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Developing countries and multinational corporations

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DEVELOPING COUNTRIES AND MULTINATIONAL CORPORATIONS

EFFECTS ON HOST COUNTRIES' WELFARE AND THE ROLE OF GOVERNMENT POLICY

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Foreword

This study by Mr Sanjaya Lall of the Oxford University Institute of Economics and Statistics was commissioned by the Secretariat as an input into Commonwealth consultations, at the ministerial and other levels, in the general area of relations between host Governments and foreign suppliers of investment and technology. The study is partly based on, and summarises the empirical work done by the author, in co-operation with Mr P.Streeten and associates, for UNCTAD.

The subject of relationships between host countries and transnational enterprises continues to occupy national and international attention. It is felt that the wider circulation of this paper could assist in these discussions.

The views which Mr Lall expresses are his own and do not necessarily reflect those of the Commonwealth Secretariat or of Commonwealth Governments.

Commonwealth Secretariat
November 1976.

SUMMARY

This paper seeks to examine the nature and main effects of multinational corporations (MNCs), mainly in the manufacturing sector, on the economies of developing countries, as a basis for identifying:

(i) the benefits which governments should try to extract and the costs they should try to minimise,

(ii) the policy considerations for attracting MNCs and foreign investment in general,

(iii) some policy considerations in respect of issues such as project evaluation, control and bargaining,

(iv) the kind of problems that can emerge in formulating and implementing these policies.

Definition

At the cost of some vagueness the argument in this paper is conducted in terms of MNCs defined as firms of very great size with investments in many countries. MNCs tend to:

(i) specialize in oligopolistic industries, where marketing and technological innovation are key characteristics, and concentrate amongst manufacturing industries, in particular chemicals, machinery and transport equipment which together account for over half the total;

(ii) produce sophisticated products made by capital intensive techniques and aimed at high income groups;

(iii) have an increasing concentration of decision making powers at the apex of the organisation;

(iv) have a centralization of financial strategy which enables them to operate across different countries to minimise risk and tax payments. This involves heavy reliance on the local capital market and reinvested profits for financing their expenditures and provides the environment for the manipulation of transfer prices and other arbitrarily assigned payments such as royalties, management fees and interest;

(v) show a preference for majority ownership of their investments.

Quantitative information on the size and distribution of foreign investment in general and MNCs as a group is far from adequate. Data on the value of foreign capital by DAC countries in 20 developing Commonwealth countries at the end of 1967 showed that of the total private investment nearly 20% or £6,350 million was accounted for by Commonwealth countries. The United Kingdom owned the major share of this investment holding over 50% in two thirds of the countries surveyed and between 60% and 97% of the investment in half the countries surveyed.

Costs and Benefits

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The costs and benefits of MNCs are difficult to assess until we clarify whose welfare we are talking about; it is argued that conventional measures using market prices are unacceptable at face value, (even if they are corrected for tariffs

and similar distortions) because they incorporate dubious value premises about income distribution, taste creation and political relationships. While we cannot provide an alternative definition of "social welfare" which has the quantitative precision of the market value of output, it is proposed that any assessment of social desirability be based more on considerations of the well-being of the poorer sections of the population, (the vast majority in developing countries) and on income redistribution than on criteria derived from the free play of competitive market forces.

The nature of the product

MNCs can benefit the host countries by providing, very quickly, the production facilities for a wide range of modern products. It is useful to distinguish between consumer goods and capital/intermediate goods producers. For the latter class of MNCs the products offered can raise the productive efficiency of other industries in the host economy; for the former they can raise consumption benefits by providing a wide range of choice.

On the other hand product differentiation is wasteful while the goods produced can be irrelevant to the needs and incomes of the population. Furthermore, where the products are aimed at high income groups they perpetuate a dependence on cultural and economic patterns created abroad. MNCs can be held responsible for the social costs of their production only if their presence worsens the income distribution, reduces savings and investment by inducing a higher level of consumption, furthers greater dependence abroad and involves greater waste.

Transfer of technology

Technology may only be available through direct investment particularly where the technology is the sole property of the MNC and is not willingly sold on a licensing basis. The benefits of technology transferred by MNCs may extend beyond direct savings of enormous costs or an increase in the productivity of an investment, to externalities such as inducing modernisation in competing firms and the stimulation of complementary R & D activities in the recipient firm or its suppliers.

On the debit side a lot of MNC technology, designed to suit conditions of labour scarcity and capital abundance, is for the production of high income sophisticated consumer goods not necessarily appropriate to or required by host countries. Second, the dependence inculcated by complete reliance on MNC technology may stifle local research and the adaptation of foreign techniques to local conditions, and prevent the starting of a cumulative learning process in technological innovation. Third, the cost of acquiring technology can be unduly high particularly when the seller has a monopoly of that technology.

Organisation and management

The sophisticated and tightly knit organisation of MNCs may benefit host countries by their efficiency, entrepreneurial abilities, the provision of training to local employees and by their demonstration effect on local industries. However, in terms of costs, they may permanently relegate the subsidiaries employees to an inferior position in the inter-

national hierarchy while creating an elite class in developing countries whose loyalties lie abroad rather than with their own people. These superior entrepreneurial powers may also suppress domestic enterprise and reduce it to the minor status of suppliers. Furthermore, it is relevant to note the significance of tight organisation to the manipulation of inter-company accounts.

Marketing

The MNCs' access to international distribution networks and their knowhow in forging new markets can be of immense benefit to host countries. This has been amply demonstrated in the case of manufactured exports from Latin America. Additional benefit can be gained through the development of domestic retailing as well as through the improvement of standards in packaging and advertising. On the cost side MNC marketing may induce inappropriate tastes, wasteful proliferation of models and excessive expenditure on advertising.

Capital

The provision of capital can be one of the greatest benefits of MNCs especially to countries which need foreign exchange. Second it can stimulate the inflow of aid from official agencies. Third, the MNCs' access to overseas funds on better terms than other enterprises means lower servicing costs to host countries. Fourth, foreign capital can mobilise local savings. Finally by entering the local capital market MNCs may stimulate its growth. The servicing cost of capital obtained by direct investment tends to be high relative to other channels, and the ability of MNCs to gear themselves highly on local savings in fact means that the host country provides its own resources to improve the profitability of the original capital contribution from abroad. Moreover, MNCs are sometimes treated as priviledged customers by local financial institutions, (and certainly by local branches of foreign banks), and their local borrowing can serve to deprive local enterprises of capital.

Productive efficiency

There seems to be a presumption that subsidiaries of MNCs are more productive than local firms; the little data that exist do not support this presumption strongly. Generally they are more profitable but profits are not a valid measure of productive efficiency in a framework in which enterprises are highly oligopolistic and possess so much market power. In the course of research done for UNCTAD, it was found that the higher level of the effective rate of protection granted to investments the more inefficient was the project in international terms and the worse were its net income effects. However MNCs can only be said to have undesirable effects on this score if they are, by virtue of their bargaining or their ability to inflate their true costs, able to extract a higher level of protection than other firms. The training provided to employees of MNCs probably benefits the host economy and their competitive powers can help break up local monopolies and induce greater local efficiency. On the other hand various restrictive practices with regard to exports, imports, technology, prices and production limit the benefits of MNCs' operations.

Balance of payments effects

This paper concentrates on the direct balance of payments effects which comprise the import of funds and exports on the benefit side and imports of capital goods and raw materials, and exports of profits, interest and technological payments on the cost side. A recent study of private foreign investment in selected developing countries concluded that the net direct balance of payment effects of most foreign investments with the exception of whose which are specifically export oriented, are negative. Of the sample of 159 firms, 91% had negative balance of payments effects. Amongst the findings were:

> The evidence of export oriented investment was not very widespread, although one would not normally expect import substituting investments, (the commonest form of foreign investment in developing countries) to become major exporters.
>
> A few cases of formal export-restrictive clauses were found, while other UNCTAD studies have found many examples of such practices.
>
> 60 per cent of the firms surveyed were taking out more in terms of profits than they were putting in in terms of new investments. This fact, however, tells us nothing about the overall effects of the investment. It is necessary, inter alia, to compare the actual cost of servicing foreign capital with the cost of providing investments from alternative sources. Over 40% of the firms had negative net financial effects in so far as they would have been cheaper to finance locally.
>
> There are many sorts of hidden transfers in inter-firm transactions such as transfer prices, royalties and fees of various sorts. Transfer prices are extremely difficult to monitor. Royalty payments to parent companies by subsidiaries are quite large and there is some evidence that local purchasers of technology collude with foreign firms to enable them to charge higher effective rates than are officially permitted.

Policy considerations for attracting MNC investment

The attraction of MNC investment to particular host countries depends partly on factors outside their governments' control - market strategy of the firms, policies of the home governments of MNCs, the given facts about host countries such as size of markets and political stability - and partly on factors within their control. Of the latter the most important are their policy on protection and import substitution, the provision of information, the stability of policies laid down, ease of negotiations and lack of red tape, provision of infrastructural facilities and the existence of inter-government agreements on property rights, arbitration, taxation and so on. Fiscal incentives to foreign investors seem to be unimportant except for 'foot-loose' export processing firms and, perhaps, for individual small countries competing with each other for a given amount of foreign capital.

Despite their preference for control, many MNCs have shown themselves to be extremely adaptable to different requirements and regulations laid down by governments promoting local ownership. Some firms may not be willing to transmit their latest technology in such arrangements, but for a wide range of conventional and even advanced technology, MNCs may be willing to participate in ventures on minority or a 'fade out' basis. What appears to be more important for attracting MNCs is not so much the stringency of the conditions laid down - though obviously there are limits of acceptability which would vary from firm to firm - as their predictability, stability and ease of negotiation. The cost of laying down strict conditions of local ownership or control would depend on the terms struck, the willingness of the MNC to transfer its latest technology, and the capability of the recipient enterprise; it may be higher or lower than the alternative cost of having a foreign subsidiary, the outcome being determined by the profitability of the investment and the bargaining power of the two parties.

Policy approach to project evaluation control and bargaining

The general level

(i) Policies need to be geared to ensuring that the MNCs, by the nature of their product, do not perpetuate inequities in income distribution. Governments can restrict industries to that output which is considered socially beneficial.

(ii) Passive acceptance of total dependence on MNC technology would stifle innovation in capital intensive techniques and promote income inequality. Policy should be aimed at encouraging local innovation and adaptation of imported technology.

(iii) The most effective way to minimise political pressure from abroad is to limit the scope and total amount of foreign capital in the country.

(iv) To prevent the initiative of local entrepreneurs being suppressed by MNCs several policies are applicable. In India, for example, periodic lists are issued of industries in which foreign investment is allowed, in which foreign technology but not direct investment is allowed, and in which neither is allowed. One approach taken by the Andean Pact countries is to restrict the activities and ownership of the foreign investor over time by having divestment arrangements. Some countries restrict ownership and control by actively promoting joint ventures.

The sectoral level

Once it has been decided which industries need MNC investment, regulation must revolve around the prevention of excessive advertising and product differentiation, the control of monopolistic and predatory business practices, the use of appropriate technology, non-discriminatory access to capital for local firms, the promotion of local enterprise, and the encouragement of local suppliers. Many of these measures are part of the normal regulatory procedures of most administrations; the presence of MNCs required, however, that they be implemented with special care to protect local enterprises and to circumscribe normal commercial practices.

Project evaluation

At the project evaluation level two sets of decisions have to be made; whether or **not** a particular investment is worth undertaking at all, and whether or not it should be left to an MNC or undertaken locally (or some appropriate combination). The desirability of an investment as such must depend partly on the social criteria used for assessing the value of its output (which is not the same thing as its market price corrected or otherwise) and partly on considerations of scale, technology, efficiency, labour, raw materials and the like.

The project evaluation exercise requires the establishment of a unit which possesses comprehensive information on technology and foreign markets, has extensive contacts with local enterprise and has the ability to select projects along lines which promote social welfare.

There are several dangers which policy makers must guard against such as: a too rigid approach to investment selection; the influence of local or foreign pressure groups; taking a too narrow view of technology and accepting whatever is offered.

It is emphasised that project evaluation does not admit to easy straightforward solutions either in theory or practice.

Bargaining and regulation

There is a lot of hard work to be done in improving the the host country's pocition (by gathering information, centralising all dealings with MNCs, improving negotiating skills) so that various items like the proportion of local ownership, taxes and subsidies, the form and cost of technology, the extent of protection, the composition of output, exports, tra: page 15 icing and employment can be decided upon in its

The settling of a bargain must be followed up with appropriate measures to see the terms are met especially with regard to transfer pricing, restrictive practices, employment and protection. These are all difficult and cumbersome tasks, yet if they are left to the mercy of market forces it is likely that MNCs will turn the situation very much to their own favour: their power and dominance can render the traditional market checks and balances largely redundant.

A comprehensive and coherent policy on MNCs thus asks a great deal of the political and administrative apparatus of a host country. The greater the number of restrictions and regulations imposed on the operations of MNCs or the greater the profit opportunities for the MNCs in a particular country the greater will be the pressure put on the abilities of the administration. It is important therefore that bureaucracies in developing countries continually improve their efficiency, administration and skill which are essential ingredients for bargaining with and regulating multinational enterprises.

Developing Countries and Multinational Corporations: Effects on Host Countries' Welfare and the Role of Government Policy

INTRODUCTION

"The multinational corporations have developed distinct advantages which can be put to the service of world development. Their ability to tap financial, physical and human resources around the world and to combine them in economically feasible and commercially profitable activities, their capacity to develop new technology and skills and their productive and managerial ability to translate resources into specific outputs have proved to be outstanding.... At the same time, the power concentrated in their hands and their actual or potential use of it, their ability to shape demand patterns and values and to influence the lives of people and policies of governments, as well as their impact on the international division of labour, have raised concern about their role in world affairs. This concern is probably heightened by the fact that there is no systematic process of monitoring their activities and discussing them in an appropriate forum."

(U.N. 1973, p. 3)

"..It is beyond dispute that the spread of multinational business ranks with the development of the steam engine, electric power, and the automobile as one of the major events of modern economic history. Social and economic developments of this magnitude always entail a mixture of benefits and costs. Whether the balance in the aggregate turns out to be on the "benefit" or the "cost" side, a detailed perspective is needed for an understanding of precisely where the gains and losses are, so that public policy can be formed to preserve the gains and minimize the losses."

(U.S. Tariff Commission, 1973, p.78)

1. These extracts from two recent studies of the multinational corporation (MNC), eminent by virtue of their status and their comprehensiveness of scope, capture the essential problem posed by the emergence of this phenomenon. The MNC has come of age: it dominates the international economic scene in the non-Socialist world and is even making incursions into many Socialist countries; it has grown far beyond its traditional confines of primary product extraction to many branches of manufacturing industry, commerce, tourism, banking and other services; and it has created around itself an aura of superiority, dynamism and power, all the myths and symbols that accompany the rise of a new social force.

2. This paper seeks to examine the main effects of MNCs, mainly in the manufacturing sector, on the economies of developing countries, for the purpose of clarifying the issues of host government policy: what the benefits are which the government should try to extract, what the costs are that it

should minimise, what instruments it possesses to achieve its aims and what the main problems are in using these instruments. Much has been written about these question, especially on the costs and benefits, in recent years, yet the problem has become more complex, and the debate more heated, than otherwise. This has been especially true of MNCs in the poorer countries, and particularly in Latin America where their presence is larger than in other areas. We cannot hope to resolve the fundamental conflicts of opinion; but before we launch into the main body of our discussion it may be useful to mention two basic analytical problems concerning the broad social implications of multinational corporations.

3. First, these implications are far from being 'merely' economic. Hardly anything is ever 'merely' economic, in that economic relationships between people, groups or nations necessarily influence their social, political, legal and cultural behaviour. Certainly the MNC is too large an entity for us to assume that its overall social effects are neglible: it is a 'social' phenomenon in the widest sense of the word, and its impact must, however inadequately, be assessed as such. Most of the difficulties encountered in discussing its costs and benefits, the nature of its impact and the desirability of the diverse effects, arise in part because they are so diffuse and numerous, and in part because the value attached to any of them depends on the political and moral stance of the particular observer.

4. The magnitude of the multinational phenomenon thus raises enormous problems of analysis, and it would be incorrect to fit it into the narrow confines of orthodox economics, developed to explain a different sort of reality (and increasingly tending to social irrelevance). Yet alternative tools are sadly inadequate, and we have to try to steer a course between being technically conventional (and ending up with inappropriate trivia) and being over-general (and so saying nothing useful). We also have to try to define our values carefully: value judgements are a necessary basis for assessing social welfare, and so for discussing policy options, and since they are necessary they should at least be openly described. It is therefore obvious from the start that there cannot be definitive answers to the main problems regarding MNCs - not only can their effects not be fully guaged, any particularly definition of 'welfare' of host countries can be found faulty by someone with a different conception of welfare.

5. Second, a set of related difficulties arises from the fact that MNCs are only one of a set of economic institutions active today in the fields of trade, finance, technology and business. Multinationals are undoubtedly very important in all of them, but their role cannot be separated from those of, say, smaller firms, governments, trades and financiers: as far as the effects of MNCs on developing host countries are concerned, consequently, we cannot isolate the impact of multinationals from that of the developed countries as a whole. Again, we have to choose a middle path between putting too much responsibility on MNCs and absolving them altogether by considering only marginal effects.

