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