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How Powerful are the Multinational Corporations?

by Ehrenfried Pausenberger, Gießen*

Much unease, distrust and criticism is being expressed in the current debate about the potential power of multinational corporations and the possibilities of abuse. What is the basis for the power of the multinationals, and what possibilities are available for controlling and limiting that power?

In his book "The Concept of the Corporation" published shortly after the Second World War, Peter F. Drucker expounded the view that the large corporation was the characteristic social institution of the present day. He was not referring primarily to its quantitative importance but meant that large corporations determine the level of productivity and prosperity in an economy, that they help spread new technology even if they do not develop it and that it is precisely to large corporations that we look for the solution of social problems. According to Drucker the advent of Big Business, that is to say the emergence of large integrated industrial units as a social reality, represents the most important occurrence in the recent social history of the western world.¹

The question arises whether today, thirty-five years after Drucker expressed this view, it may be possible to regard the multinational corporation as the characteristic social institution of our time. Is it not the symbol of modern capitalism to friend and foe alike, on the one hand acclaimed as the most important driving force behind economic development, especially in underdeveloped regions, and on the other hand execrated as a particularly ingenious form of colonial domination and exploitation of developing countries?²

Distrust on the Part of Host Countries

Perhaps the multinational corporation can be adjudged to be typical and style-setting chiefly because with its worldwide activities and global strategy it overcomes the constraints of the nation state and points the way to new forms of political organisation yet to come.

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Such futuristic thoughts fade into the background in the current debate, however. Attitudes towards multinational corporations are determined more by unease, distrust and criticism kindled by the very size and complexity of these enterprises and the opacity of their transactions. The relations between multinationals and nation states are particularly prone to conflict. On the one hand, states are eager that these enterprises operate in their territory, create jobs, pay taxes, generate export earnings and introduce modern technology; on the other hand, they not infrequently take exception to the autonomy and freedom of movement of these corporations – the nation state can exercise sovereignty only over a restricted territory, whereas multinational corporations can operate anywhere in the world.

The distrust on the part of the governments of host countries is aroused primarily by the fact that decisions affecting subsidiary companies located on their territory are taken in group headquarters in a distant land and that insufficient regard is paid to the interests of the host country. This inequality in territorial coverage gives rise to the fear that multinational corporations will elude the regulatory intervention of the state and undermine its sovereign rights. Even a conservative commentator as

¹ Peter F. Drucker: *The Concept of the Corporation*, New York 1946.

² See for example Raymond Vernon: *Storm over the Multinationals. The Real Issues*, Cambridge (Mass.) 1977; Ehrenfried Pausenberger: *Internationale Unternehmungen in Entwicklungsländern. Ihre Strategien und Erfahrungen*, Düsseldorf and Vienna 1980.

³ Kurt H. Biedenkopf: *Politische Probleme multinationaler Unternehmen*, in: *Dialog*, Vol. 3 (1972), No. 3. pp. 29-36; here, see p. 33.

Kurt Biedenkopf voices these doubts when he says that "the multinational corporation breaks the territorial bounds of the political systems by which mankind rules itself and thus leaves the sphere in which political decisions are taken and implemented".³

This fear is widely shared in the world of politics; countless political groups and institutions – ranging from the German Bundestag to the United Nations via the Commission of the European Community, from individual trade unions to the World Council of Churches – have concerned themselves with the power potential of multinational corporations or have even made this concern a permanent part of their activities. At least ten international organisations have set up special departments to deal with multinationals, the best known being the Centre on Transnational Corporations at the United Nations in New York.

Multinationals and Power

Multinational corporations differ from domestic companies in that they invest in foreign countries, set up manufacturing plant and marketing companies there, employ personnel and in this way integrate permanently into other economies. The links between the various parts of the corporation operating in different countries are provided by centralised management from group headquarters and operate through cross-border transfers of information, persons, capital and goods.⁴

Max Weber gave a definition of "power" that is still used today as a starting-point in the social sciences: power is "any opportunity within a social relationship to impose one's own will, even in the face of opposition",⁵ in other words the possibility of influencing market processes in favour of one's own economic objectives.