6. There are many other problems at a more empirical level, which we shall mention below. The above qualifications must, however, be borne in mind throughout this paper, whose

arguments are, where appropriate, illustrated with data obtained by the present author in the course of case studies conducted for UNCTAD during 1969-73 (for a summary see Streeten and Lall, 1973).

CHAPTER I DEFINITIONS, CHARACTERISTICS AND SCOPE OF MNCs

7. This part is sub-divided into three sections; the first attempts to give a workable definition of MNCs; the second discusses the main features which characterise the modern multinational (manufacturing) corporation, and the third presents some figures on the present size and distribution of MNCs, especially in Commonwealth countries.

Definition of MNCs

8. Though such terms as 'multinational', 'international', 'transnational' or 'global' corporations (or firms, or enterprises) have entered the common parlance of economics and related social sciences, their exact meaning has not been clearly defined. Most authors use them interchangeably to mean more or less the same thing, while some differentiate between them to stand for different degrees of largeness, openness or lack of national commitment, and some others introduce a fresh terminology to classify their attitudes to the world (e.g. "ethnocentric, polycentric or geocentric"). The U.N. study devotes its entire Annex II (U.N., 1973, pp.118-21) to quoting different definitions used in the literature, all differing slightly in emphasis and interpretation, depending on the interest of the authors and their orientation.

9. It is natural at this stage that such a looseness of definition should exist, with terms being used flexibly to suit the task at hand. Since the tradition in economic analysis has been to think in terms of small firms maximising profits in competitive environments within their own countries, and to conceive of direct foreign investment simply as an (undifferentiated) part of "capital flows" abroad, the emergence of MNCs has led to most definitions being framed as contrasts to the traditional concept of the business enterprise. We can distinguish between three areas in which this contrast has been emphasised in order to characterise the modern MNC.

10. First, its <u>large size</u>, <u>geographical spread</u> and <u>resources</u>. This definition, used, for example, by Vernon (1971) and the U.S. Tariff Commission (1973),[1] is the one which appeals

(1) The criterion used in selecting the 187 MNCs studies by the Harvard Multinational Enterprise project was to take those of 500 largest U.S. industrial firms which were in manufacring and which had subsidiaries in six or more countries. The U.S. Tariff Commission defines the MNC as a firm with "net sales of $100 million to several billion dollars. Direct foreign investment in manufacturing facilities in a number of foreign countries usually accounts for at least 15 to 20 per cent of the company's total investment. 'Direct' is generally thought to mean at least a 25 per cent participation in the share capital of the foreign enterprise, i.e. a large enough share to imply operational control of the enterprise..." (p.81).

most directly to the economist; it highlights very effectively not only the differences between the MNC and the traditional "firm", but also between it and (a) the large national firm which does little investing abroad, (b) the small foreign investor who goes abroad but remains a relatively minor economic unit, and (c) the large firm which invests abroad but only in one or two foreign countries. As we shall note below, such MNCs also tend to be highly oligopolistic, marketing-or research-intensive, difficult for governments to regulate, and tightly controlled from the centre (the parent firm); however, these characteristics need not be included in a practical definition.

11. Second, its internal structure and organisation. This sort of definition generally takes size and geographical spread for granted and concentrates on the centralisation of authority, the strategy of international expansion, the ability to counter or circumvent the policies of particular host governments, or the division of labour between different units of the firm as the most significant features of the MNC. Clearly such a perspective, more that of the organsation or industrial analyst than the economist proper, enables one to highlight the distinction between the highly sophisticated, complex and tightly-knit structures possessed by most MNCs and the looser, more independent and less coordinated structures of smaller firms.

12. Third, its motivation and philosophy. The management specialist pays greatest regard to those aspects of 'corporate philosphy' and 'executive motivation' which mark the evolution to "true multinationalism", such as a global point of view, a lack of nationalism, an overwhelming concern with the firm as a whole rather than with any of its constituent units, or 'feeling at home' in every country of operation. Thus, of two firms of equal size with comparable investments abroad, one may be considered more 'multinational' than another if its executives are more 'egocentric' than the others. (1)

13. These three sorts of definitions, which we may label economic, organisational and motivational respectively, are each addressed to different aspects of the phenomenon. Each definition is correct in its own way, and suited to the analytical purpose of its originator; particular elements from each can be combined in order to facilitate a more comprehensive analysis, or further refined to study details of particular interest. What is common to all of them is a recognition of the important changes wrought by the growth of private firms from small or medium to very large sizes, and from production in one or two to a large number of countries. These are the most noticeable features of multinationals, others are rather more difficult to ascertain.

14. The definition which suits our present purpose is the simple economic one of size and spread, though for examining policy problems we shall also have to consider some organisational features of multinational investors. Since we are concerned to analyse the MNC from the view-point of a less developed host country, however, the economic definition provides the best practical start: it enables us to distinguish a small foreign investor from the large multinational one, and serves as a reasonable proxy for such attributes as their relative

(1) This sort of definition based on attitudes is adopted by Perlmutter, 1960.

bargaining power, their control over technology and other resources, and their industrial and organisational structures. These distinctions are vital from the point of view of official policy, and it is unfortunate, for instance, that the U N study adopts the much broader and less useful one including every foreign investor as a multinational corporation, while most of its arguments are really directed to the large and powerful multinationals. The U S Tariff Commission also ends up by including every American firm with foreign manufacturing facilities in its study, which may facilitate statistical work but confuses the policy issues.

15. We are not in this study concerned with the statistical analysis of multinationals in developing countries, so that a precise separation of MNCs from other foreign investors is not of any relevance to us. At the cost of some terminological vagueness, we shall conduct our argument in terms of MNCs, defined as firms of very great size and investments in many countries, and 'other' foreign investors, smaller and less widespread; we shall ignore the inconvenient gray area between the two, consisting of firms on the verge of becoming multinational (1), for such fine distinctions will not lend much to the understanding of the problems at hand.

The theory of direct foreign investment and characteristics of MNCs

The definitions of MNCs in the previous section already suggests some of their prominent features; they do not, however, provide any sort of explanation of why foreign investment, by MNCs and others, takes place, nor of why MNCs are found to be concentrated in particular industries and why they have certain modes of operation. An incursion into the theory of foreign investment, though not at first sight relevant to the rest of the paper, will be very helpful in understanding the nature of the welfare effects of MNCs and the sorts of policies needed to cope with them.

17. There is a large body of literature on the theory, motivation and determinants of direct foreign investment, which often tend to be treated as one comprehensive explanation of this phenomenon. (2) We are not for the moment concerned with the motivation, though this is significant when policies are considered to attract and retain foreign investors to less developed countries; nor are we concerned with the determinants (which are closely related to motivation, but in the literature are dealt with by means of econometric tests rather than by questioning firms directly) of investment abroad, though this constitutes the attractiveness of a particular host country to the investors and therefore its bargaining strength. (3) This is because though motives and attractions do show from the firm's viewpoint why they wish to invest abroad, they do not show the underlying economic factors which permit such investment, and especially which permit foreign rather than local, and direct rather than portfolio, investment.

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(1) For an interesting comparison of the growth of small, medium and large firms in international business, see Rowthorn and Hymer, 1971.

(2) For a recent annotated bibliography, see Lall, 1974, (a) especially Chapter 3.

(3) See Reuber *et al* (1973) for a discussion of these two factors in relation to less-developed countries.

18. Traditional trade theory is singularly unhelpful in this respect. It treats direct investment simply as one component of total international capital flows, and assumes that such flows take place in response to differences in interest rates which reflect relative capital scarcities in different countries. Thus, while it may seem to explain why a particular investment has attracted capital from abroad - local capital is scarce and is already earning higher interest rates - it does not capture the vital difference between a movement of loanable funds (portfolio investment or foreign borrowing) and an act of direct investment which implies control from abroad as well as a whole package of different accompanying factors (marketing, technology, management, brand names and various other inputs). Interest is, in this context, quite distinct from profit in its implications, and it is the latter which is at the crux of direct investment.

19. Recent analyses of foreign investment have, therefore, discarded pure trade theory and turned to theories of monopolistic competition for explanations of why such investment occurs. (1) Such theories are based on an explicit recognition of the fact that firms' in the advanced capitalist countries as well as in international markets operate in an oligopolistic framework with a few large companies dominating their respective industries,and relying heavily on product differentiation, marketing, innovation, scale economies, access to capital and managerial efficiency to maintain and strengthen their dominance. In such a framework, capital does not flow freely between different uses to equalize returns, but tends to stay in the sectors in which it is earned and can show marked differences in its rates of return. Since it is these oligopolistic firms which do the bulk of investing abroad (and so become multinational), clearly capital spreads more easily across national boundaries than across industrial ones, and the same factors which explain the national growth of these firms can to a large extent explain their growth internationally.

20. The essence of the explanation lies in three sorts of advantages which these firms enjoy in investing directly.

21. <u>Advantage of large established oligopolists over small local firms</u>

In the case of developing countries, this advantage is overwhelming, since local firms, if they exist at all, lack the capital, know-how and organisation to compete with foreign firms. It is often argued that firms going abroad face the initial handicap of operating over long distances in alien environments (though it is difficult to imagine such a handicap being very substantial for present MNCs contemplating entry into a new market); obviously the comparative advantage of the international investor has to be sufficiently large to overcome the communication barrier.

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(1) The monopolistic-competition approach was first advanced in 1960 in an unpublished thesis by S. Hymer; it is expounded clearly by Kindleberger (1969), and extended by Caves (1971) and Knickerbocker (1973).

Kindleberger (1) distinguishes between four types of advantages:

i. In selling goods (in product markets), by means of of product differentiation, marketing skills, pricing policy, and so on.

ii. In production (in factor markets), by means of patented or secret technology, easier access to capital, better management.

iii. Economies of scale.

iv. Government policies, especially regarding imports and customs unions.

22. Of these the fourth is not of particular benefit to the MNC except when it is in a position to extract more concessions from national governments than other firms - not an unusual case. To the above list we may add such items as the ability of MNCs to evade taxes, to shut down particular operations, to call on direct or indirect support of their home governments, to manipulate international financial markets, and, more generally, to use the great power of their size, experience and versatility to bend social, market and political forces to their interest - a sort of cumulative advantage which grows with size and which is not properly captured by the simplified enumeration above.

23. The undeniable market power of large firms in industrial countries does not provide the complete rationale of foreign investment. We still have to explain why this power is not exploited by means of exporting the product, or, if that were not preferred, by means of exporting the different advantages they possess. There must be specific advantages to direct investment as compared to these alternatives.

24. Advantage of direct investment over exporting.

It is possible to argue that if all the oligopolistic advantages of large firms show up in lower prices, better quality product or larger captive demand, the firms should exploit these advantages by exporting rather than by undertaking the task of organising manufacturing operations abroad. Indeed, in many industries, exports expand with very little investment abroad (e.g.steel or aircraft); in others, exports of parent firms expand together with an expansion of their overseas investment. But why invest abroad at all? We can think of three reasons:

i. Firms may think, rightly or wrongly, that national markets in particular industries are better served by manufacturing subsidiaries rather than by mere selling agencies. Furthermore, it has been noted (especially by Knickerbocker, 1973) that oligopolistic firms pay great attention to what their rivals are doing, and that they feel their export markets severely threatened if a rival establishes a plant there. Perhaps being close to the consumer helps a better designed product, or perhaps the presence of a manufacturing plant induces greater sales efforts;

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(1) See Kindleberger, 1969, pp. 11 - 27.

the 'follow-the-leader' pattern of investment abroad observed, however, seems to indicate that these are simply rationalisations of a more basic need not to be left out of any action which is taking place. This oligopolistic investment pattern occurs regardless of whether or not there are other threats to export markets.

ii. These other threats, chiefly or tariffs or quantitative restrictions in importing countries, can induce firms to switch from exports to direct investments. Indeed, these are often cited as the main factor behind the growth of foreign investments in developing countries.

iii. While the first two advantages of direct investment over exporting arise mainly from marketing factors, a different kind of pressure to invest arises from technological factors. This is explained by the 'product cycle' theory, which takes accountof the fact that technological superiority is not a permanent advantage, but is eroded over time by the diffusion of knowledge, competition in research, and imitation. (1) Thus, a firm with major technological innovation can rely on exporting from the home country, which has the richest market, only as long as there are no effective competitors; once other firms can produce substitutes, costs of production become more significant, and the innovating firm has to shift manufacturing to more economical areas. The parent firm would continue to produce and export commodities in which its technological lead was still untrammeled, while subsidiaries in lower cost countries would take over the manufacture of threatened products.

25. These factors all contribute to direct investment being in particular cases a more profitable means of capturing and serving foreign markets than exporting; they explain, in other words, why the existing oligopolistic market power of particular firms is best exploited by one means rather than another. But we still have to consider why the elements of the oligopolistic 'package' are themselves not sold abroad as a substitute to direct investment.

26. <u>Advantage of direct investment over the sale of production and marketing skills</u>

Just as there is a balance to be struck between the profitability to a firm of exporting vis a vis investing,there is a balance to be struck between the profitability of investing vis a vis selling licenses, management services, patents, brand names, etc., or lending its capital abroad. In many cases it is clearly preferable to do the latter, and many firms from developed countries do sell these particular productive factors, mainly technology, to other firms in developing countries. (2) The decision rests on a

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(1) This theory owes its origin to R. Vernon; for a recent exposition, see Vernon,1971, Chapter 3.

(2) We may regard a foreign investment in a very small percentage of the equity capital of a local firm, which gives no control to the foreigner, as a 'sale' of technology rather than direct investment proper, which is generally associated with control from abroad.

number of factors, such as the riskiness of direct investment, the size of the market, the value of the technology to the firm, the threat to sales elsewhere, the policies pursued by host governments and the attitudes of the firm itself. In general, the more attractive and stable the market, the newer and more specialised the technology and the more out-ward looking the firm, the more will the balance be struck in favour of direct investment; and the smaller or riskier the market, the more diffuse the technology, and the more restrictive the government, the more will it be struck in favour of selling the factors. The 'product cycle' model also partly explains the urge of firms to sell technology in its middle age when other reasons prevent its exploitation by investment.

27. While MNCs do occasionally sell some of their 'advantages' separately - the sale of Fiat know-how to the Soviet Union is a good example - in most cases they prefer to exploit them by means of setting up subsidiaries; it is the smaller manafacturing firms, which are not great innovators and which do not have other sources of market power to compete with MNCs, and more specialized service firms (consultants, accountants, traders) which are more likely to sell particular elements of the package. It should be obvious why. The MNCs maintain their oligopolistic leadership precisely because of their ability to combine several elements into a profitable package; once the package exists, the marginal cost of using it in new areas is relatively small and the quasi-rents implicit in exploiting it by direct investment are relatively high. The local firm which wants to buy a particular element of the package cannot really offer full compensation to the MNC because it is not paying in full for the quasi-rent foregone on the other elements. Since it is in the nature of things impossible to separate all the elements and sell them (e.g. the MNC cannot sell its organisation, experience or contacts) it will usually pay the MNC to invest and capture the whole quasi-rent rather than collect royalties or management fees.

28. There are, moreover, dangers to export markets and to technological superiority inherent in selling licences and trade-marks to unrelated firms. It has been argued that a firm is an 'organic' unit, and the returns on a particular investment affect the profitability of all its other investments. If this were true, the MNC would prefer to invest even in cases where the marginal profit were not much higher than, say, the alternative of selling a license, in order to protect the market and earning power of the enterprise as a whole: it would not in this case simply compare the marginal rate of profit on an investment with the relevant royalty offered. It also follows from the nature of the oligopolistic 'package' that the MNC would prefer to retain complete control over its subsidiaries so as to prevent others from its quasi-rents. The preference would be strengthened by the direction of the recent organisational changes in multinationals which have accompanied their growth in size, and which have tended towards increasing centralisation and tight control of certain important decisions. (1)

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(1) See U.N., 1973, Chapter II, and a more comprehensive analysis in Stopford and Wells, 1972.

29. A review of the theory of direct foreign investment enables us to see why MNCs expand abroad, both from the 'inside' (the preferences of the firms) and the 'outside' (the market factors), and provides a useful framework within which to consider the particular welfare implications and policy issues of MNCs. Before we leave this secion, however, we may remark on some of the main characteristics of multinationals which are not clearly brought out by the theory and which will be valuable in further discussion.

Main characteristics of MNCs

30. First, MNCs are heavily predominant in certain manufacturing industries and not in others. They thrive in oligopolistic industries which are characterised by one or both of two factors: the importance of marketing (advertising, product differentiation, taste creation, brand names, etc.) and the necessity of continuous innovation (both minor, in terms of small changes in models or packaging, and major, in terms of new processes and products). The relative importance of marketing and innovation differs from industry to industry, with the former playing a larger role in consumer goods industries and in industries with comparatively stagnant technology. The distinction between these two sources of market power cannot, however, be drawn very clearly, since a great deal of research and development expenditure, all classified as 'technological', in fact goes into what may be broadly termed 'market research' (i.e. adapting products to suit particular tastes, which may in turn have been created by advertising) rather than into technological c: nge proper. MNCs are found mainly in such manufacturing industries as food products, pharmaceuticals and other chemicals, rubber products, electrical and non-electrical machinery, transport equipment and paper, with chemicals, machinery, and transport equipment accounting for over half of the total.

