Managers want to locate in a cluster only if being in a cluster enables them to get more benefits than they give
 - It might be the low-quality firms that expect to gain the most, and give the least, from being in a cluster
 - You might not get the firms you want in the cluster
- Result of recent advances in IB academic literature (i.e., Shaver & Flyer)
 - Look at the location of foreign plants in a country (cluster vs. non-cluster)
 - Identify measures of the strength of the foreign firm
 - Identify the performance of the foreign plant
- Bottom line: Higher-quality foreign firms tend to locate their plants outside of clusters. When you build a cluster, you may not get the firms that you really want in that cluster.

Example 2 continued

- Scholar: here's another way to get the benefits of foreign firms' spillovers
- Result of recent advances in IB academic literature (i.e., Blalock)
 - Look at the impact of MNCs' plants on local suppliers as well as local competitors
 - Local suppliers to MNCs' plants enjoy big spillovers
 - Productivity increases
 - Quality improvement
- Bottom line: Maybe you can get the benefits of foreign firms' spillovers by allowing the foreign firms to locate anywhere in the country, and encouraging local suppliers to set up near them. This may attract the best foreign firms.

Example 3

- A minister or lobbyist proposes a policy to change property rights regime to make it easier for local firms to use knowledge from overseas
 - Less rigorous patent rights

- Policymaker: Do you support it?

- Scholar: How can you help the policymaker decide?

Example 3 continued

- Scholar: people don't stand still
 - MNCs will change their behavior in response to changes in policy
- Result of recent advances in IB academic literature (i.e., Oxley)
 - When property rights in a country are weakened, MNCs respond in at least two ways:
 - They locate less knowledge in that country
 - They organize their subsidiary to reduce the risk of leakage of knowledge
- Bottom line: Changing property rights may enable you get some of the benefits you want, but don't expect the end result to simply be "the world as it is today" with the exception of the policy change.

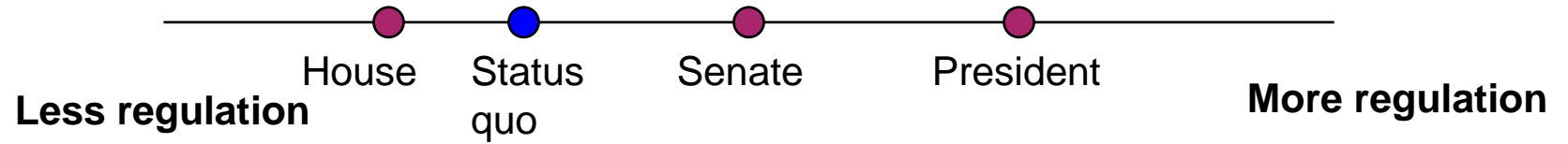
Example 4: The Status Quo is Powerful

- A minister or lobbyist comes up with almost any proposal at all
 - Change in tax policy
 - Change in regulation of an industry
 - Change in labor law
- The policy will provide net benefits to the country, but some people will be worse off
- Policymaker: How can I get this policy passed in the face of opposition?
- Scholar: How can I help the policymaker get this policy passed in the face of opposition?

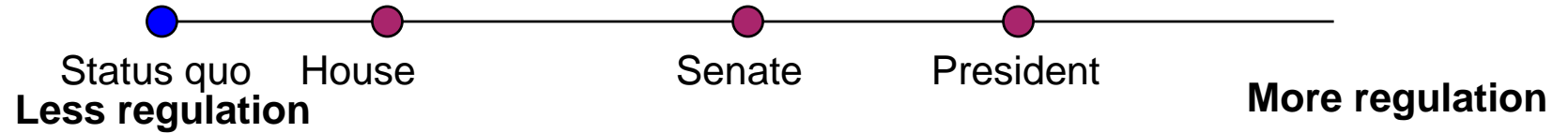
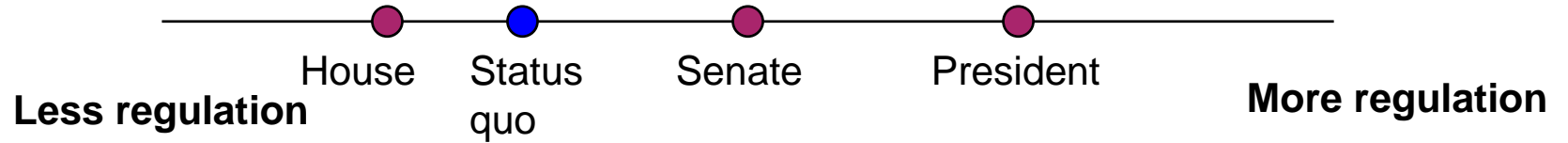
Example 4 continued

