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.

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 élite and bourgeoisie to foreign socio-cultural 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 <u>is</u> 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.

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## 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-

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