It was also recognised very early on that power comes down to the existence of ample room for manoeuvre and that those who have fallen victim to the exercise of power have only limited options. This aspect is of especial relevance in economic relationships, as the examples of the monopoly and the boycott illustrate. Hence economic power can be described in terms of the breadth of the margin for action, and in an economic context the exercise of power means restricting the room for manoeuvre of other market participants and exploiting one's own advantages.

If we wish to characterise the potential power of multinational corporations, we must therefore inquire into the alternative courses of action or organisational privileges that are open to multinationals but not to domestic companies.

The Basis of the Multinationals' Power

One of the earliest arguments expressed against the multinationals was that enterprises with a turnover larger than the gross national product of many countries were more powerful than those nations. The annual turnover of, say, Exxon (more than \$ 100 billion) certainly exceeds the gross national product of most countries; however, this is not a comparison of like with like, but of gross earnings with net product and, furthermore, even the largest enterprise can offer nothing to match a state's absolute legality and power.

It is an incontrovertible fact that the size of an enterprise strongly influences its relations with the state, but there is nothing to be gained by setting dissimilar entities in juxtaposition with one another.

The considerations that follow shall not be coloured by events even as extraordinary as the involvement of ITT in the overthrow of Allende, the bribery of foreign politicians by Lockheed or the enduring influence of the United Fruit Company, which has turned Central American states into "banana republics". Instead, the aim is to enquire into the theoretical, structural and organisational advantages that multinationals have over domestic companies, and to this end the approach outlined above will be adopted.

In order to give an idea of the degree of internationalisation that individual corporations have achieved we show in Figure 1 the shares of foreign activities in the Hoechst group.

The figure shows the different overseas shares for individual aspects of the group and provides clear evidence of the increasing internationalisation over the period under review. The latest figures for 1981 indicate a further increase in the overseas share of production (to 38.6 %) and turnover (72.4 %). Hoechst has 430 foreign subsidiaries in more than 100 states, with production facilities in 66 countries.

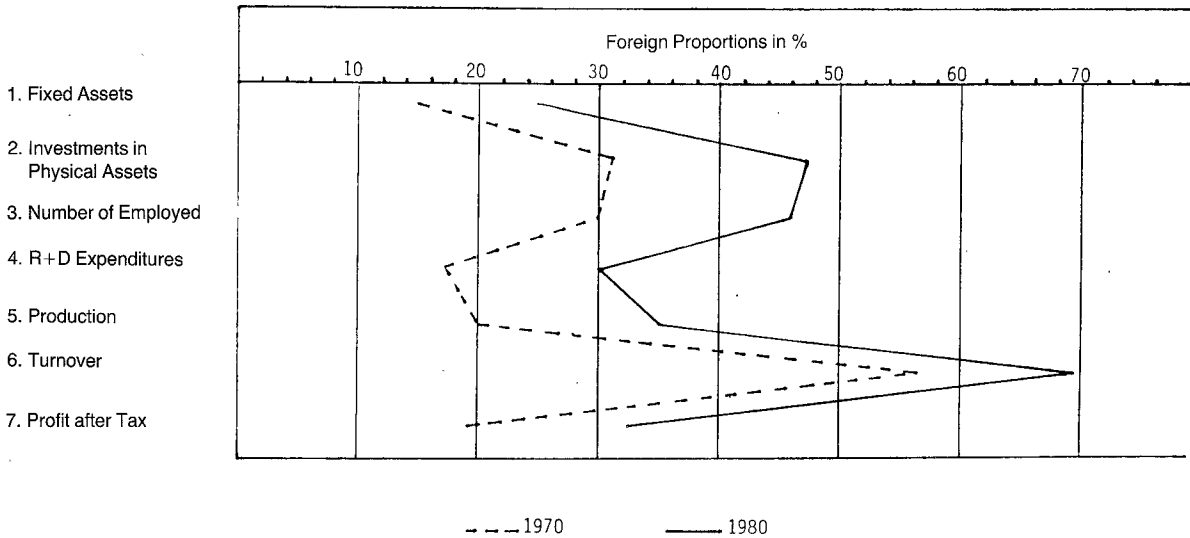
The economic power of multinational corporations can be illustrated in terms of four concrete advantages,⁶ which are closely interlinked:

⁴ Cf. Ehrenfried P a u s e n b e r g e r: Die internationale Unternehmung. Begriff, Bedeutung und Entstehungsgründe, in: Das Wirtschaftsstudium, Vol. 11 (1982), pp. 118-123, 332-337, 385-388.