31. Second, it follows from the nature of MNC's advantages and specialisation that their products have one or both of two characteristics: they are produced by techniques which are very advanced and highly capital-intensive, and they are consumed by groups with relatively high incomes (relative that is, to the population in general, especially in less-developed countries) and tastes similar to those of the advanced countries. (1) While there seems to be no logical reason why MNCs should not utilise labour-intensive techniques and produce commodities for the mass of the population, the theory of direct investment shows clearly why this is not where the commercial advantage of MNCs lies.

32. Third, the growth of the largest firms has been marked by an increasing concentration of decision-making powers in the central organisation, with routine matters delegated to the operational units but key matters tightly controlled by the head office. While the distribution of power within an enormous enterprise is not easy to decipher, and there may be opposing forces at work, there is little doubt that the evolving structure of MNCs has led to, even necessitated, a gathering of vital functions at the apex and a close-knit

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(1) It should be noted that what is considered a mass consumption item in a rich capitalist country (e.g. a refrigerator, small car, television or washing machine) may be an elite commodity in most less-developed countries.

hierarchical structure to enable world-wide operations. (1) When considered together with the growth in the economic power of the firms themselves, the implications are that the leaders of multinationals have come to form a super-elite in political and social terms, wielding enormous influence on various aspects of the life of their home countries and, in somewhat different ways, of their host countries. The realisation that the large corporations have great socio-political power, and that economic elites are closely interwoven with political and other elites, has not yet seeped into the main body of economic thinking, but it has become a commonplace in sociology and corporate analysis. (2) These tendencies mean that the growth of MNCs has created greater concentration of power (broadly conceived) both externally, in their social context, and internally, within the organisations themselves.

33. Fourth, with their increasing economic strength and the evolution of a 'global perspective' to go with their global spread, the MNCs have developed (or, more precisely, are in the processing of developing) certain financial strategies which enable them to maximise their overall profits in, and minimise their overall 'exposure' to, a world of political risk, exchange rate instability, tax differences, imperfect capital markets and gaps in host countries' knowledge. These strategies involve a certain pattern of capital financing, using relatively little investment from the parent firm and relying heavily on local gearing and reinvested profits; the manipulation of transfer prices, the prices assigned to goods traded between different units of the same firm, and other arbitrarily assigned payments, such as royalties, management fees and interest, to minimise tax obligations and circumvent monetary policies and restrictions on dividend remittances; and the minimisation of exchange rate 'exposure' in risky situations by appropriate management of liabilities in different currencies, sometimes amounting to active speculation against weak currencies. (3)

34. There are many other features of multinationals which are of significance, but the ones noted above are particularly relevant to our analysis of effects and policies. It should be apparent that all these characteristics of MNCs are to some extent peculiar to them, and mark them off from other types of private enterprise, foreign investors and other means of selling components of the 'package' which we mentioned above. The reasons which enable MNCs to reach their enormous size, the changes which accompany thier growth, and the strategies which evolve to strengthen their position, all impart a distinct character to multinational firms; the next section provides some data to illustrate their magnitude.

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(1) See Hymer, 1972: Barnet and Muller, 1974; and, on financial aspects, Robbins and Stobaugh 1973.

(2) For recent works along these lines, see Tilman, 1974, and Stanworth and Giddens, 1974.

(3) See Robbins and Stobaugh, 1973, for a detailed discussion of 'optimum' financial strategy for multinationals.

Scope of foreign investment and MNCs

Quantitative information on the size and distribution of foreign investment in general, and on MNCs as a group, is far from adequate. This is so partly because of differences in definitions of multinationals employed by different surveys and partly because detailed data are not readily available for the exact value of foreign investment and for the activities of non-U.S. multinationals. Having due regard to problems of interpreting book values and estimates based on incomplete data, however, we may still get a reasonable picture of the present situation. The U.N. study (1973) provides the most recent figures, and we shall draw heavily on it, supplementing, where necessary, with data from the U.S. Tariff Commission's report (1973) on American MNCs.

36. The total value of foreign private investment outstanding in the world is $165 billion, of which two-thirds is in developed and one-third in less-developed countries. The U.S. accounts for over a half of the total, and, together with the U.K., France and West Germany, accounts for over 80% of the total. Other countries with large foreign investments are Switzerland, Canada, the Netherlands, Italy, Belgium and Japan, with most other developed countries having some foreign interests.

37. MNCs predominate heavily in the foreign investment scene. About 250-300 firms account for over 70% of U.S. investment abroad while 165 firms for the U.K., and 82 firms West Germany, control over 80% and 70% of their foreign investments respectively. The MNCs in turn are highly concentrated: of the 650 largest industrial corporations in the world for instance, the 4 largest (3 U.S.) account for about 10% of total sales, and the 210 largest (127 U.S.) for about 70% of total sales. (1) In terms of international spread, about 500 corporations from developed countries, the multinationals *par excellence*, have affiliates in over 10 countries.

38. The growth of foreign investment has been dramatic after the Second World War, with the pace accelerating in the 1960's. Between 1960 and 1971, the book value of U.S. direct investment abroad rose from $33 to $86 billion, that of the U.K. from $12 to $24 billion, that of West Germany from under $1 to over $7 billion, and that of Japan from under $0.5 billion to almost $5 billion. Developed countries received substantially more foreign capital inflows than less-developed countries. (2)

39. Manufacturing accounts for more than 40% of total foreign investment, with its relative importance being greater in developed countries than in less-developed ones (where extractive industries are still more important). In recent years multinational expansion has also taken place in such sectors as banking, tourism and consulting. Within the manufacturing sector, technology intensive industries are, as noted above, especially important, with chemicals, machinery and transport equipment being of particular significance in US foreign investment.

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(1) U.N., 1973, Table 1.

(2) Among developing countries, Latin America accounts for 18% of total foreign investment in the world, Africa for 6%, Asia and the Middle East together for 8%.

40. The significance of MNCs in the world economy is illustrated by the value of their production and trade. The UN study points out that "the value-added by each of the top ten multinational corporations in 1971 was in excess of $3 billion - or greater than the gross national product of over 80 countries. The value-added of all multinational corporations, estimated roughly at $500 billion in 1971, was about one-fifth of world gross national product, not including centrally planned economies".(1) Since the growth of investment and production by MNCs has outstripped that of most countries' GNP, their share of world output has continued to grow rapidly in recent years. While predictions of their future role in the world economy are obviously subject to many qualifications, many sober observers foresee an international capitalist framework of production with a handful of MNCs controlling up to three-fourths of investment and output.

41. The international production of MNCs may to some extent have substituted for trade between countries, but it has not by any means diminished their importance in international trade. The US Tariff Commission study finds that American MNCs (broadly defined) and their affiliates by themselves account for a quarter of world exports of all commodities and a fifth of world manufactured exports: for the US alone, they account for 62 per cent of manufactured exports and 39 per cent of manufactured imports. It also notes that "as a group, private institutions on the international financial scene controlled some $268 billion in short-term liquid assets at the end of 1971 - and the lion's share of these assets was under the control of multinational firms and banks headquartered in the United States. (This) was more than twice the total of all international reserves held by all central banks and international monetary institutions in the world at the same date". (2)

42. The importance of MNCs varies greatly from country to country in the developing world, with only a few countries having stocks of foreign capital exceeding $1 billion: Argentina, Brazil, India, Mexico, Nigeria,Venezuela and a few Caribbean islands account for 43% of total foreign investment in developing countries. In the manufacturing sector, Argentina, Brazil, India, Mexico and Philippines each has foreign investments of over $200 million. The United States accounts for over half of foreign investment in developing countries, but in the Western Hemisphere its importance is much greater, while in the Commonwealth countries Britain tends to predominate. The table in Appendix 1 (page 00), presents data on the stock of foreign capital in 20 developing Commonwealth countries, (including Hong Kong) owned by Development Assistance Committee (DAC) countries, which comprise nearly all the providers of foreign aid and investment in the non-communist world. Of the total private investment in the developing world of $33 billion, the Commonwealth countries in the table account for $6,350 million or 19%. The share of Britain in the total for all developing countries is far smaller than its share in the Commonwealth; the reverse is the case for the US, though the rate of growth of the latter has been faster

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(1) UN, 1973, p.13. Emphasis added.

(2) US Tariff Commission, 1973, pp. 8-9. Emphasis added.

than of the former.

43. Finally, a note on ownership and financing patterns. There are a number of reasons mentioned above, such as the existence of large quasi-rents, technical secrecy, centralised control, transfer pricing, etc., which predispose MNCs to seek complete or majority ownership of their foreign investments. While control can be exercised even with minority share holding or a management contract, clearly a dominant ownership position is less vulnerable and preserves quasi-rents better. Thus, the U.N. study reports that "at least 80 per cent of United States affiliates and 75 per cent of United Kingdom affiliates are either wholly-owned or majority controlled. In terms of stock investment, these two countries have placed about 90 per cent in affiliates which are at least majority owned."(1) Japanese firms appear more willing to accept minority positions, partly because more of their investments are in developing countries which tend increasingly to impose statutory limitations on the extent of foreign ownership. This tendency has of course, also affected new British and American investments, and has, despite the MNCs' own preferences, (2) led them to becoming generally more flexible as regards their demands for certain patterns of ownership and control.

44. As far as financial strategy is concerned, the analysis of U.S. MNCs by the Tariff Commission suggests that firms keep the amount of equity investment by the parent company to a minimum (12% in manufacturing), and rely on local borrowing (35%), profits (27%) and depreciation (26%) to finance their expenditures (in new plant, 46%, in current assets, 43%, and in profit remittances, 11%).(3) In part this has been caused in recent years by the U.S. Government's policy of discouraging exports of capital from the home country and by the enormous opportunities offered by the Euro-dolaar market; in part it has been the rssult of deliberate policy on the part of firms to gear their capital highly, to limit their capital costs and to reduce their 'exposure' to exchange risks by minimising the commitment of resources from abroad.

45. This concludes our sketch of the scope of foreign investment and MNCs. The picture is, in brief, one of a world with rapidly increasing 'international production' dominated by a few hundred multinational firms from developed countries, mainly the U.S., with trade, investment, and technology in the most dynamic sectors all coming under their aegis; an interpenetration of the developed countries by each others' multinationals, with the less-developed countries accounting for a small and relatively stagnant portion of international investments; a growing and enormous concentration of economic power in a small number of private enterprises which by any measure are more important than a relatively large number of host countries; and, following naturally from all these, a growing anxiety about the effects, responsibilities and regulation of such a scale of private enterprise. We now turn to a discussion of the effects on less-developed host countries.

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(1) U.N. 1973, p.12.

(2) See Tomlinson, 1970, and Stopford and Wells, 1972.The exact pattern of ownership is, of course, determined to some extent by the relative bargaining strengths of the firms and host governments.

(3) U.S. Tariff Commission 1973, pp.420-21. The figures are for 1966-70. Very similar findings are reported for Southeast Asian countries by Allen, 1973.

COSTS AND BENEFITS OF MNCs TO DEVELOPING COUNTRIES

What is the 'welfare' of host countries

46. We started this paper by remarking on the inherent difficulties of assessing the general implications of a social phenomenon as important as the modern multinational firm. Not only are its effects numerous and sometimes unquantiable, they are also not strictly 'economic' and are subject to wide differences in interpretation. This is not, however, the end of the problem. Almost any general effect of MNCs, economic or otherwise, can be considered good or bad for the host countries' welfare depending on the particular conception of 'welfare' used. Endless controversy rages around this subject (and, of course, many others like it) partly because the fundamental premises are usually not defined explicitly, and the role of value judgements tends to be forgotten. (1)

47. This is hardly the appropriate venue for an exploration of welfare economics, yet some clarification of the issues is necessary before we can proceed with a discussion of the 'welfare' effects of MNCs. It will soon become obvious why. The essence of the present problem is whether economic 'welfare' in less-developed countries can be defined in terms of the increased production of commodities measured at market prices (corrected for tariffs and similar 'distortions'). Economic theory as it stands in its present neo-classical form provides this as the only true measure of welfare, and, despite its turbulent intellectual origins, the concept now possess the attributes of a scientific and objective measure of economic well-being.

48. There are, however, a number of logical steps of dubious psychological, moral and political value involved in arriving at the conclusion that a free market provides an objective and desirable measure of welfare; it is incorrect to argue that such a measure is objective or free of idology.(2) For the value of goods sold in a market measures just that: it says nothing about its social desirability unless a number of premises are first introduced. These premises are:

a) The psychological ones that people act so as to maximise economic 'utility' (which is often defined in such a circular manner as to make the proposition tautological); that the 'needs' they fulfil are independently formed and 'real' in some sense; and that they themselves are the best judges of their well-being (though this is also partly an ethical premise). Modern psychology would certainly not support the behavioural implications of the 'rational economic man', but this is not as serious as the fact that it is now indisputable that 'needs' are not independently formed in developed societies. All studies of human behaviour, including certain branches of applied economics, show that 'needs' are heavily conditioned by income levels, advertising, demonstration and more obscure psychological factors: it is a far cry from the original justification

(1) For a brief review of different schools of thought on foreign investment in less-developed countries and their value judgements see Lall, 1974(b).

(2) For excellent treatments of these issues, see Myrdal, 1953, Robinson, 1962, and Ward, 1972.

of utilitarian philosophy to assert that the fulfilment of such needs adds to social welfare. Furthermore, it is far from proven that individuals or groups are the best judges of their own welfare.

b) The moral ones that individual 'utilities' as expressed in market behaviour are what should be maximised; that the income-distribution and other influences on market behaviour are acceptable as they stand, and the 'free play' of market forces is a good thing; and that the social good is simply the sum of individual welfares maximised through the free market, which also contains the political premise that different groups (or classes) have no clash of interest. All these propositions are value judgements with clear ideological bases, and their acceptability in the context of less-developed countries is highly debatable (see below).

c) The political ones that there is (as noted above) no clash of economic interest between different groups, especially those with and those without property; that the distribution of economic power is in some way neutral in the socio-political context, and does not enable one group to impose its interest, views and ideals on another, and so does not infringe the exercise of 'freedom' in any way. The harmony-of-interest and neutrality-of-economics premises are fundamental to laissez-faire economics, yet there is little in other social sciences which lends support to these beliefs.

49. It should be clear from these assumptions, and indeed many economists would find it quite obvious, that the practical application of welfare criteria based on the 'free play of market forces' is subject to many severe criticisms. In the particular context of MNCs in less-developed countries, these criticisms are even more forceful. MNCs are the leading manipulators of taste and creation of new needs in both developed and less-developed countries. Business economists and writers like Galbraith stress these attributes of the large modern corporation; moreover, our review of the theory of direct investment reveals the importance of marketing and product differentiation in the expansion of MNCs.(1) Why does this matter for developing countries? The groups which are catered for, and whose tastes are influenced by MNCs, are the economic élites of the countries, whose demands are very similar to those of developed countries. These élites are closely allied to, if not identical with the ruling élites in most developing countries,(2) so that 'free play' of market forces leads to the implementation of a pattern of demand and consumption which it would require blind faith to consider as promoting the welfare of 'the people' of these countries.

(1) This is not to argue that MNCs are solely responsible for moulding tastes; trade, tourism, cultural exchange and direct domination are also responsible, but in the ultimate analysis the largest firms are the prime movers of changes in consumption patterns.

(2) This is one of the basic tenets of the 'dependence' school of thought in Latin America. See various works by C. Furtado, especially his 'Underdevelopment and Dependence: The Fundamental Connections', 1973, where he points out that "The existence of a ruling class tied up with consumption patterns similar to those in countries where the level of capital accumulation was much higher and geared to a culture focussing on technical progress became the basic factor in the evolution of peripheral countries".

50. Even the most orthodox of economists admit that some interference with market forces is warranted to ensure that resources are devoted to providing thebasic necessities of life to the mass of the people rather than to providing Cadillacs or stereo sets to a few; yet the logic of the argument is not pursued to the point where the validity of the liberal market philosophy is itself questioned, and where it is admitted that some independent judgement may have to be formed about the social value of commodities. The paternalistic implications of such a conclusion are repugnant to most economists, and obviously a non-market value system faces various problems of its own, but we cannot deny that it would be a poor definition of national welfare in developing countries to leave it to an uncontrolled market. Indeed many countries do try to control the worst excesses of what is euphemistically termed 'inappropriate' consumption, and to attach higher priority to 'merit wants', feeling implicitly towards a definition of welfare which is more equitable and humane.

51. We cannot hope to provide a precise alternative definition of welfare which lies between that of the free market on the one hand and a completely centralised paternalistic system on the other. There are too many problems of the sort mentioned above implicit in any particular definition; yet we need a practical criterion to be able to proceed. We shall base ours on two rather general premises:

First, the supply of a good increases the welfare of a less-developed country if it is aimed at the needs of the majority of the people, especially at the needs of the poorest sections.(1)

Second, an economic structure which promotes equality between different income groups is preferable to one which increases inequality.

52. These stipulations may be open to a variety of interpretations, but the general tenor of the argument, away from a purely market-based system to one which is based more on particular considerations of usefulness and social justice, is well-known and probable acceptable to most developing countries. Such a definition, though far from rigorous or analytically satisfactory, provides a basis for further discussion of the MNC problem which is more satisfactory than an unquestioning reliance on orthodox welfare economics, which is equally value-loaded in its own way.

