CHAPTER II COSTS AND BENEFITS OF MNCs TO DEVELOPING COUNTRIES

<u>What is the 'welfare' of host countries</u>

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.

Effects of MNCs: nature of product

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 costs 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 ·e 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

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(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 intrafirm 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

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.