⁵ M a x W e b e r: Wirtschaft und Gesellschaft; quoted from the 5th edition, Tübingen 1976, p. 28; see also Helmut A r r n d t: Wirtschaftliche Macht, 3rd edition, Munich 1980.

⁶ Cf. Ehrenfried P a u s e n b e r g e r: Die Stellung der multinationalen Unternehmung in der Volkswirtschaft, in: Jens Harms (ed.): Das multinationale Unternehmen im sozialen Umfeld. Ökonomische und ethische Aspekte, Frankfurt 1983, pp. 25-39; here, see p. 31 ff.

Figure 1
Internationalisation Profile of the Hoechst Group



- the international distribution of plant and offices,
- cross-border mobility,
- transfer pricing and profit manipulation and
- intra-group organisation of cross-border transactions (internalisation).

International Distribution of Plant and Offices

The multinational's presence in a large number of countries brings it various advantages, of which the most important are:

- A better supply of information. On account of the worldwide nature of their activities, multinational corporations can track down the optimum sources of supply, gain local advantages and exploit market opportunities. In the supply field this relates particularly to the procurement of raw materials and energy and the exploitation of lower wage rates abroad. Particularly important is the acquisition of technological innovations in advanced markets or participation in modern research and development.
- More effective servicing of foreign markets. Supplying a foreign market by means of exports is only a second-best solution from the point of view of proximity to customers and swift reaction to changes in market conditions. By manufacturing on the spot, a firm is better able to seize market opportunities and also gains sales advantages for product divisions that have not been internationalised. Where the host country makes

importation difficult or impossible, the establishment of local production facilities is the only possibility.

- Enhanced growth prospects. Where the markets of the country of origin are showing signs of saturation – which is actually happening for many products (last year the German chemical market increased by 0.1 % in nominal terms, so that it contracted by about 5 % in real terms) – the multinational corporation can continue to pursue its growth objectives by means of regional diversification. Hence it can further expand the advantages of large-scale operations over its domestic competitors.

- The spreading of risks and stability of the corporation. The distribution of production potential and activities over many countries evens out the risks and as a rule even reduces the overall risk, as individual investment projects are exposed to different and often contrasting environmental influences. Losses in the markets of one region can be offset by profits in other markets via intra-group subsidies.

- Greater independence from the country in which the corporation is domiciled. Geo-political decentralisation also brings greater independence from the individual state. If necessary, the multinational corporation can withdraw from a regional market without endangering its own existence. Some enterprises deliberately follow a strategy of limiting their dependence on an individual host country by keeping capital investment and share of turnover low.

In short, multinational corporations have demonstrably greater independence from the nation state and enjoy built-in competitive advantages over their domestic rivals.

Cross-Border Mobility

One of the most important options open to multinational corporations is the *choice of country of domicile*. This is influenced not only by market size, factor costs or infrastructure but also by state parameters such as the tax burden and the degree of regulation. Where political conditions are unstable the corporation ceases to invest; if the framework of conditions set by the state is made less advantageous the corporation can abstain from further expansion in that country and perhaps even disinvest, either covertly or openly, and thus extricate itself from the regulatory intervention of the state. Of course, resource mobility diminishes as a subsidiary increases in age and importance, but it never falls to zero.

Examples of such an evasion strategy are:

- the transfer of external growth abroad if competition legislation does not permit this at home. The high US direct investment of the sixties and seventies was certainly in part a reaction to the stringent anti-trust laws;
- the withdrawal of IBM from India and Nigeria because of the prohibition of wholly-owned subsidiaries, or
- the withdrawal of Exxon and Mobil Oil from joint ventures with the Libyan Government.

