

SUMMARY

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

- (i) the benefits which governments should try to extract and the costs they should try to minimise,
- (ii) the policy considerations for attracting MNCs and foreign investment in general,
- (iii) some policy considerations in respect of issues such as project evaluation, control and bargaining,
- (iv) the kind of problems that can emerge in formulating and implementing these policies.

Definition

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

- (i) specialize in oligopolistic industries, where marketing and technological innovation are key characteristics, and concentrate amongst manufacturing industries, in particular chemicals, machinery and transport equipment which together account for over half the total;
- (ii) produce sophisticated products made by capital intensive techniques and aimed at high income groups;
- (iii) have an increasing concentration of decision making powers at the apex of the organisation;
- (iv) have a centralization of financial strategy which enables them to operate across different countries to minimise risk and tax payments. This involves heavy reliance on the local capital market and re-invested profits for financing their expenditures and provides the environment for the manipulation of transfer prices and other arbitrarily assigned payments such as royalties, management fees and interest;
- (v) show a preference for majority ownership of their investments.

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

Costs and Benefits

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

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

The nature of the product

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

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

Transfer of technology

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

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

Organisation and management

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

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

Marketing

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

Capital

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

Productive efficiency

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

Balance of payments effects

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

The evidence of export oriented investment was not very widespread, although one would not normally expect import substituting investments, (the commonest form of foreign investment in developing countries) to become major exporters.

A few cases of formal export-restrictive clauses were found, while other UNCTAD studies have found many examples of such practices.

60 per cent of the firms surveyed were taking out more in terms of profits than they were putting in in terms of new investments. This fact, however, tells us nothing about the overall effects of the investment. It is necessary, inter alia, to compare the actual cost of servicing foreign capital with the cost of providing investments from alternative sources. Over 40% of the firms had negative net financial effects in so far as they would have been cheaper to finance locally.

There are many sorts of hidden transfers in inter-firm transactions such as transfer prices, royalties and fees of various sorts. Transfer prices are extremely difficult to monitor. Royalty payments to parent companies by subsidiaries are quite large and there is some evidence that local purchasers of technology collude with foreign firms to enable them to charge higher effective rates than are officially permitted.

Policy considerations for attracting MNC investment

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

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

Policy approach to project evaluation control and bargaining

The general level

- (i) Policies need to be geared to ensuring that the MNCs, by the nature of their product, do not perpetuate inequities in income distribution. Governments can restrict industries to that output which is considered socially beneficial.
- (ii) Passive acceptance of total dependence on MNC technology would stifle innovation in capital intensive techniques and promote income inequality. Policy should be aimed at encouraging local innovation and adaptation of imported technology.
- (iii) The most effective way to minimise political pressure from abroad is to limit the scope and total amount of foreign capital in the country.
- (iv) To prevent the initiative of local entrepreneurs being suppressed by MNCs several policies are applicable. In India, for example, periodic lists are issued of industries in which foreign investment is allowed, in which foreign technology but not direct investment is allowed, and in which neither is allowed. One approach taken by the Andean Pact countries is to restrict the activities and ownership of the foreign investor over time by having divestment arrangements. Some countries restrict ownership and control by actively promoting joint ventures.

The sectoral level

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

Project evaluation

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

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

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

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

Bargaining and regulation

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

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

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