53. If this digression seems unnecessary and its conclusions obvious, we may point out that much of the discussion of MNCs has tended to ignore these fundamental problems of definition and has taken the economic benefits of commercial superiority for granted. The premise of most arguments has been "It must be good if it is profitable"; it is just

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(1) The moral problem here is to separate 'real' or 'important' needs from artificially created (or less important) ones. The scope for disagreement here is perhaps not as great as may be imagined in less-developed countries. One method for deciding on the social desirability of commodities - as apart from the commercial value - would be to separate various 'characteristics' of products, e.g. packaging, practical usefulness, brand names, consumers, comparison with substitutes, etc., and evaluate them accordingly; see Helleiner, 1974.

this link between social good and market success which we must break. If it makes the 'social good' into an amorphous concept, it is a problem which is intrinsic to all the social sciences and must be accepted as such.

54. The costs and benefits of MNCs in developing areas can be discussed under seven different headings which characterise their 'advantages' over local competing or smaller foreign firms: nature of product; technology; organisation; marketing; capital; balance of payments; and productive efficiency. In each of these categories we can distinguish certain benefits which MNCs offer to the host country as well as certain costs; we can also try to distinguish between who is responsible for the particular configuration of costs and benefits, whether it is the MNC, the international economy, the host government or the nature of the host economy.

<u>Effects of MNCs: nature of product</u>

As MNCs are among the leading innovators of manufactured goods in the world, the benefit they offer to host countries consists of the provision of the entire range of modern products in the industries in which they operate. There is probably no quicker way of having these products manufactured locally than by inviting an MNC to set up production facilities. In the normal course of events, new products would be introduced into developed countries and imported into less-developed ones: production in the latter may be started after a considerable lag.(1) This cycle may be prolonged if the economies of production or demand patterns do not favour local production, but it may be shortened if local conditions are especially favourable, if the host government imposes restrictions on imports, or if competitors start local production.

56. The special advantage of MNCs over other producers lies in their great diversity of output and their product differentiation. It would be useful to distinguish here between consumer goods and capital/intermediate goods producers. For the latter class of MNCs, the products offered can raise the productive efficiency of other industries in the host economy: for the former they can raise consumption benefits by providing a wide range of choice.

57. The <u>costs</u> of such a nature of output arise from three factors, which apply particularly to consumer goods. First, product differentiation is by its very nature wasteful, since it introduces elements into a product which add nothing to its absic usefulness or performance, but simply lead to a proliferation of more or less similar models and to rapid changes in those models. These tactics are an indispensible part of oligopolistic competition and are commercially necessary, but they add considerably to costs and little to the welfare of the host country.

58. Second, even if the products were not differentiated, the basic forces causing the specialisation of MNCs in sophisticated and new products leads their output to being in many cases irrelevant to the needs and incomes of the bulk of the population. This is obviously true of many consumer goods (e.g. electronics, automobiles, household gadgets), but it also applies to some capital goods which

(1) See Vernon 1971. This does not apply to international 'sourcing', where particular processes are transferred to low-cost areas but the final product is made in, and aimed at, developed countries. See the section on balance-of-payments effects below.

embody highly capital-intensive technology quite inappropriate for countries with vast labour surpluses (see section on technology). There are, of course, exceptions also: pharmaceuticals, (1) certain plastics or low cost public transport, for instance, and many kinds of industrial chemicals, fertilizers or machinery.

59. Third, following from the previous point: since many MNC products are aimed at the high income elites in less developed countries, they serve to perpetuate their dependence on cultural and economic patterns created abroad, to reduce their integration with the rest of the population, and to heighten the ostensible differences in consumption between different classes. This problem is not peculiar to MNCs, of course, but is inherent in all sorts of inter-relationships between rich and poor countries. However, MNCs bear a special responsibility in that they are the world-wide leaders in the process of demand creation, and their presence in LDCs makes the transfer of products and consumption patterns far easier and quicker.

60. Our argument tries to strike a balance between two extremes: the conventional economists on the one hand, who assume that any increase in production, regardless of its composition, is a good thing, and the dependence theorists on the other, who seem to reason that everything produced by MNCs is undesirable from a social point of view. We cannot provide _a priori_ rules for determining which commodities should be considered desirable, and how much variety and change is beneficial rather than wasteful: it is unfortunate, but inevitable, that a certain element of arbitrariness has to be present in judging social value of production.

61. While a large element of waste is inherent in the nature of MNC production in any context, it is clearly wrong to place the entire responsibility for a socially undesirable pattern of production on their shoulders. The importation of alien consumption patterns is, as we have noted already, an historical phenomenon and takes place through a number of channels. Furthermore, as long as incomes are badly distributed and local production can provide for the demands of elite consumption even without recourse to MNC investment, we can attach responsibility to the MNCs for social cost only if:

a) the presence of MNCs itself worsens income distribution, or strengthens the position of elite groups;

b) their presence induces a higher level of consumption out of a given income, so reducing savings and investment;

c) the pattern of consumption induced itself has undesirable social (cultural alienation, greater ostentation) or economic (greater dependence abroad) consequences;

and d) the waste involved is greater than with other patterns of production.

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(1) Pharmaceuticals are, however, a special case which is mentioned below. For a critical evaluation of the international drug industry in less-developed countries, see Lall, 1974 c.

62. All these are possible, and will be considered at various points below. The point to note here is the vital one about the role of product differentiation and taste-creation in MNCs' success, and the waste intrinsic to it - this applies to all countries in which they operate and is quite independent of income-distribution considerations. In so far as it is a new form of economic growth springing from affluent societies, its extension to less-developed countries via the powerful channel of MNCs is especially undesirable and is their responsibility.

Effects of MNCs: technology

We must not give the impression that product differentiation and marketing (considered below) are the only factors responsible for the growth of MNCs: clearly their technological superiority is also of equal importance.(1) MNCs tend to be predominant in technology-intensive industries (with some exceptions) and to devote more of their resources to R and D than other firms. They take out the bulk of new patents in both developed and less-developed countries, and are responsible for the bulk of 'trade' in technology in the world. Indeed, it is for this attribute that most developing countries, including many in the Socialist bloc, look to MNCs, and part of the reason for our stressing the role of other 'advantages' has been to redress the balance in favour of non-technological factors which are often neglected in the literature.

64. The benefits of advanced technology are clear, and they can be immense. Given that the product is desirable and appropriate, the advantage of the latest technology is simply that it offers the best version of the product made with the most efficient means. It combines the various factors of production presumably in the best possible fashion; and for developing countries, the acquisition of such technology from abroad saves them the enormous costs of having to develop it themselves.

65. Since MNCs are the prime movers in this field, and are able, not only to discover and develop new technology, but also to utilise it effectively by supplying all the complementary factors (such as management, technicians, servicing, 'trouble-shooting', special materials, etc.), it is obvious why they are of vital importance in the international transmission of technology. The benefits of the technology transferred by MNCs (and this includes technology purchased on license) may extend beyond the direct savings in cost or increase in productivity of the investment in a developing country. It may include such externalities as inducing modernisation in competing firms, a more technological outlook among industrialists generally and the stimulation of complementary R and D activities in the recipient firm or its suppliers.

66. The strongest point in favour of technology transfer by MNCs rather than other agents is that the technology market is highly fragmented and oligopolistic, with certain forms of knowledge being the sole property of particular firms, so that there are no other sources of those forms of technology available. Small foreign firms (or sometimes official aid agencies) may be able to provide a wide range of well-

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(1) There is a vast literature on this subject, but see Helleiner, 1974, Streeten, 1972, Stewart, 1973, and Reuber, 1973 for useful discussions.

established technology, but for the newest and most sophisticated forms there is no recourse but to MNCs. Moreover, since the quasi-rents on such technology are very high, they may not willingly be sold by MNCs on licensing basis, but may only be available with direct investment.

67. What are the costs to developing host countries of this structure of the technology market? First, it is important to note that a lot of MNC technology is for the production of high-income, sophisticated consumer goods which may not be wanted in poor countries. Just as not all production is 'good', not all technology is valuable. Moreover, a large portion of the R and D expenditure of MNCs is directed to producing 'new' products which are commercially viable but in fact add little to the real performance of existing products. Thus, an older version of the technology may be just as useful, and probably much more easily and cheaply available, than most modern version supplied by MNCs.

68. Second, the technology supplied may be quite inappropriate to the existing factor endowments of developing countries. MNCs develop their technology to suit conditions of labour scarcity and capital abundance, and apply it with little modification to conditions where the reverse is true. The effect is to distort the desirable pattern of resource allocation, leaving labour unnecessarily idle and skewing income distribution in favour of capitalists. Various reasons have been advanced why more appropriate technologies are not used by MNCs: a 'range' of technologies, combining labour-capital in different proportions, does not exist; it would be very expensive to develop labour-intensive technologies, and in any case factor prices in developing countries are distorted so as to render capital artificially cheap; firms may prefer to use capital-intensive techniques to avoid shortages of certain skills, or to reduce their exposure to labour-union activity.

69. We must be careful, again, not to place the responsibility for the transfer of inappropriate technology only on MNCs. In fact, technology demanded by local firms is just as capital intensive, sometimes more so, than that used by MNCs. Furthermore, we must not label all modern technology 'inappropriate', because in some instances it is just not feasible to have labour-intensive technology which is capable of producing the same results (e.g. power generators or transformers, production of heavy chemicals or machinery requiring extreme precision). There may, in other words, be 'technological fixity' in the production of various commodities, which may not be resolved even with a vast R and D effort. It is difficult to generalise without going into the merits of each case; the most we can say at the moment is that in some industries there is the potential for an intermediate technology, and that in such cases the importation of technology by MNCs may be undesirable.(1) The implication is, of course, that someone within the country or abroad is able and willing to produce the requisite intermediate technology (or revive it from outdated technology) for a reasonable cost. There is considerable evidence that this is possible in many cases, but the effort has to come from the government and not from private enterprise.

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(1) This is well illustrated in the case of soap production in Kenya by Langdon, 1974.

70. A number of products which display 'technological fixity' are of a sort which we mentioned in the first case above (high income consumption goods), and thus ought not to be produced at all in developing countries. One way of reducing the impact of capital-intensive technologies may thus be to concentrate on products which are conducive to the well-being of the lower income groups and which are also amenable to labour-intensive technologies.

71. Third, a very real danger posed by the present state of technological 'dependence' of most developing countries is that it stifles local innovation. Not only does the easy access to foreign know-how prevent local entrepeneurs from investing in research, it also makes them biased against using what innovations are produced locally.(1) The effect is cumulative, since R and D generates considerable 'learning by doing' over time: the less research developing countries do, the less experiencethey gather to do it in the future. The Japanese experience proves the immense value of fostering local research and engineering talents: it is very unlikely today that a country could start on a similar path if it opened its doors to MNCs.

72. Fourth, the cost of acquiring technology through MNCs may be unduly high for various reasons: the institutional framework of the international patent system may enable them to buy up patents in developing countries and use them, not for production butfor high priced imports;(2)the absence of adequate knowledge on the part of the buyer, which may be a subsidiary, a local firm or the state, may enable them to charge monopolistic prices and induce the 'over import' of technology;(3) the weak bargaining position of the buyer may enable them to impose all sorts of restrictive conditions on the host country. (4) If one regards the technology market as one with very little knowledge on part of the buyer and strict monopolistic control on part of the sellor, it is easy to understand why the price set on the technology may favour the sellor. The responsibility for this state of affairs rests heavily on MNCs and the institution framework of patent-protection which sustains their dominant position.

73. In sum, therefore, some of the technology supplied by MNCs is undesirable because it produces the wrong sorts of products; some of it is undesirable because it uses an inappropriate combination of factors; most of it may serve to suppress local innovation; and most of it may be sold for unduly high (open or hidden) prices. On the other hand, MNCs can prove to be the fastest and most efficient means of transmitting whatever modern technology is considered desirable; policy must be directed to finding what is needed, where it is available, and how the best bargain is to be struck.

Effects of MNCs: organisation and management

The organisational, managerial and entrepreneurial powers of MNCs are the patently obvious, andhave been extensively

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(1) For examples from India, see Kidron, 1965.

(2) See Vaitsos, 1973, and on pharmaceuticals Lall, 1974c.

(3) See Carlsen and Neerso 1973 on this phenomenon in India.

(4) UNCTAD, 1972, and Vaitsos, 1970. These include 'tied' purchases of intermediate goods on which very high prices can be charged, further raising the real cost of the technology.

analysed in business-school literature. (1) The growth of international activities, the need to control a large number of subsidiaries in a flexible yet cohesive manner, and the emergence of a global view of business has led to major evolutions and experiments in organisation by MNCs. The newest forms, based on product divisions handling various lines of activity with a powerful head office making crucial financing, pricing and investment decisions, have proved extremely efficient, but clearly new structures will continue to evolve.

75. The benefits to the host economy of having subsidiaries of such complex and efficient organisations are: first, the efficiency with which the foreign investments are operated; second, their entrepreneurial abilities which enable them to seek out and implement profitable investments; third, the training provided to local employees and the spillover effects by the departure of staff; and, fourth, the demonstration effect on other firms which may be included to manage themselves more efficiently. While many of the advantages of superior management will accrue to the firm itself in the form of higher profits, the host economy will also share in the form of taxes on these profits, the effects on local managerial skills and attitudes, and, in some cases, by higher levels of wage and salary payments by MNCs.

76. In this category we may also include the benefits of increased competition in host economies, forcing local firms out of protection-induced lethargy, and introducing a general spirit of dynamism and outward-looking aggresiveness into the whole business scene. The fact that large corporations actively seek to inculcate in their employees a specific corporate 'image' and loyalty may also help them to become more internationally minded and better integrated with the world economy.

77. The costs of a tightly controlled, hierarchical MNC are also numerous. First, as Hymer vividly describes, the nature of the MNCs' organisation itself imposes a pattern of dependence and subordination on developing countries, with the highest authority and status invested in the head offices, and branch offices behaving as colonies in an imperial system. "It is not technology which creates inequality; rather, it is organisation that imposes a ritual judicial asymmetry on the use of intrinsically symmetrical means of communications and arbitrarily creates unequal capacities to initiate and terminate exchange, to store and retrieve information, and to determine the extent of the exchange and terms of the discussion".(1) Since the head office of an MNC is always ruled by nationals of the country where it is located, there will also be a national discrimination in the distribution of power and privilege in the system which creates so much wealth: the result would be that "a regime of multinational corporations would offer under-developed countries neither national independence nor equality...... It would turn the underdeveloped economies into branch-plant countries, not only with reference to their economic functions but throughout the whole gamut of social, political an cultural roles".(2)

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(1) Hymer, 1972. p.126

(2) ibid., p.129.

78. Thus the corporate structure of multinationalism creates inequality internationally, while within host economies it creates a new élite which cooperate with existing élites to strengthen the position of the MNCs.(1) It is not simply that income distribution is worsened by employing highly paid executives; it is that these executives, loyal to the MNC and imbued with its philosophy of commercial success, lose all national aspirations, and cooperate with various government officials, local businessmen and professionals (all of whom are drawn into the glittering ambiance of the large corporations) to promote the commercial aims of the foreign firms. This is the process known as the "satellisation of the bourgeosie" in the dependence literature, and it is regarded as the most powerful force against national, as opposed to dependent, development. It serves to import foreign cultural and consumption patterns, while reducing the freedom of action of the local economy by creating powerful vested interests in favour of MNC production, and it strengthens the forces perpetuating the existing distribution of income and wealth.

79. Second, by virtue of their dynamism and market power, MNCs can, if allowed to do so, capture the leadership in all the industries in which they operate. Thus, while stimulating competition in the initial stages, they can end up by suppressing local entrepreneurship and reproducing in the host country the oligopolistic pattern of competition which exists abroad. If local enterprise is regarded as desirable, therefore, the free entry of MNCs can prove very harmful; it is, after all, difficult to imagine local firms in developing countries (and in many developed ones) standing up to the full force of competition from multinational giants. While some people may regard the resulting integration of the local economy - or the relevant part of it - into the international framework of MNC operations as desirable, certainly its social and political benefits are questionable, and its economic costs heavy.

80. Third, the close integration of the subsidiary with the parent company enables the MNC to operate a financial strategy to maximise its post-tax earnings by the use of transfer prices, various fees and royalties, and the direction of trade and payments through tax havens. This is discussed further in the section on the balance-of-payments effects, but it is relevant here to note the significance of tight organisation to the manipulation of inter-company accounts. (2)

<u>Effects of MNCs: marketing</u>

The importance of marketing in the growth of oligopolistic enterprise can hardly be over-emphasized. The MNCs are the masters of this art, and employ the most powerful techniques of persuasion, distribution, attraction and creation of demand to sell their products.(3) The benefits of the MNCs in terms of marketing are as follows.

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(1) See Carlsen and Neerso, 1973, and Weisskopf, 1971, on India, and Frank, 1972, on Latin America.

(2) See Robins and Stobaugh, 1973, and Fleck and Mahfouz, 1974. Recent Watergate investigations have revealed the use of several channels by MNCs to direct funds for political purposes in the U.S. via subsidiaries in Switzerland, Panama and the Bahamas. See <u>The Times</u>, London, 15 July, 1974, p.15.

(3) See Barnet and Muller, 1974, and Langdon, 1974, on the use of marketing strategy in developing countries.