International mobility gives a certain negotiating advantage vis-à-vis trade unions, for strikes lose some of their power in industrial disputes with multinational corporations because any strike can be rendered ineffectual by transferring production to subsidiaries in other countries. For example, IBM applies the "sister plant" concept worldwide; each product is made in at

least two countries in order to achieve greater immunity to production losses; the resultant increases in costs are consciously accepted.

The ability to evade state restrictions and trade union demands opens up a further alternative course of action that has to be assessed as an economic advantage.

Transfer Pricing and Profit Manipulation

Multinational corporations have decisively altered foreign trade, for a large and growing share of exports and imports takes place between companies within the same group. The foreign trade transactions are not conducted between two independent parties but between related parts of a single enterprise; market prices are replaced by intra-group settlement prices, which are also known as transfer prices. These are not determined by market forces but are set as a matter of principle by the group management, which can use them to pursue company aims such as the subsidisation of ailing foreign subsidiaries, the shifting of profits to low-tax countries, and so forth. German tax legislation relating to non-residents requires the prices for cross-border purchases and sales between group member companies to be set in the same way as between unrelated parties (Section 1 of the Außensteuergesetz), but there remains some scope for discretion that is not available to domestic companies.

Such latitude is particularly prevalent with regard to goods and services for which no market prices exist; a not inconsiderable role in group activities is played by the exchange of services, such as the provision of technological and management know-how, which are very difficult to value objectively.

In practice the multinationals are understandably reluctant to talk about transfer pricing possibilities. Nevertheless, with regard to the problem of transfer prices the head of the Nestlé group frankly admits that "if a man sells something to his brother he doesn't necessarily demand shop prices".

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It need hardly be said here that the latitude available in setting transfer prices can also be used against competitors; catchwords such as unfair competition and dumping prices speak for themselves.

Intra-Group Transactions

The market is not always the most efficient form of organisation for the exchange of goods and payments; many exchange and combination processes can be organised and carried out at much lower cost within the enterprise itself. These advantages of internal transactions underly the theory of the firm.

The example of the international transfer of technology can be used to apply this argument to the multinational corporation. The granting of a licence to a foreign manufacturer often proves extremely difficult,

- because there is often an appreciable discrepancy between the knowledge and experience of the supplier and those of the recipient;
- because the market value of the technology in question cannot be estimated realistically, particularly as it depends on the availability and quality of complementary factors of production; and
- because the foreign state often provides inadequate protection for technology, so that the improper divulgence of technological knowledge cannot effectively be prevented.

Most of these difficulties do not arise if the foreign recipient of technology is a subsidiary company. The technology gap is bridged by seconding technical staff for fairly long periods, the valuation problem ceases to be important – a shortfall in royalties will simply lead to higher profits – and both the parent company and the subsidiary have identical interests with regard to the

protection of technology and will thus act in unison. The permanent organisational and financial ties between parent company and subsidiary mean that intra-group transfers of know-how are always more efficient than transfers between third parties.⁷

Hence, in more general terms it may be stated that where the market cannot cope efficiently with cross-border business processes, multinational corporations find a promising field for operations – they organise these transfers internally and hence more efficiently.

If one also considers that this permits the know-how developed and tested in the home country to be used in the foreign market without occasioning additional R & D expenditure, it can be seen that the international transfer of technology is an important factor in the superiority of multinational corporations over local competitors and thus a source of economic power.

The State's Control over the Multinationals' Power

Concern springs not so much from the fact that multinational corporations possess economic power as from the belief that there is no effective control over that power. Economic power can be controlled and limited essentially by three agents: the state, competitors and the trade unions.⁸

The objection raised most frequently against multinational corporations is that they restrict the

⁷ Cf. Ehrenfried Pausenberger, with the assistance of Franz Giesel and Bernhard Volkmann: Technologiepolitik internationaler Unternehmen. Eine empirische Untersuchung über Forschung und Entwicklung, Technologietransfer und Technologieanpassung internationaler Unternehmen, in: Zeitschrift für betriebswirtschaftliche Forschung, Vol. 34 (1982), pp. 1025-1054.