- Scholar: The status quo is powerful
 - Nations (and smaller groups) end up “stuck” in equilibria
 - Those who benefit from the status quo fight to protect their “rights”
- Recent of recent advances in IB-related political economy literature (i.e., Greif)
 - You may need a “shock” to break out of the existing equilibrium
 - Example: The Interstate Commerce Commission in the U.S.
 - We can help anticipate which groups will oppose the change
 - We can help anticipate which of these groups actually matters
 - We can predict what type of shock will be sufficient to break out of the equilibrium
 - We can help identify whether a new status quo will create strong entrenched interests
- Examples: My family; child-care in Canada; Interstate Commerce Commission

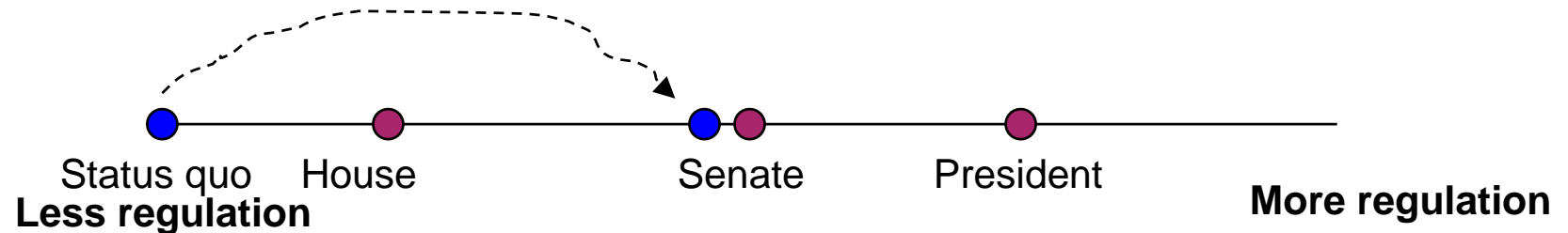
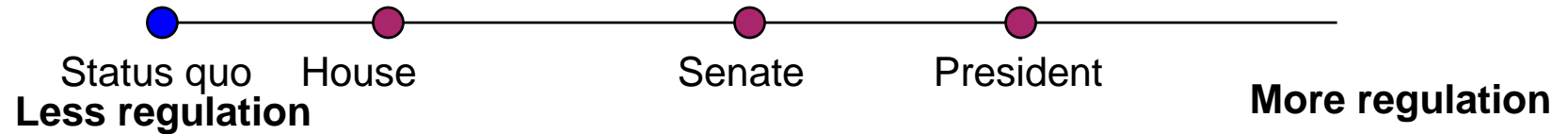
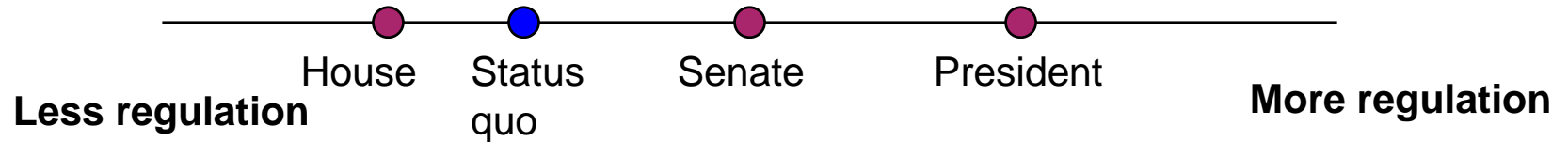
Example 4 continued: Establishing the Interstate Commerce Commission