82. First, the MNC can provide market-channels to export. The existence of an international framework of distribution can be immensely valuable in breaking into markets which would ordinarily be closed to enterprises from less-developed countries. The success of MNCs in exporting manufactured exports from Latin America indicates how important this can be, especially if the production of the subsidiaries is properly enmeshed with the production and sales of the parent firms. Furthermore, MNCs can provide the marketing know-how to break into new markets, even without using the existing channels.

83. Second, MNCs can help to develop the internal distribution framework in developing countries, by organising retailers, improving information networks, and creating a better infrastructure to move goods from factories to consumers.

84. Third, they can raise the standard of packaging and advertising, raising the consumers' 'welfare' not only directly by their own sales but also by forcing local competitors to follow suit.

85. The costs of MNC marketing should be apparent from previous discussion. First, it is difficult to regard taste creation, oligopolistic advertising and fancy packaging as adding to 'welfare' in a poor country: on the contrary, this may be considered as a prime force in distorting tastes, creating undesirable demands and reinforcing the most conspicuous effects of a bad distribution of income. The costs of marketing can be very high, even in such essential products as medicines,(1) and are met by the consumer whose 'welfare' is supposed to have been increased. To a large extent, of course, high marketing costs are inherent to any private enterprise system, but it is undesirable that the growth of enormous oligopolistic corporations, with different units of the same firm 'competing' with each other, has added greatly to the costs of marketing without raising its beneficial informational content.

86. Second, the fact that MNCs have an overwhelming superiority in marketing, owing to their established brand names, their highly-developed advertising tactics, their willingness to invest large sums in creating or extending their market power, and to the bias on the part of consumers in developing countries in favour of foreign brands implies that they can crush local enterprise which may be equally efficient in terms of production. Again, if the promotion of domestic enterprise is considered _per se_ desirable, this can constitute a heavy cost for the host economy if MNCs are allowed to operate freely. The responsibility for marketing costs lies with the basic mode of operation of MNCs.

Effects of MNCs: capital The world's largest enterprises can command enormous resources for investment, both internally and from other institutions, which can be of immense benefit to recipient developing countries. Not only do MNCs have knowledge of an access to capital markets all over the world, they have privileged access and can obtain funds on better terms than smaller firms. Furthermore, the recent expansion of financial institutions internationally means that firms and banks which have long-established links in the home countries can

(1) See Lall, 1974c. In the U.S. the cost of marketing pharmaceutical products can be as high as one-third of the value of sales, with little 'benefit' to the consumer.

extend these links, and the advantages contained in them, to other countries.

88. The benefits to host countries are: first, simply the provision of investible resources, in foreign exchange, which would not otherwise be forthcoming. Given the various 'gaps' which confront developing countries, especially of hard foreign exchange, this is clearly one of the major contributions that host countries look for from MNCs.

89. Second, the inflow of MNC capital may also stimulate the inflow of aid from official agencies, since the aid policies of many leading capitalist countries are based on the attitudes of host countries to their firms.

90. Third, the fact that MNCs can raise funds abroad at lower rates of interest or for longer periods than other enterprises means that the servicing cost to host economies is lower.

91. Fourth, it is often claimed that foreign capital can mobilise local savings which would otherwise remain idle or be invested in less productive activities (like luxury housing or foreign exchange).

92. Fifth, by entering local capital markets MNCs can offer a wider investment choice to local investors and stimulate the growth of the capital markets.

93. The costs, on the other hand, can arise in a number of ways. First, it is widely recognised that private investment is a relatively expensive way to acquire foreign capital. Not only does the rate of profit exceed the rate of interest in world capital markets, the initial stake of the foreigner goes on increasing through reinvestment and the foreign liability of the host country goes on mounting despite heavy annual servicing. It must be remembered, however, that foreign private investment is not generally substitutable by aid or loans by developing countries, and the contribution of foreign investment is supposed to be much broader than simply its financial component. Whether or not this non-financial contribution is worth the extra cost is another matter, and must be judged from case to case according to the various considerations mentioned elsewhere in this paper.

94. Second, the actual capital contribution of MNCs is not as large as may be imagined. We have noted in our description of the scope of MNCs that the proportion of total funds provided by the parent company is small, and is deliberately kept low; for U.S. MNCs, for instance, it only came to 12% of the total in manufacturing for the period 1966-70. The privileged position of MNCs enables them to 'gear' themselves highly on locally borrowed savings, sometimes even on official loans, which in turn increases the return on their own capital, providing profits for both reinvestment and for dividend payments. Thus almost 90% of the U.S. MNCs' funds came from locally generated earnings (only partly on the basis of their own capital) and from local savings. This must be offset by the benefit mentioned above of directing savings from less to more productive uses, though this may not apply to institutional funds.

95. Third, even the direct capital contribution of parent firms is in many cases not in the form of cash but of capital goods or capitalised intangibles (know-how or brand names). Both of these payments in kind are subject to extremely arbitrary valuation, and can easily be exaggerated by the MNC to raise the apparent value of their investment. It has,

moreover, often been found that the capital goods provided by MNCs are second-hand machines whose value has already been fully depreciated at home, and whose marginal cost to the firm is very low.(1) While the responsibility for such practices may partly be laid at the government's feet for its offering protection against world competition, and so permitting inefficient practices, the issue of protection is a larger one involving different considerations (mentioned below) and the rate of effective protection is often determined by the MNC itself. Certainly the valuation of intangibles has little to do with government industrialisation policy, and MNCs can easily capitalise technology which is out-of-date and readily available in the host country. In any case, the MNCs must bear the larger part of the responsibility for engaging in such practices deliberately when the host governments are not well-informed or incapable of checking all their prices or accounts properly.

Effects of MNCs: productive-efficiency

It is often claimed that foreign enterprises are more efficient in their operations, by virtue of the several advantages they have, than competing local enterprises. Certainly they are often more profitable, and the fact that they are parts of highly successful, sophisticated and technologically advanced international enterprieses creates the presumption that they would also be more efficient. Profits are, however, not a valid measure of productive efficiency when the enterprises are highly oligopolistic and possess so much market power; furthermore, the benefits of efficiency are themselves dubious when the products are not particularly desirable.

97. Let us, however, put aside these problems for the moment and consider investments which are considered beneficial for a developing economy. Let us also ignore the various costs of MNC operation mentioned above and concentrate on the conventional economic problems of efficiency.

98. First, are subsidiaries of MNCs in developing countries really more efficient than their counterparts? Evidence on comparative efficiencies in production is naturally difficult to gather and hard to interpret. The little data that do exist do not indicate any strong relationship of efficiency with the extent of foreign ownership, though there are faint indications that in a few industries in some countries foreign affiliates may have been more productive.(2) In the course of research, conducted under the direction of the present author for UCNTAD, on the social income effects of foreign private investment in various developing countries, (3) no significant relationship was found between the net effects of sample firms and their ownership patterns, size or age. Of a total of 159 firms, of which 53 were in India, 11 in Jamaica, 8 in Kenya and 15 in Malaysia, nearly 40% were found to have negative effects on social income, on the application of a simplified method of social cost-benefit analysis. The method, though subject to many qualifications mentioned in the summary report (and limited by excluding the several factors discussed above, which cannot really be quantified), had the merit of showing why particular investments were more desirable than others when measured at international prices.

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(1) See Kidron, 1965, and Vaitsos, 1970.

(2) See Reuber, 1973, p.237

(3) Summarised in Streeten and Lall, 1973.

99. The most important determinant of the comparative desirability of investments was found to be the effective protection granted to them. The higher the level of such protection, the more inefficient the project in international terms and the worse its net income effects. The second determinant was the amount of local capital employed by the firm: as we mentioned above, the higher the amount of local 'gearing' by the foreign investor, the higher his own profits and the greater the cost to the economy. The third was the net direct balance of payments effect of the investment, which we shall discuss in the next section. Let us pass on to the next problem of efficiency and consider these points in more detail.

100. Second, if the level of effective protection is important in determining welfare, what is the justification for adopting protective policies and who is responsible for the level of protection obtained? There is a vast literature on the pros and cons of protection in developing economies with the critics pointing to the obvious cost of subsidising inefficient production and the supporters to the less obvious 'external' benefits of promoting domestic enterprise and creating a broad industrial base. Perhaps both sides have a point: too much emphasis can be laid on externalities and so provide an excuse to set up industries without the least regard to comparative advantage; on the other hand, protection has played a vital role in the industrialisation of every major world economy, and clearly one cannot argue that 'externalities' are unimportant or illusory.

101. Even if we grant the desirability of a policy of selective protection, it is far from clear that most governments in developing countries have followed a rational policy in this respect. They have often granted protection by means of prohibititive tariffs or quota restrictions to industries which cannot be efficeintly operated in their economies, and to this extent they are responsible for the poor performance of many investments. The UNCTAD studies show clearly that many projects should not have been undertaken at the social costs involved, and the fact of the ownership of the investment being foreign or local is largely irrelevant to the matter. Largely, but not completely: if it is the case that the MNC can extract a higher level of protection than a comparable local firm, then the foreigner also shares part of the responsibility.

102. There are three reasons why an MNC can extract a relatively high level of protection:

1. Its greater bargaining power vis à vis the government because of its monopolistic hold over technology or other resources.

2. Its ability to conceal its true costs of production by inflating the value of intra-firm imports and various other items, simultaneously securing higher protection and remitting untaxed profits abroad.

3. Its ability to dominate the local market and so set higher prices, in cases where protection is given by means of prohibition of imports.

103. It is clear that these attricutes of MNCs facing developing countries can affect the protection outcome in fairly subtle ways which are difficult to check or control. There are

also other means of applying leverage on local governments which are perhaps less commonly used - such as bribery, diplomatic pressure from home governments, collusion with domestic producers - but which may present a potential danger.

104. Third, an issue related to that of market power but not involving protection arises when the industry is so structured internationally that its prices are too high with reference to its costs, so that it is able to inflict unwarranted social costs on all its host countries. The best example of this is the pharmaceutical industry, one of the most multinational of all modern industries, in which the structure of R and D (backed by patent protection), marketing, and profitability is such that the prices of drugs is excessive by almost any standard, and yet small competitors, selling at far lower prices, are unable to make any headway into the larger firms' domination of the market.(1) International comparisons of prices and costs are irrelevant here, but an examination of the internal working of the industry reveals that MNCs can prove extremely costly.

105. Fourth, the operations of MNCs in developing countries are often characterised by the imposition of various restrictive practices with regard to exports, imports, technology, prices and production.(2) The best known of these are export-restrictive clauses in technology contracts (or informal restrictions on subsidiaries) and tie-in clauses for the purchase of raw materials, but there also exist such provisions as the free acquisition by the MNC of the results of any innovation carried out by the local partner, the monopolisation of retail outlets, international cartels, and restrictions on production levels. Whether such policies are pursued by MNCs in response to government policies in particular countries or in pursuit of their overall business strategies is difficult to say; probably both factors are important. In either case, the freedom of action of the host economy is diminished, and the costs of foreign investment raised, as compared to a situation where MNCs are not present.

106. Fifth, on the benefit side of the scales, we can add the effects of training and experience on the skills of the employees of MNCs.(3) These benefits can range from the training of unskilled labour, and their inculcation with the discipline of factory work, to the improvement of the skills of technicians, managers and accountants. These are useful to the host economy if they spill over to other activities outside the MNC, by means of employees transferring to other jobs or simply by emulation by other firms.

Effects of MNCs: balance of payments

The balance-of-payments effects of foreign investment can be considered at two levels: direct and indirect. The direct effects comprise imports of funds and exports on the benefit side, and imports of capital goods and raw materials, and exports of profits, interest and technological payments on the cost side. Indirect effects also include the final balance-of-payments impact of local sales (via import substitution) and local purchases, as well as the use of local capital. A comprehensive survey of all the effects leads

(1) See Lall, 1974c.

(2) See UNCTAD, various, on Restrictive Business Practices, and Vaitsos, 1970.

(3) See Reuber, 1973, Chapters 5 and 6.

to the social cost-benefit evaluation mentioned above; we shall not discuss this here, but concentrate on direct effects.

108. The net direct balance-of-payments effects of most foreign investments, with the exception of those which are specifically export-oriented, are negative. Of the UNCTAD sample of 159 firms, for instance, 91 per cent had negative balance-of-payments effects, with Jamaica and Kenya showing relatively better results than the others. The general direction of the net effect is not at all surprising, since most of the investments in the sample were import substituting: it may, however, be worth looking at some of the specific components in detail to throw light on the policy issues.

109. Exports. Though the new phenomenon of export-oriented foreign investments in less-developed countries, particularly in the 'export processing zones', has caused considerable interest recently,(1) the effects of such investment are not very wide-spread, especially in Commonwealth countries. (2) Only 26 firms in the UNCTAD sample (of which 5 were in Jamaica, 6 in Kenya, 3 in India and 4 in Malaysia, and the rest in Colombia) exported more than 10% of their output; and only 5 (of which 3 were in Kenya and 2 in Jamaica) exported more than 50%. Even for these firms the exports were directed mainly at neighbouring markets; only one firm in Jamaica exported its entire output to its parent firm in a developed country. There was no 'sourcing', the production or processing of particular components in a low cost area, evident in the sample; clearly this is localized to a few areas in the Far East and Latin America, with only Singapore and Hong Kong among the Commonwealth (and Empire) region being included.

110. A number of countries are now trying to promote 'export processing zones' as a part of their drive to increase their exports of manufactures. The attraction of MNCs for this particular activity demands the provision of very liberal tax laws, cheap and skilled labour, minimum regulation and a stable political environment: attributes which many developing countries cannot, or may not wish to, provide. The benefits of such zones are not very large, since little is purchased domestically, tax payments are very low or nil, and the employment offered is not great in absolute terms. However, it seems an attractive proposition in that it "costs nothing" and provides some employment,(3) and perhaps some technological spillovers (though this is doubtful in view of the labout-intensive nature of the activities).

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(1) Helleiner, 1973.

(2) Hone, 1974, points to the role of international buying groups and large retailers in developed countries rather than MNCs in increasing exports of Asian manufactures.

(3) There are indications, however, that the social cost can be substantial in terms of poor wages and appalling living conditions for workers in these areas (from information supplied privately to the author), while the political costs of dependence on the MNCs can also be quite high (this is argued for Mexico by Fernandez, 1973).

111. As far as the export of domestic-market-oriented investment is concerned the major problems are the high costs of production and the global marketing strategy of the MNCs. The former is outside the scope of our discussions; the latter is very difficult to resolve. The increased exports of one host country may mean decreased exports of another; the final outcome may simply depend on the relative bargaining positions of the respective host countries, with the weaker ones losing to the stronger. This is, however, looking very far ahead; at the moment individual host countries may still be able to increase their exports substantially by making competitive producers expand at the cost of producers in developed (parent) countries. The existence of export restrictions hampers this policy, and is therefore reprehensible.

112. Foreign Capital Inflows. The majority of firms with foreign investment in the UNCTAD sample (60% of 147 firms) were taking out more in terms of profits than they were putting in in terms of new investments. This is, however, not a very meaningful comparison, for it tells us nothing about the overall effects of the investment. What we should be concerned with in this context is the financial strategy of the MNC, especially i. the value of capital goods or capitalised intangibles imported in lieu of foreign exchange as equity investment, and ii. the gearing of the foreign investment to local savings. We have little hard evidence on the former, by the nature of the problem; on the latter, we can test for the 'net financial contribution' of foreign investment, by comparing the actual cost of servicing foreign capital with the cost (hypothetical) of providing the investment from alternative uses. For the UNCTAD sample, for instance, we find that over 40% of the firms had negative net financial effects, and would have been cheaper to finance locally. The more profitable was the foreign investment, clearly the more the host economy lost by providing finance in the form of loans rather than equity. Such considerations are leading many countries to restrict local long-term borrowing by MNCs and to force them to raise local equity participation.

113. Profit and Other Outflows. These comprise not only declared dividends, but also many sorts of hidden transfers in intra-firm transactions, such as transfer prices, royalties, and fees of various sorts. The most effective channel is transfer prices, which are applicable to a fairly high value of imports and are extremely difficult to monitor.(1) However, the other channels are not marginal. Royalty payments to parent companies by subsidiaries are quite large, and are often simply a way of minimizing tax payments on overall remittances. Countries like India now prohibit the payment of royalties by wholly owned subsidiaries for this reason, and closely watch the negotiation of other technological contracts, sometimes setting limits on the rates of royalty payable for various kinds of technology. There is, however, some evidence that local purchasers of technology collude with foreign firms to enable them to charge higher effective rates than are officially permitted (by encouraging overpricing of imports, etc.), making regulation and bargaining more difficult.(2)

(1) See Lall, 1973, and Vaitsos, 1970. The U.S. Tariff Commission, 1973, frankly says, "The chief strategy of tax minimisation by multinational companies is manipulation of transfer prices", p.133. See also Fleck & Mahfouz, 1974, on the use of tax havens.

(2) See Carlsen and Neerso, 1973.

It is unfortunate that many host countries seem to be ignorant of, or find it too hard to tackle, the problems of transfer pricing; we shall return later to the possibilities of action here.

114. This concludes our review of the costs and benefits of MNCs. The argument has necessarily been very compressed and sketchy, but we have tried to cover all the different aspects of this vast subject in a short space. The next section tries to sum up the various arguments, insofar as they can be coherently put together.