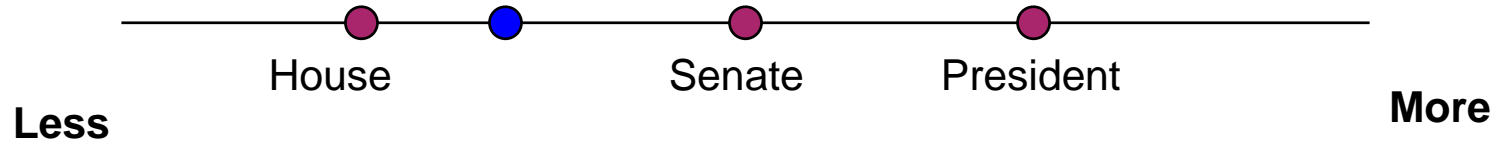
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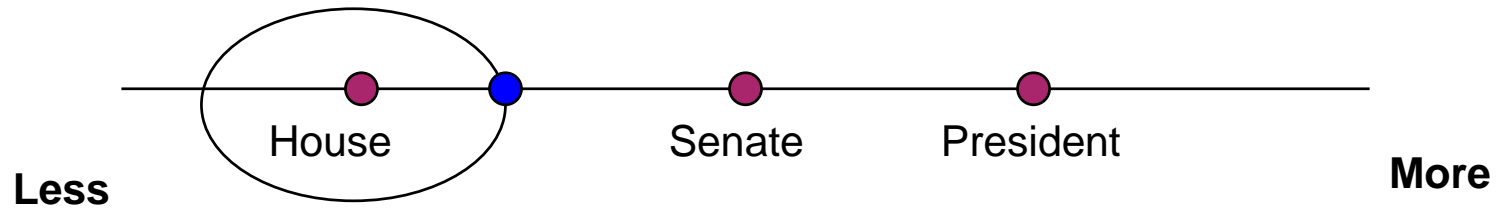
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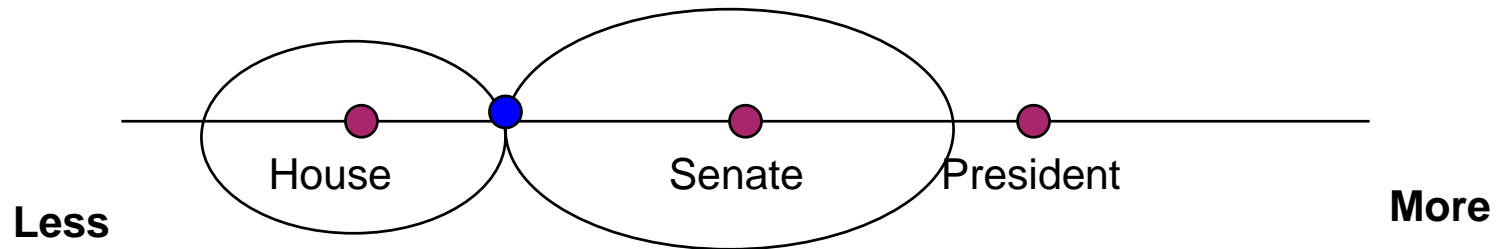
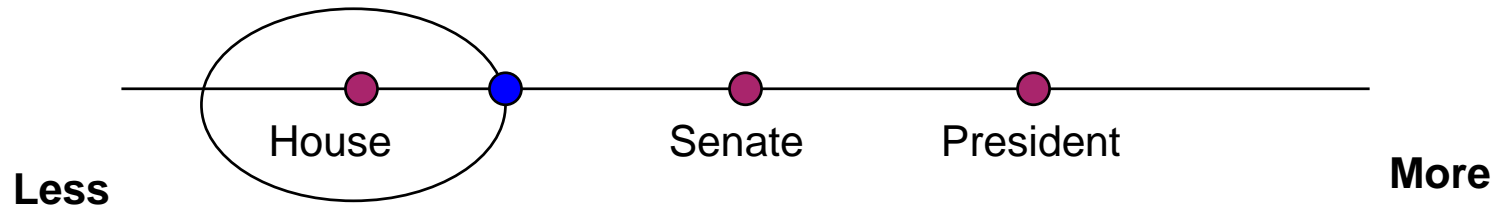
Example 4 continued: Applying Game Theory to Policymaking