CHAPTER II THE NET EFFECT ON HOST COUNTRIES

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115. Unfortunately, most discussions of the effects of MNCs end up being a catalogue of various pros and cons; we are very much at fault for doing this, yet what is the alternative? It would be presumptuous to sum up the entire constellation of diverse effects and present a 'net effect'; it would be equally unsatisfactory to leave out the unquantifiable and 'non-economic' effects and concentrate solely on things which can be measured. The formulation of any policy towards foreign investment and MNCs must, obviously, depend not only on the use of orthodox economics but also, perhaps even more so, on sensitive social, political and cultural judgment.

116. This leaves everything at too vague a level. Foreign investment has to be acted on, choices have to be made and policies have to be implemented. Let us, therefore, try to rearrange the factors determining the costs and benefits in a way which provides a better tool for policy formulation. While this does not tell us whether MNCs as such are a 'good thing' or not - any such statement must be treated with great caution - it enables us to see at what level the different effects can be dealt with in practice.

117. There are basically four levels at which the effects of MNCs can be analysed: the general level of the country as a whole, the sectoral level, the project evaluation level, and the bargaining level.

The general level

The general effects of MNCs entry (assuming that they are let in freely) depend primarily on the size and scope of their activities in the host country, which in turn depends on the policies of the government in attracting them (directly by offering concessions or indirectly by protecting domestic production) and on the attributes of the economy (the size of the market, availability of labour, stability, natural resources). It must be noted that the 'activities' of MNCs must be defined broadly: the prime concern is, of course, the size of their investments in relation to total investments in the economy and their dominance of local industry, but their influence can also be felt through sales of technology, management contracts, local partners and the part of local economic activity benefitting from their presence. In judging their effective political and social influence, therefore, we must look at the entire collection of producers, workers, officials and professionals who are dependent on them to some extent, and who are prepared to act in their interests.

119. The effects of MNCs at such a level are on: income distribution; the composition of output and the pattern of investment; institutions, infrastructure and markets; the form of technology used and the local effort to innovate; the attitude of the local élite and bourgeoisie to foreign sociocultural patterns; the policies of the government regarding trade, industrialisation and investment; and the relationship between the host and home countries.(1) We are not arguing that MNCs determine these things or even that they are the most important influence on them: all we are saying is that they can affect them, to a greater or lesser extent depending on their total presence and on responsive elements in the host economy. Thus, a developing country with a large foreign presence dominating important sectors of industry and trade, will probably come to have an economy much more closely geared to consumption patterns abroad, using more foreign technology, having more foreign financial institutions and fragmented markets, supporting foreign enterprise (by not protecting domestic entrepreneurs) more its policies, and having closer political ties (with the home country or countries) of the MNCs, than one which has a small foreign presence. There is no value judgement yet: it is simply a matter of the interplay of economic and other social forces.

120. We have argued that the pattern of development engendered by a large and unrestricted inflow of MNC capital, the syndrome of 'dependent' development, may not be considered very desirable for the host countries' social welfare. This _is_ a value judgement, as was made explicit at the start. It follows that for policy purposes efforts must be made to diminish the less desirable aspects of the general effects of MNCs; we shall return to this in Part IV.

The sectoral level

The entry of MNCs into a particular industry can change a number of factors for all the firms in it, without affecting other industries significantly. At this level the most important effects can be: on the range of output produced (product differentiation, model changes, new products); local entrepreneurship; supplier industries; marketing practices (packaging, advertising, retailing); technology; organisational practices; access to capital; degree of market concentration; and productive efficiency. The general effect may be beneficial or otherwise, depending on whether the entry of the MNCs improves the quality of output and efficiency of the sector, and of its suppliers, as a whole, without destroying too much local enterprise, depriving them of capital, inducing inappropriate technology or wasteful oligopolistic marketing practices and leading ultimately to greater concentration. This in turn depends on the strength and competiveness of local enterprise; if it is already monopolistic, oriented to foreign technology and relatively inefficient, the effect of MNC entry may be beneficial; if it is reasonably efficient (or has a chance of becoming so), able to adapt technology to local needs, and not too wasteful in marketing, the entry of MNCs may well cause net harm.

The project evaluation level

The net effects of having a foreign firm undertake a particular investment depend upon: the viability of the project as such and the amount of effective protection it needs

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(1) The specific economic effects of the investment on the economy and its balance of payments should be considered at the project level.

(determined by scale factors, supplies of materials and management), the availability of the technology (assuming the most appropriate has been chosen) without foreign equity, the comparable ability of local enterprise, the relative costs of foreign profits vis a vis local capital costs, the exporting abilities of the foreign and local alternatives and the benefits/costs of being integrated with a world-wide enterprise. There are, in effect, two distinct decisions to be made at the project level (though they may have to be taken simultaneously): whether or not the investment is worth undertaking at all, and whether it can be undertaken by local enterprise without foreign investment.(1) The comparison of hypothetical alternatives is obviously a tricky task, since the outcome itself depends on how efficiently controls can be implemented and how good a bargain is struck (considered below), but in general the benefits of foreign investment are greater the scarcer the technology, the more complex the task of organising production and backing-up the technology, and the more productive is local capital in other uses, while the costs are greater and the more technologically efficient and productive is local enterprise and the higher the quasi-rents earned by foreign capital. Since we have assumed that there is a presumption in favour of promoting local enterprise, we can propose that when an investment can be undertaken locally without foreign capital (and preferably without foreign technology) it should be preferred to one with some foreign capital (and foreign technology), which in turn should be preferred to one with complete foreign ownership (as part of an MNC).

123. The most powerful argument in favour of having an investment undertaken by an MNC is its combined provision of capital and technology, and the likelihood that the technology will not be available elsewhere. The force of such an argument varies from case to case, however, and in many instances the technology may be necessary for the host country, or it may be already there, and the financial contribution may be obtained at too high a cost.

The bargaining and regulation level

Once it has been decided to accept investment by an MNC, the host country can increase its benefits considerably by an appropriate strategy of bargaining and regulation.(2) The net benefits which a foreign investment yields to the host economy at the micro-level consist of three things - taxes, lower prices and increase in the net income of factors of production - all of which can be increased by various means. Given that the tax rate is fixed, the tax receipts of a host government can be increased by checking all the channels of clandestine transfer of funds and the removal of special concessions. Consumption benefits can be raised by negotiating the lowest possible rate of protection, or, in the case of internationally high prices, the negotiation of low selling prices. The net receipts of local factors can be increased by having a higher percentage of local equity, lower local gearing, more labour-intensive techniques, more assistance to local suppliers, and so on.

125. The most important problems on which bargaining should concentrate are transfer prices, the kind and cost of technology, the extent of protection, the amount of local ownership,

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(1) For a detailed discussion of the methodology see Streeten & Lall, 1973.

(2) See Streeten, 1973.

and the amount of output exported. There are also some other points - like the training to be given to labour, the means of resolving disputes, the structure of ownership over the longer run, the sharing of new technology and the use of restrictive practices - on which mutual agreement can be reached by a bargaining process before the investment is made or after its inception.

126. On all these points the balance of advantage is delicate, and depends greatly on the skills, advantages and experience of the negotiating parties. If everything is left to the blind working of market forces, the MNC is almost bound to get the better of the situation, since its immense skills and economic powers will let it ride roughshod over local competitors, partners, or minor government officials. If the government intervenes, there is some redress in the balance, but the MNC may still retain the upper hand unless a rational, coordinated and intelligent policy is conceived and honestly implemented. Let us turn to discuss these policy problems at greater length.

CHAPTER IV MNCs AND POLICY ISSUES : the attraction of foreign investment

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127. The policy considerations of developing host countries *vis a vis* MNCs may be divided into two broad groups: those concerning the attraction of MNCs, and of foreign investment in general, to a particular country, and those concerning their evaluation, control and bargaining by the host government.

128. The attraction of foreign firms, large and small, to a particular economy depends on a combination of economic, strategic and political factors,(1) some of which are under the control of the host governments and others are not. The one which are not under the direct control of host governments are considered below.

129. First, internal motivations and determinants of MNC investment. We have seen in an earlier section of the paper that the factors which determine why MNCs choose to grow by means of direct investment abroad are complex, and to some extent outside the influence of individual host countries in the developing world. The structure of international oligopoly, the growth and nature of technology, the developing marketing and organisational advantages of multinationals, are all factors internal to the industrial evolution of capitalist enterprises, and are largely determined by forces in the developed world. While host countries can by their policy affect the MNCs' perception of profits, or security, in particular markets (which we consider below), they can hardly affect such determinants of investment as the product cycle, the nature of organisational change, the size and growth of their own markets, the availability of natural resources or even their own long term stability. Yet these factors, especially the nature of the market and stability (economic, political and social) are crucial to the investment decision; MNCs are not attracted to small, stagnant markets, unless compelled to serve them by threats of pro-

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(1) For recent surveys of empirical work on the motivation, and determinants of foreign investment see Hufbauer, 1973, and Dunning, 1973.

tection, and they are, by the nature of their planning and operational requirements, lovers of the predictable. While a certain amount of 'normal' business risk, as may be raised by devaluation, labour problems, inflation, or anti-monopoly legislation, is taken for granted, certain other risks, such as the erratic imposition of restriction, changes in ownership, price controls, exchange restrictions and nationalisation, are obviously deterrents to investment.

130. Whatever the socio-political implications of the spread of MNCs, it is important to note that MNCs themselves are extremely flexible as regards ideology and government: they have shown themselves willing to operate in the most restrictive of environments and to collaborate with public sector firms, and their obvious preference for control and free entry has not prevented them from entering into a variety of different arrangements with host governments and local firms. What is relevant in this context is, therefore, not so much the basic attitude of host governments as the predictability and stability of the conditions laid down for MNC operations. In other words, a host government can attract MNCs, even if it lays down stringent conditions, if it is accepted that it will stick by them in the future, while a liberal or welcoming government will not attract foreign capital if its prospects of survival are dim. However, these matters are to some extent inevitably outside a particular government's control, and act as constraints on the policies which it can adopt.

131. In a similar manner, the internal motivations of MNC expansion,(1) such as the supply of cheap capital, liquidity or a quest for diversification, are not directly controllable by host governments. The inner processes of investment decision in an MNC are complicated, and subject to various different pressures, not all of which appear 'rational' to the economist;(2) the outcome can vary from firm to firm even in very similar external circumstances, so affecting the flow of resources to particular areas.

132. Second, home country policies - The nature of incentives, restrictions, insurance, political support offered by, as well as the general economic policies of, home countries can influence the direction and extent of the flow of investment abroad. Many countries offer their firms more liberal conditions for investing in less-developed areas as compared to other areas; there are also various investment guarantees, information schemes and fiscal incentives in existence for this purpose,(3) which can ease the flow of capital. Political support for direct investment may come in the form of pressure exerted by the home government on the host countries to extract more favourable conditions; this can be backed up by diplomatic, aid and military pressures.

133. The general economic conditions and policies of home countries can also affect foreign investment, though often in contradictory ways. An economic boom, for instance, may reduce the maount of capital available for investment abroad,

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(1) On diversification as a means of reducing risk, see Paxson, 1973.

(2) Aharoni, 1966.

(3) For surveys see OECD, 1970, and Delupis, 1973.

but it may also add to the profits of large firms in the most dynamic sectors and so encourage overseas expansion. A strong trade union movement can, similarly, induce firms to look for cheap or pliable sources of labour abroad, but it may also force government action to reduce the 'export of jobs'. The tariff policies of the government may encourage the setting up of particular plants and processes abroad (as with the policies of the U.S. government encouraging the growth of 'sourcing' in recent years)(1), while discouraging the growth of other manufactured exports from developing countries. Again, all such factors are not directly influenced by the policies of developing host countries, and may, if at all, be affected only by means of indirect diplomatic pressure on the home government of MNCs.

134. There are, however, a number of other factors which influence MNC investment which are under the control of host governments, and can be used to attract their capital.

135. Provision of Information A number if less-developed countries have established investment promotion centres abroad and in their own countries to provide information on the opportunities for foreign investment in their economies(2). These centres can supply up-to-date economic data as well as details on the relevant laws and procedures on investment by foreigners; in some cases they can also carry out a preliminary screening of potential investors, discouraging those which are clearly inappropriate and encouraging those which are desirable.

136. Fiscal and Other Incentives While some developing countries do not provide any special tax concessions to MNCs investing in them, many mainly small countries which compete with each other for foreign capital, offer fairly substantial incentives. All the surveys which have been carried out on this show that MNCs investment decisions are not significantly influenced by fiscal or financial incentives(3), and that host governments' unnecessarily lose revenue by offering temporary concessions. This is not surprising in view both of the fact that many concessions simply add to the revenue of the home countries, as well as of the long-term factors which determine MNC investment abroad, and it is perhaps difficult to understand at first sight why governments offer fiscal incentives. The following factors may, however, bear upon their decision: first, the offer may be construed as a gesture of good faith and welcome, and may be particularly significant for a country which has changed its attitudes on foreign capital from a hostile to a friendly one; second, it may improve a particular country's position as one competitor among many for scarce foreign capital; and third, certain types of foreign investor, especially the 'foot-loose' ones looking for cheap bases for 'sourcing' may pay more attention to fiscal incentives than others.

137. The solution to these conflicting factors is two-fold: the formation, on the one hand, of common foreign investment policies among groups of small countries with regard themselves as competitors, so as to cut out special incentives on a joint basis, and the granting, on the other, of special incentives to 'foot-loose' MNCs to set up export industries

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(1) See US Tariff Commission, 1970.

(2) For a critical but constructive evaluation see UNIDO, 1973.

(3) See Reuber, 1973.

but not extending them to other investors. The former is difficult, since it requires cooperative political effort; but it is not impossible, as the formation of the Andean Group on the West coast of South America shows. The latter is entirely within the power of the host government, and should, where possible, be implemented by larger host countries which attract foreign capital on their own merits.

138. Stable Policies The announcement and enforcement of a clear set of rules regarding foreign capital would be of great help in attracting MNCs, especially if its sustained over a long period and is backed up by comprehensive company laws, auditing systems, tax agreements, employment regulations, etc. which are stable and regarded as acceptable by MNCs. The ideal from the MNCs' point of view would probably be an internationally uniform set of statutory and legal requirements, which would not be arbitrarily changed or repudiated by particular countries in difficult times and which would be reasonably stable over a long period. If this is not feasible, the unilateral adoption of stable policies would still be beneficial, even if the policies themselves were fairly restrictive.

139. International and Bilateral Agreements(1) The attraction of investment in developing areas can be enhanced by international action of the sort noted above, as well as by the negotiation of double-tax agreements, international arbitration arrangements in case of conflict, the provision of information by international agencies to both parties, and the international taxation and protection of MNCs. Insofar as resentment of MNCs arises from fears of loss of control by individual nations, it may be resolved better by international action than by a haphazard proliferation of national controls. Failing international agreement, however, it may still be feasible and desirable to formulate bilateral arrangements between host and home countries on specific aspects of direct investment such as taxation, prices, arbitration, disclosure, expropriation, and so on.

140. Protection The single most important factor inducing the growth of foreign investment in developing countries has been the imposition of import restrictions and the fostering of import-substitution activities by their governments. The interaction of these protective policies with the oligopolistic market strategy of MNCs has led to a 'follow-the-leader' pattern of international investment, with the entry of one firm causing others to imitate it within a relatively short period, regardless of cost and scale consideration(2). The result, in terms of efficeincy and prices, has not often been very beneficial for the host countries, but it is evident that the existence of this inducement furnishes a powerful tool for bargaining to them which has not been efficiently handled, but which is great potential in the future (we shall return to this below). The efficacy of protection can be increased by enlarging the area which is protected, by regional integration, or less ambitious cooperative policies, between host countries acting in concert.

141. Labour Policies For such investments as are attracted to developing countries by the prospect of cheaper labour, the government concerned can undertake policies to provide this particular input in an efficient and mutually satisfactory fashion. First, it could build infrastructual facilities

(1) See U.N. 1973.

(2) See Knickerbocker, 1973.

(housing, sanitation, hospitals, etc.) to ensure that the workers are properly treated in the zones in which investments take place, and not simply drawn into urban slums. Second, it could train them in order to increase their skills relative to workers of other areas competing for the investment. Third, it could legislate on employment and wage conditions, and encourage unionisation, to facilitate the development of proper labour relations within the MNCs investing there. Such organisations as the I.L.O. can provide assistance in the formulation of humane, uniform and retional labour policies(1). It should be borne in mind that while too stringent an interpretation of wage and employment requirements by the host government can deter prospective investors, a neglect of this area can have even worse results in terms of the workers' welfare.

142. Bureaucracy However well-planned the policies of the government and however beneficial their effects in theory, an inefficient complicated or corrupt bureaucratic structure of enforcement can vitiate much of the purpose of the effort and deter prospective investors from entering the country. We shall return to these problems below; in the present context it is sufficient to note that a streamlining of procedures, a minimisation of red tape and a clarification of the whole gamut of regulations to be run can by itself increase the attractiveness of a country to MNCs.

143. To sum up the present discussion: the attraction of a host country to the MNC depends partly on objective economic and political conditions which are largely outside the government's control, and partly on policies followed by home and host governments. The host government can draw more foreign capital to its economy by measures which increase the rate of return to the investor (by means of protection or fiscal concessions), impart more information and minimise administrative problems, raise the value of inputs (by labour training) or the size of the market (by regional integration), and render the environment more stable and predictable. While the exact mix of policies designed to promote the flow of MNC investment depends on many other factors, some of which are discussed below, we believe that excessive protection and granting of concessions are not desirable policies; it is far better to have efficiently administered, explicit and stable 'rules of the game' for dealing with MNCs, and, where feasible, to increase the size of the market, which also raises the hosts' bargaining strength.

144. We have not so far distinguished between the attraction of MNCs as opposed to smaller foreign investors. In general the policies mentioned above apply to both, but the relevance of particular measures will depend upon whether the investor is a large firm with an international organisation and world-wide outlook, or a firm with relatively small financial and managerial resources, oriented primarily to its home market, and inexperienced in dealing with alien governments. The MNC is by virtue of its size, experience and philosophy much more willing to take risks, adapt to different environments and compare the advantages of various possible investment locations, than smaller foreign investors. This renders the multinational in some ways easier to attract and deal with than the smaller firm, and much more difficult in other ways. It is an easier customer

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(1) See ILO, 1973, for a useful review of the problems of MNCs and social policy.

because it needs relatively less assistance from host governments in terms of information, it pays less attention to minor administrative problems and normal business risk, to differences in laws and regulations and even to political instability. It is, on the other hand, more difficult precisely because it can choose another site, play off one government against another, and, for 'foot-loose' firms, scan the countries for fiscal incentives.

145. The distinction cannot be pushed too far, but it may be safe to generalise that the greater the economic attraction of a country (in terms of its market and the entry of competing oligopolist's) the less will the factors mentioned above affect the investment decision of the MNC, while the smaller the economic attraction of a country the more will they become relevant. Furthermore, the smaller foreign investor will generally require more wooing by the host government but may be able to affect the terms of its entry less, while the multinational may require less wooing but will be able to impose more rigorous terms on the government.

146. The attraction of foreign capital is, however, not the only problem facing host governments. We have argued that the pervasive nature of MNCs requires action by host governments at various levels; some of these could deliberately restrict the scope of MNCs' entry and operations, while others may unintentionally deter otherwise desirable foreign investment. If the 'rules of the game' were, however, worked out in sufficient detail and implemented efficiently, it is likely that the amount of desirable MNC investment would not be too adversely affected over the long-run. Certainly the final result would be better than the patchwork of restrictionist and encouraging policies which are being built up now, on an ad hoc basis under pressure from various forces, without a clear idea of what factors are involved and what end is to be achieved. Let us, therefore, consider the requirements of policies of regulation and control and try and construct a more coherent structure.

CHAPTER V — MNCs AND POLICY ISSUES : evaluation, control and bargaining

147. It will be helpful at this stage to revert to the distinction between the four 'levels' at which MNC effects were discussed (in Chapter III). The taxonomy is mainly for analytical purposes. It is not suggested that the policy issues at each 'level' should be clearly demarcated and handled by different administrative units; on the contrary, it will be recommended that dealings with MNCs should, with obvious exceptions of issues which can only be dealt with on a national scale, be entrusted to a centralised body and not spread over various departments. Furthermore, a number of issues, mainly concerning technology, the composition of output, ownership and income distribution, form a common thread which runs through all the 'levels'; the distinctions made below are, in consequence, bound to be somewhat arbitrary. Bearing these points in mind, let us proceed with the argument.

The General Level

It is at the general level of the social, cultural, political and economic life of a country that the effects of MNCs, and of foreign influence in general, are most difficult to discern and deal with. While it can hardly be denied that

such factors do exist and interact between different countries, it can certainly be argued that such 'interdependence' (to distinguish it from the 'dependence' case) is a necessary fact of modern life, and even that it is a desirable and efficient method of promoting the 'modernisation' and 'development' of the power countries(1). These words (in quotation marks) have extremely vague meanings; usually they mean what the user, like Humpty Dumpty, wants them to mean. We have proposed that development does not imply a wholesale importation of the consumption, production and distribution patterns of the developed capitalist countries, as is inherent in the opening up of developing economies to the developed ones by means of foreign investment and free trade. While 'interdependence' may certainly exist, and the influence of socio-political-economic factors may work both ways, we agree with the dependence school that the influence is heavily asymmetrical: developed countries have a much larger effect on the pattern of development in less-developed ones than vice versa, and that the result is not one which promotes the welfare of the majority of people there.

149. It is difficult to say whether or not such influence is 'necessary'. It is necessary if the host developing country wanted to follow the dependent pattern; it may, to some extent, be avoided of a different pattern of development were envisaged. Certainly some of the ill-effects can be mitigated by appropriate policy, and we shall discuss these rather than go into extreme solutions of armed revolution.

150. The most important issue is the inter-related one of income distribution and composition of output. If distribution is very uneven, and the structure of production is geared to it, the entry to MNCs on a large scale will tend to bias consumption even further towards the elite, and to create pressures in favour of policies which promoted a preservation and accentration of inequality. This issue is much broader than one simply of foreign investment, and a real solution may well involve extreme measures; however, within the constraints of a given socio-political structure, the government can undertake the following measures to reduce the impact:

(i) Sectoral control of MNC entry, restricting it to industries where its output is considered socially beneficial. Needless to say, industries which are socially undesirable should not be promoted with local enterprise; nor should their products be freely imported. We cannot go into precisely what is desirable for each country; much depends on the levels of income, social norms and cultural requirements - though these are also subject to change.

(ii) The promotion of income equality through fiscal measures, and by use of appropriate technology (see below). These considerations may well permit MNC investment in export industries regardless of the composition of output, if other factors were favourable.

151. The issue of technology is also significant at the general level, and concerns both national science and education

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(1) For a clear exposition of the 'dependence' case, see Sunkel, 1969-70, and for a sympathetic critique see O'Brien, 1974.

policy as well as the choice of techniques used. (1) The basic problem is to stimulate local research and development in order to build up the (cumulative) capacity to innovate and to adapt technology to local needs, without wasting resources in reproducing work already done abroad and without committing avoidable mistakes. A passive and total dependence on MNC technology would stifle local innovation, use capital-intensive techniques, and so, even in socially desirable industries, promote income inequality. Possible measures to deal with these problems are:

(i) To set up and actively promote research centres in the public sector to adapt foreign technology to local needs, both in terms of the type of output and the use of inputs.

(ii) To induce local firms buying foreign technology to become independent of imported techniques, to invest in adaptive R and D, and to use the results of local innovation as far as possible.

(iii) To induce small foreign firms to invest (or to sell technology) using techniques which are more labour intensive and perhaps use locally available skills, and producing goods which are not the most 'modern' but more sensible for the host country. This may reduce the cost of capital goods imports by utilising second-hand equipment, and simultaneously reduce the scope for rapid product-differentiation.

(iv) To induce MNCs to adapt their technology to local factor endowments(2), by correcting relative factor prices as far as possible, by contracting with them for the development of specific technologies, by specifying a certain amount of local R and D, and by restricting their entry into sectors where local technology was considered inadequate.

(v) To induce foreign private or public international organisations to undertake the requisite adaptive R and D and the development of intermediate technologies, and to diffuse the knowledge of such innovations in one developing country to all others.

(vi) To promote cooperative, regional or other, research between different developing countries facing similar technological problems.

152. The issues of political pressure is more difficult to deal with, simply because government policies are themselves an outcome of conflicting internal and external pressures, both of which are in turn affected by MNCs. By external pressures we mean pressures from abroad (by the home governments and international organisations)(3) and from national groups outside the government (local businessmen, professionals, traders, etc): by internal pressures we mean the influence of groups within the government and the administration supporting the MNC cause. Insofar as the

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(1) On the problems of national science & education policy, see Sunkel, 1971.

(2) See Helleiner, 1974.

(3) Hayter, 1971, presents a critical examination of such pressures from aid donors.

policy-making and implementing process must be shaped by these pressures, the only way to minimise them is to limit the scope and total amount of foreign capital in the country, and to foster attitudes which reduce intellectual social and political 'satellisation'. This again raises broad issues of aid and trade relations, education policy, income distribution, the role allotted to the public sector, and so on, all of which fall outside the scope of our paper yet are directly related with it.

153. The issue of local entrepreneurship is ambiguous, in that it has been argued that MNCs both supress local enterprise and promote it. Perhaps the two are not incompatible: MNCs can take over the leadership of the most dynamic technological industries in which their main advantage lies, thus suppressing local initiative, while promoting the expansion of local ancillary industries, thus stimulating it. The net effect is not clear; what is likely is that local enterprise is reduced permanently to a secondary role and that all the major initiative in indsutrial development passes to foreign enterprises. If this is regarded as undesirable for other reasons, the answer is to:

(i) Reduce the extent and scope of MNC entry;

(ii) Restrict it to sectors where local enterprise is lacking, or to where its technology is necessary;

(iii) Restrict its ownership and control by promoting joint ventures, subjecy to the MNCs bargaining power and to the qualification that this may not prevent the suppression of weak local entrepreneurship but merely ensure it a share of the MNCs quasi-rents;

(iv) Restrict its activities and ownership over time by having 'divestment' arrangements(1). Such provisions have now been incorporated into the rules of the Andean Pact.

154. Many such policies are already in force in a number of developing countries; India, for instance, issues periodic lists of industries in which foreign investment is allowed, in which foreign technology but not direct investment is allowed, and in which neither is allowed. The rationale of such policies may be seen as the breaking up of the foreign investment 'package' into its components, and of finding a compromise between the facts that its entrepreneurial and organisational contributions are harmful while its technological contributions are beneficial.

The Sectoral Level

Once the desirable amount and pattern of foreign investment has been decided, the problems which arise at the industrial level concern product differentiation, marketing methods, technology, access to capital, organisational and productive efficiency and relationship to suppliers. Some, especially technology and effects on local entrepreneurship have been mentioned above and need not be discussed again till later.

156. The problems of MNC marketing and product differentiation are related partly to income distribution and the composition of output, which we have discussed already, and partly to their effects on the practices of other firms in the relevant

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(1) See Hirschman, 1969, for proposals for setting up formal divestment arrangements in Latin America.

industries. If the effect of MNC entry is to change marketing practices so that advertising expenditures rise for the sector as a whole and oligopolistic product differentiation and rapid model changes become much more common, there is a social cost involved which must be reduced by government action:

(i) Advertising tactics and expenditures can be regulated by special consumer protection bodies, similar in concept to the institutions recently set up in the United Kingdom. The social value of advertising in terms of its informational content, must be weighed against its costs, such as its distortionary effects on consumption of people with low incomes, or its confusion of true market information (which can be important in industries like pharmaceuticals). There is some conflict between the roles of advertising as a means of healthy competition and as an instrument for moulding tastes or promoting unnecessary consumption; the correct method of regulation can only be found by trial and error.

(ii) Product differentiation and model changes can be controlled by laying down specific criteria for permitting the introduction of 'new' products, comparing their performance with existing ones and judging their social desirability. There are, once more, problems of deciding how far minor modifications add to performance, and how far competition in this manner is necessary for productive efficiency. Clearly the extent to which such practices exist in developed nations is not recommended for poor countries, but clearly products (especially in non-consumer goods industries) also improve over time in some objective sense, and some compromise has to be found between the two.

157. The access to capital of local enterprises may be limited by MNC entry if financial institutions and capital markets give preference to the larger foreign enterprises than to smaller national ones. This problem may be exacerbated by the entry of foreign banks and other financial institutions. To some extent the preference may simply reflect 'sound' banking practice, but it may also deprive 'sound' local borrowers of scarce capital and may be influenced by an irrational bias in favour of established names. To counter this, the government may:

(i) Limit the amount of long-term local borrowing of MNCs;

(ii) Induce then to accept local capital in the form of equity rather than loans;

(iii) Induce financial institutions to lend to local enterprises by guaranteeing these loans, or by laying down statutory provisions;

(iv) Counteract the irrationality of capital markets by itself holding local shares, or namaging unit trusts with properly balanced portfolios;

(v) Assist local enterprises directly by lending from state funds.

158. The issues raised by productive efficiency, market concentration, relationship with suppliers, and so on may be dealt

with together as the general effect of MNCs on the productivity of the industry. We have noted that this effect may well be favourable if their entry destroys local monopoly, induces changes in organisational and productive methods and develops local supplies. The basic problem with trying to protect local enterprises lies in the danger that the government may end up subsidising inefficient production for inexcusably long periods, and may delay the introduction of necessary changes in their structure. As with determining any sort of protectionist policy, one has to find the correct balance between inefficiency and suppression of viable entrepreneurship.

159. To maximise the benefits of MNCs in these respects and to prevent the emergence of concentration in the MNCs' favour, the government may:

(i) Pass and implement anti-monopoly legislation, controlling take-overs and preventing predatory action on the part of any firm, foreign or local. This may include the regulation of retail prices, control of retail outlets, franchises, and so on;

(ii) Specify the local content of inputs used by MNCs, in order to promote local suppliers but not at too high a cost in terms of protection.

(iii) Regulate wage and employment policies of all the firms, ensuring, on the one hand, that they all observe minimum wage and social security requirements, and, on the other, provide training to their employees.

The Project Evaluation Level

We have little to add to what has already been said above about decising upon the social desirability of projects(1), except to reiterate that market prices are not a reliable guide, and considerable judgement, rather than a set of automatic rules, has to be exercised in selecting worthwhile investments. Once the desirability of an investment is established, taking into account its competitiveness in international terms (the level of protection and costs of imports may themselves be subject to bargaining, discussed below), such 'externalities' as its effects on training, skills, learning by doing, and the environment, and its technology, the problem arises of deciding whether or not it can be undertaken by local enterprise.

161. The comparison of local and foreign enterprise is hazardous and based on many imponderables. In particular, it must take into account such items as the shadow price (opportunity cost in social terms) of local capital, the capacities of local entrepreneurs, the availability of technology either locally or abroad without foreign direct investment, the ability of local enterprises to export, and their effects on employment and training. In terms of concrete policy, the project evaluation exercise requires the establishment of a unit which possesses comprehensive information on technology and foreign markets, has extensive contacts with local enterprise, and has the ability to select projects along lines which promote social welfare. It must also have close contacts with the unit which bargains with MNCs, or it could be a part of the same unit, since the choice of foreign or local ownership must be made simultaneously with the decision to undertake a project.

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(1) For recent advances in project evaluation see Little and Mirrlees, 1974, and UNIDO, 1972.

162. The main dangers which policy makers must guard against at this level are:

(i) They must not have recourse to rigid and over-simplified rules in selecting desirable investments.

(ii) They must not be swayed by pressures exerted by particular groups, either local or foreign, to override considerations of broad, social and national welfare.

(iii) They must not take a narrow view of technology and accept whatever is offered, but must bear in mind its appropriatness, adaptability, local availability and cost; at the same time, however, they must not fall into the trap of taking a static view, assuming that once a particular technology is present locally nothing more need be done to keep up with innovation abroad. A number of proposals for divestment and technology purchases tend to ignore the dynamic aspect of technology, and the fact that continuous contact has to be maintained in some cases to gain the maximum benefit from it.

163. It may be worth emphasising that the problems of valuation raised in the early parts of this paper are very difficult ones, which do not admit to easy, straightforward solutions in theoretical or practical terms. While it is only natural that social welfare is an elusive and complex concept, open to many interpretations, it is something which has to be defined, albeit crudely, for the pressing needs of day-to-day policy making, and acted upon by numerous people in the government and outside. We have not sought to pursue the definition in any depth, using the economist's usual escape route of leaving it to 'the policy maker'; however, we realize that the policy maker is neither independent of pressures nor ominiscient, and that leaving decisions to the arbitrary judgement of officials raises all sorts of difficulties of its own. We shall return to these questions in the final section.

Bargaining

The real spadework of dealing with foreign investors and MNCs has to be done at the level of bargaining and regulation. The potential benefits of astute bargaining to the host country are now co-monly accepted in the literature, and the tools of game theory are often used to illustrate the complicated and fundamentally indeterminate nature of the process and its outcome. The question of bargaining in this context arises because there is no well-structured competitive market for foreign investment or for its various componenets, and the range within which the 'prices' set can lie is very broad indeed.(1)

165. The bargaining strength of the respective parties, MNCs and host countries, lies in the benefits they offer to each other and the costs of comparable alternatives. The benefits offered by MNCs consist of their capital, technology, management, access to overseas markets, provision of special inputs, marketing know-how, and contacts with foreign governments and financial institutions:(2) the alternatives to

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(1) See Streeten, 1973, and Kindleberger, 1969.

(2) These are benefits defined in a commercial sense; clearly not all of them are valuable, even desirable, for the social welfare of the host country.

investment by a particular MNC are investment by another MNC, the purchase abroad of technology, managerial talents or other scarce components of the package by a local investor (public or private), the local provision of all the components, import of the relevant products, or doing without these products altogether. The benefits offered by host countries consist of their market, labour, natural resources, infrastructure, and sometimes technology; the alternative to investment in a particular country are investment in another country with comparable benefits, selling components of the package to a local enterprise, or withholding investment altogether (and trying to export to it from abroad).