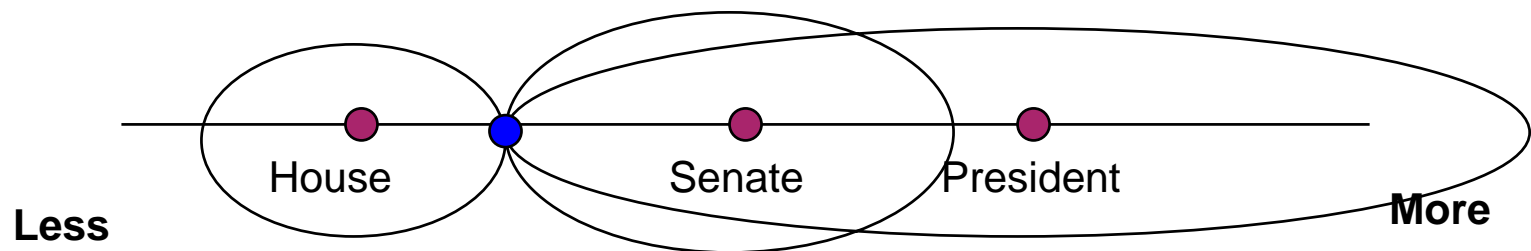
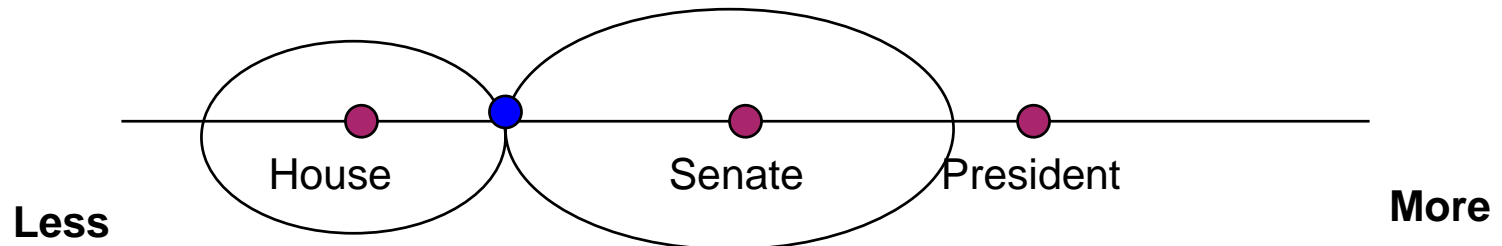
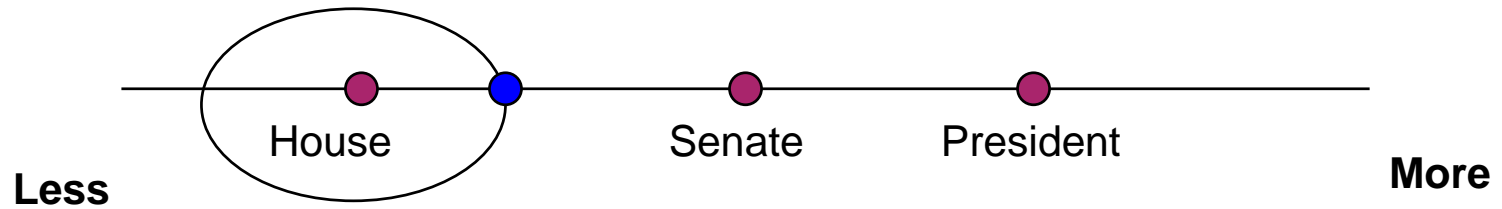
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 - You may need a “shock” to break out of the existing equilibrium
 - Example: The Interstate Commerce Commission in the U.S.
 - We can predict what type of shock will be sufficient
- **Since each country’s equilibrium is different, we can’t be sure that copying other country’s policies will yield the same results for us**

On a More Positive Note...

- Three examples where IB scholars can help policymakers take action
 - How to encourage foreign investment into the capital markets
 - Encourage transparency and good governance in public firms
 - Research shows that one of the biggest factors that affects foreign investors' willingness to invest in a country's firms is adherence to standards of good governance

 - How to encourage foreign investment in high-value-added plants
 - Encourage transparency and good governance in government
 - Invest in human capital – education, training
 - Research shows that the biggest factors that affect foreign firms' willingness to invest in a county includes transparent institutions that promote public order and highly educated workers

 - How to take advantage of the success of emigrants
 - Encourage emigrants to visit home country, and perhaps to return to home country and set up entrepreneurial ventures
 - Recent research suggests that emigrants can serve as links to move knowledge and investment back to their home country

The Big Lessons Again

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 - People find ways to optimize their personal positions, given the rules of the game
 - Incentives matter – so understanding incentives is crucial
- The status quo is hard to change
 - People who benefit from the status quo have strong incentive to perpetuate the status quo
- **As a policymaker, it is good to be cautious**
 - **It is easier to make bad decisions than to make good decisions**

How Can Policymakers Help IB Scholars to Help Policymakers?

- Give us access to data!
- U.S. government data – very easy to access
 - The bulk of studies are about the U.S.
 - Our best knowledge of how policies work is from the U.S. context
 - The best insight we can provide is for U.S. policymakers
- The greater access scholars have to data from Brazil, the greater value we can add to supporting Brazil-specific policymakers (and managers)