166. Given the basic bargaining positions of the two parties, there are various elements of strategy which can modify the process and its coutcome. The provision of concealment of information about costs and benefits, and about future action, is perhaps the most important. In any bargaining position, both parties try to make their position appear as strong as possible, and take recourse to various tactics like threats, bribes, concessions, and even walk-outs to wear down the other. It can plausibly be argued that, apart from the objective benefit - and alternatives - situation and the ultimate power of a national government to expropriate, it is the MNCs which possess the upper hand in bargaining strategy. This is so for a number of reasons:

(i) They are often the sole possessors of particular pieces of advanced technology, which the host government cannot hope to imitate for reasonable costs.

(ii) Even of the technology is not unique to them, the host country is often unaware of alternative sources, and is unable to assess the real value of the technology.(1) The same problem arises for assessing the value of management, organisation, training etc.

(iii) MNCs can conceal their true costs of production by the arbitrary valuation of imports and various services provided by the parent company or other subsidiaries.

(iv) They can also conceal the true value of their capital contribution by arbitrary valuation of investments in the form of machinery or know-how.

(v) They often possess greater skills in bargaining than host governments, by virtue of their experience and the calibre of their staff.

167. The government, on the other hand, has two important advantages:

(i) It can nationalise, or threaten to nationalise, foreign investment, paying inadequate compensation to the investors.

(ii) It can renegotiate the terms after the investment has been made, since its bargaining position improves greatly after the MNCs' resources are committed.

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(1) "In some cases, if the country knows precisely what it was buying, there would be no need - or considerably less need - to buy it. Knowledge about knowledge is often the knowledge itself". Streeten, 1973, p.11.

168. The main areas in which bargaining can take place and certain specific items within each area are considered briefly in the following paragraphs.

169. Ownership and Control Many developing countries lay down specific rules on the percentage of equity which can be held by foreign investors, initially and over a period; others do not specify the exact percentage but try to increase the local share by various policies; and others do not interfere with the MNCs at all. Even in cases where the governments have specific rules, exceptions are often made for firms in exceptionally strong bargaining positions which refuse to enter on the terms laid down. We have recommended that local capital should be provided, where possible, in the form of equity rather than loans, and that control should be kept as far as possible in local hands. This must be modified from case to case depending on the value of the investment, the preferences of the MNC concerned, and the effect on the quality of technology transmitted. It can, for instance, happen that a firm may not transfer its latest technology unless it has complete ownership, or at least control, of an investment: or it may not provide as willing and cooperative a technical back-up for the technology transferred.

170. Taxes and Subsidies In most instances tax rates are not varied from one investment to another, so that taxes do not really function as a bargaining counter. Subsidies and concessions may or may not be used for bargaining, depending on their specificity. Many countries grant 'pioneer status' or similar incentives to investments in particular industries or areas, and most grant export subsidies and duty drawbacks on components used to produce exports. These concessions are usually given on a general basis to any firm which qualifies for them; there is, however, no reason why they cannot be varied in particular cases to bargain with investors. We have argued against tax concessions to attract foreign capital in general except for export firms; there may, however, be particular cases where concessions are in order to obtain especially valuable know-how.

171. Protection The extent of effective protection is an important determinant of the desirability of an investment to the host country as well as of its profitability to the investor, yet many governments leave it out of explicit account, both in deciding on which investments are to be allowed and in bargaining. For reasons given above, MNCs are in a particularly strong position to benefit from blanket protection given by automatic prohibition of imports, and it is vital that special attention be paid to this item in striking the final bargain. Furthermore, because conditions change continuously, it is equally vital to renegotiate this element from time to time. The crucial factor in determining protection is, of course, the rate of profit which is to be allowed on the foreign investment, after taking into account risk and the costs of production. It should be the government's intention to pay the lowest rate which would induce the firm in question (or one of a set of firms) to invest; however, in order to determine the real rate of profit being earned, it must depend not on declared profits but check clandestine outflows by means of inflated transfer prices and other payments. It must also, on the other hand, allow the firm to adjust its capital base to take account of inflation, so that rates of profit are not unduly overstated.

172. Composition of output If an MNC is not to be allowed to reproduce the entire range of its operations for developed countries in a less developed one, the range of goods to be produced (including changes in models) must be negotiated at the start and appropriately adjusted over time.

173. Technology We have already indicated the sorts of considerations which should apply to the purchase of technology. Given that the technology is considered appropriate (for the time being at least), the problems which arise for bargaining concern the speed of its diffusion, the restrictive or other conditions attached to its use, the period of the contract (if there is a formal agreement), the use or non-use of patents(1), the provision of back-up services by the parent company, and, most important, the prices to be paid. Royalty rates are presently fixed more on the basis of convention than on any rational economic calculation, and can vary substantially for the same technology between different firms in a country, or between different countries for the same MNC.

174. The scope for official action is vast. In Colombia, for instance, royalty payments were reduced by about 40% by instituting a surveillance and negotiation process, which weeded out payments for outdated technology, pruned down excessive rates, and reduced the life of contracts; the government was also able to remove various restrictive clauses from technological contracts. The Indian Government has also participated actively in the negotiation of technological agreements, and has imposed ceiling on the rates which can be charged for particular types of technology. Due perhaps to the larger percentage of local ownership in India, which has naturally led foreign firms to be tougher in their bargaining over technology sales, the Government has not been able to eliminate restrictive clauses.(2) It has introduced a distinction between 'permissible' and other sorts of export restrictions, the former applying to exports to countries where the foreign firm already supplies the marker. This may be seen as a concession to the superior bargaining position of MNCs, and it reveals a not unwelcome flexibility on the Government's part.

175. Exports Export restrictive clauses are only part of the problem of exporting. The amount of output to be exported now features increasingly in the bargaining process between MNCs and developing countries, with export-oriented firms receiving marked preference over others. Many governments are prepared to negotiate almost any terms on other items if the firm commits itself to exporting a major portion of its output, but clearly the willingness of the firm to do so depends on the domestic costs of production and the geographical access of the country to markets abroad. Exports

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(1) We have not gone into the problem of whether the host country should observe international patent laws or not. A case can be made for less-developed countries opting out of this system altogether (Vaitsos, 1971), though there are dangers that this would hinder the flow of technology, if not its production. Most of the present abuses of the system can, however, be remedied by stricter checks, compulsory licensing, and, perhaps, the renunciation of the system in particular industries such as pharmaceuticles (See Lall, 1974, Scherer, 1971, Penrose, 1973).

(2) See Indian Investment Centre, 1971.

can probably be better promoted over the long run by implementing policies to improve the cost structure than by subsidising them in uncompetitive conditions, but in terms of bargaining strategy countries with large and profitable domestic markets like India may induce MNCs to export even at a loss if they were permitted to make it up by profits on domestic sales.

176. Transfer Pricing This is coming to be recognised as one of the major problems in dealing with MNCs, and one which particularly affects developing countries which have relatively high tax rates or may be unsafe, for other reasons, to declare high profits in.(1) Some countries may not appear liable to a heavy cost on this account simply because their import dependence is relatively low, but even there the cost (in foreign exchange) as a proportion of declared profits may be high, and other methods of moving funds, such as interest, management fees or commissions, may be used to supplement the use of transfer pricing of imports. Unless all these channels are monitored, it would clearly be pointless to bargain on profit rates and protection.(2)

177. There are several ways to deal with the transfer-pricing problem, none of which is completely satisfactory: first, the fixing of tax and tariff rates (on intermediate imports) in such a way that the same revenue is realised whether the firm transmits profits by declaring them or by over-pricing imports; this limits the flexibility of tariff policy and may adversely affect industries which do not have MNCs or firms which would not use transfer pricing.

178. Second, the channelling of all importa through an official agency which negotiates import prices on its own. This may involve delays, heavy administrative expenditures and inefficiency.

179. Third, the taxation, of MNCs on the basis of the profits on their world-wide operations, allocated to particular countries by using a formula based on sales, capital, or some such item. This is, of course, a convenient method of taxation, provided that world-wide profit figures were available; unless every government agreed on the allocation formula, however, it may result in the MNC being over-taxed or under-taxed.

180. Fourth, the checking of transfer prices directly. This would be a cumbersome and difficult task, especially for commodities which do not have open market prices for comparison, and which have high overhead expenses. The U.S. administration's experience of this problem is not very encouraging; however, the amount of savings achieved in Colombia lead one to believe that the efforts may be worthwhile. It may also be possible to engage foreign consultants to handle the

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(1) See Lall, 1973.

(2) Besides the arbitrary pricing of exports and imports to related firms, MNCs may transfer funds via royalties, technical fees, commissions, interest on intra-firm loans, payments for brand-names or trade-marks, and similar service charges. They may also speculate against weak currencies by leading or lagging intra-firm payments. See Robbins and Stobaugh, 1973.

problem, as Tanzania has done, apparently with very satisfactory results,(1) so saving the government from overtaxing its administrative resources.

181. Fifth, the joint taxation of MNCs by all governments which play host to them. While in many ways this could be the ideal solution, it seems for political reasons highly unlikely in practice to be achieved in the forreseeable future.

182. Sixth, the institution of internal checks on MNCs by promoting local shareholding and management. This suffers from the problems that local managers may not be competent to deal with a sophisticated use of transfer prices (or even be aware of it), and that local entrepreneurs can easily be pursuaded to collude with the foreigner in return for payment in foriegn exchange.

183. Perhaps the best solution would be a combination of different policies, especially the third and fourth ones: the allocation of profits using global figures for particular MNCs whose transfer prices were difficult to chaeck, and the checking of prices on the most important commodities which can be assigned arm's length prices. The former would effectively leave the MNC free to set its own prices as long as it paid the host country an agreed percentage of tax on its total profits: in terms of bargaining, therefore, this would probably be the easiest to agree upon.

184. A number of other items, such as the amount of training, the local content of inputs, employment of nationals, arbitration, etc., are also subject to bargaining, but we need not go into them in any detail here.

185. The nature of bargaining involves a large element of flexibility and skill on both sides.(2) The number of factors with which the game can be played is very large, and the information required is also diverse and diffuse. It is not bargaining if the government simply lays down statutory provisions for all these items: it does not get as much as it could from some MNCs while others may be deterred from investing altogether. A number of measures may improve the host government's position.

(i) Centralisation - Often the different items of the bargain are decided upon by different ministries or departments, which do not see the problem as a whole and can act in contradictory ways. The MNC, on the other hand, always acts as a unit and has a clear idea of its objectives (which are of course much narrower and easier to grasp than the objectives of social policy). Unless the government can centralise its bargaining and regulation function, and coordinate all the elements of its bargaining position, it will suffer from a dissipation of its bargaining strength.

(ii) Information - The government needs a vast amount of information to bargain effectively, which it can get partly by research, partly by building up its own store of experience, partly by assistance from sililar countries and partly by help from international

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(1) Neerso, P, 1972.

(2) On the importance of flexibility and coordination, see the Canadian Government's study of 1972.

organisations. The proposed United Nations Commission on Multinational Corporations could prove of great importance in this context because it could coordinate the knowledge of all developing countries as well as drawing upon the expertise of consultants, businessmen, officials and scientists in the developed world.

(iii) Skill - In order to cope with a highly sophisticated and skilled opponent, the host government must devote to the task of bargaining an equally well-trained, informed and honest body of nationals, drawn from the administration, public sector industries, universities and perhaps private enterprise. While less important items on the agenda can be decided at lower levels, and minor problems be settled by reference to standard procedures and rules, the overall package and its more important elements must be reviewed and negotiated by a competent authority which can understand national priorities and implement them without either dogmatism or compromise. There may, however, be a trade off between the need to build up an experienced and mature organisation and the danger of corruption, arising from continuous exposure to powerful temptation from MNCs. These points will be raised again in the last section, but they impinge upon the effectiveness of all the policy measures considered in this paper.

Regulation

Many of the considerations arising in bargaining recur in the regulation of existing investments. The purpose of regulation is, first, to ensure that the laws and provisions relating to foreign investments are met, second, to ensure that the particular bargain struck with an MNC is kept in practice, and, third, to ensure that the renegotiation of the initial bargain is kept up-to-date.

187. Many problems of the regulation of foreign investments apply to industry generally - health and safety measures, anti-monopoly rules, social security, employment and wage provisions, quality control, compliance with various municiple laws, and so on - but some are specific to the former. The main ones are the regulation of remittances abroad (which goes together with taxation), employment of nationals, open or hidden participation in local political activity, and the use of unfair or disallowed (as part of the bargain) business practices. All these have been discussed at some stage already, and we need not go into them again here; what we need to stress here is the importance of efficient regulatory mechanisms which would be able to carry out these tasks, the full reporting of MNC activities, the registration of all forms of contracts and agreements, and a recourse to speedy and fair arbitration in cases of dispute.

CHAPTER VI PROBLEMS IN FORMULATING AND IMPLEMENTING POLICY

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188. We have, throughout this paper, laid enormous stress on the role of the government, in finding out what is conducive to social welfare, in specifying policies which would promote it, and in implementing those policies with honesty and efficiency. At no stage have we tried to make it sound easy;

however, before finishing we must mention some of the problems inherent in formulating and implementing policies for dealing with MNCs.

189. At the level of policy formulation, we may distinguish between two general problems, quite unrelated to those of information, skill and coordination mentioned above. The first arises from the perception and definition of social welafre, perhaps the most pliable and amorphous of concepts, open to an enormous range of interpretation, and basically a matter of the social conscience of whoever is in power. Is there any guarantee, or even the liklehood, that the 'welfare' which is pursued by a particular government conforms to the welfare of the greater majority of the people in the country? If what is in fact understood as 'welfare' is simply the benefit of the privileged èlites, there is a fundamental conceptual barrier which prevents the real problems from even being considered.

190. The second, similarly, arises from the pressures exerted in the shaping of policies, even assuming that social welafre is correctly perceived. No government policy of any importance to the distribution of wealth and income can be formed independently of the groups which control them, and even the most liberal of administrations is subject to the realities of a given power structure.(1) If policies on MNCs are part of a larger effort to redistribute wealth and promote independent national development, they can succeed only to the extent that the internal political structure permits a meaningful basis for such policies.(2) In many cases the only feasible result may be 'dependent' development of the sort discussed earlier, with the interests of MNCs, national industrialists and the political èlite corresponding to a large enough extent to prevent any major change.

191. We must not, however, assume that there is no freedom for manouevre. There are clearly a number of issues on which the interests of different groups in a host country would coincide, or at least would not clash, and on these a solid foundation of MNC policy can rest: the regulation of the direct cost of MNC investment, the promotion of domestic technology and domestic enterprise, and the use of labour-intensive techniques are good examples. The policies of the Andean Group, which lay down fairly stringent conditions for the entry and operation of MNCs, are pursuing precisely this sort of objective, of getting a better deal from foreign investors without attempting to reform the domestic pattern of distribution and development. The extent to which any individual government will shift the balance inside this range of freedom, to favour one section over another, will depend again on its political basis and its ability (by

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(1) See a fascinating recent study of the sociology of administration based on the Latin American experience, by Stinchcombe (1974), who is Professor of Sociology at Berkeley.

(2) "Responsibility of the political èlite to constituencies inside the country is the only long-run alternative to responsibility to a constituency of copper companies, <u>frigorificos</u>, and oil companies. And that responsibility to national constituencies has stable structural supports only if the poor are organised into leftist parties and strong trade unions". ibid., p.183.

consensus or by force) to apply its preferences in practice. Conversely, the structure of the political system will itself reflect the interplay of the various social and economic groups, with the dominance shifting in response to changing economic circumstances, in this case the entry of MNCs.(1)

192. Given the practical limits to the formulation of MNC policies, their implementation faces a host of different problems. Bureaucracies in developing countries are not renowned for their efficiency, administrative skill or honesty, when these are all essential ingredients for bargaining with and regulating MNCs. There are ample opportunities for administrative incompetence and corruption when a tough line is taken against the massive multinationals, which are adept at using these situations to their own advantage and quite aware of the possibilities of intimidation, persuasion, concealment and bribery.(2) The greater the number of restrictions and regulations imposed on the operations of MNCs, and the greater the profit opportunities for the MNCs in a particular economy, the greater clearly will be the pressure put on the abilities of the administration. If these abilities are limited, in terms of skill or honesty, a case can be made for reducing the opportunities for bureaucratic interference rather than increasing them.

193. We do not intend to end on a pessimistic note. The recent course of events in the world economy indicates that host countries are indeed waking up to the problems created by the emergence of MNCs, and many of their actions have redressed the balance of power in their favour. The initiative undertaken by the United Nations in proposing a permanent Commission on Multinational Corporations is a very hopeful sign, and the realisation within the developed countries that orthodox reliance on competitive-market models for forming policy is outdated is inducing MNCs to reform themselves and think of their 'social responsibility'. The entry of trade unions from developed countries into the scene, mainly as an attempt to reestablish their own bargaining power, also augurs well for the prospects of control, while various measures undertaken by the Government of the United States, the home of the biggest MNCs. show that all will not go the multinational way. The developing countries must, however, look after their own interests, since they diverge both from those of MNCs and their home countries: there can be no substitute for independent and strong action to promote their development.

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(1) For a comparative socio-economic analysis of the development of political structures in various countries (U.S.A., U.K., Germany, Russia, India, China and Japan) see the brilliant study by Moore, 1966. For the application of such an analysis to the MNC phenomenon in India, Pakistan and Bangladesh, see Weisskopf, 1971, and Alavi, 1972.

(2) Interestingly enough, business-school literature frankly discusses all these measures for dealing with governments in developing countries, while pressing firms to be 'good citizens'. See, for instance, Williams, 1965.

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