⁸ Cf. Harald Schumacher: Die ökonomische Macht multinationaler Unternehmen, in: Wirtschaft und Wettbewerb, Vol. 23 (1973), pp. 6-12.

Table 1
The Importance of Foreign Multinational Corporations to Individual Branches of Industry
 (Percentage Shares in Total Assets or Turnover of the Industry Concerned)

Country	Industry	Chemical Industry	Rubber Industry	Electrical Engineering Industry	Motorcar Industry	Reference Year
Industrialised Countries						
Australia		84	83	1972/73
FR Germany		33	48	51	...	1974
Canada		73	70	64	84	1973
Developing Countries						
Argentina		...	75	33	82	1967
Brazil		69	100	78	84	1972
Mexico		68	100	60	79	1972

Sources: United Nations: Economic and Social Council: Transnational Corporations in World Development: A Re-Examination, 1978, p. 273 f.; and United Nations Conference on Trade and Development: The International Market Power of Transnational Corporations, 1978, p. 85.

sovereignty of states. This applies to the countries of origin but more especially to the host countries, which suspect that the subsidiary company of a foreign group is a Trojan horse serving the interests of group headquarters abroad or even those of the foreign government. In the sixties Europe feared that entire economies would be swamped by the high level of US direct investment; how much more understandable would such a fear be on the part of the developing countries.

It cannot be denied that a state of economic dependence can develop if entire industries are dominated by foreign firms. A few examples are listed in Table 1.

The nation state has the option of excluding all foreign investors from its territory, as most of the eastern bloc countries do; alternatively, it can forbid them access to particular industries and make their business activities subject to numerous restrictions (such as ceilings on plant size and equity holdings) and to continual authorisation (e.g. the release of foreign exchange for the transfer of profits, royalty payments, etc). The Trojan horses can be barred from the country or kept on a leading rein.

National and International Regulation

A series of national regulations also intervenes in the transfer process (prices to be set as though between third parties, Section 1 of the German Außensteuergesetz) or even claims extraterritorial applicability, as in the case of the German Law Prohibiting Restraints on Competition, that also makes an amalgamation initiated abroad subject to merger control if repercussions are to be expected in the Federal Republic (Section 98 II). Highly problematic from the point of view of international law! Another notable example is the provision of the Federal Republic's 1972 Law relating to the taxation of non-residents which claims the right to make certain income of foreign companies liable to domestic taxation if the majority of the shares of these companies are held by residents (Zugriffsbesteuerung). These examples show clearly that national regulations do impinge strongly upon the multinationals' global field of operations. Nevertheless, they remain of only local importance and are difficult to implement because of their limited scope.

Owing to the inadequacy of national regulations, efforts have been under way for years to impose certain forms of behaviour on multinational corporations by means of an internationally approved code of standards. The International Chamber of Commerce in Paris, the OECD, the International Labour Organisation

(ILO), the European Parliament and the ECOSOC of the United Nations have all issued codes of practice of this kind, although none of them carry force of law. The difficulty in establishing meaningful and practicable codes of practice derives from the contrasting interests of East and West, North and South, nation state and private enterprise.

A first step towards controlling multinational corporations might be taken by improving the ability to monitor their activities. What springs to mind in this context is the Seventh EEC Directive, which provides for all large enterprises operating internationally to draw up consolidated balance sheets in accordance with uniform principles of accounting so that they are comparable.

Limitation of Power through Competition

Liberals see competition as the most effective instrument for limiting the power of an economic entity; in their view, a monopolistic power position cannot endure in a free enterprise system as it is repeatedly eroded by competition from imitators.

In reality, of course, permanent power positions also exist, mostly as a result of restrictions on market entry, such as know-how protected by patents, high capital requirements and the like.

The question therefore remains whether multinational corporations are exposed to sufficient competition. This obviously depends partly on whether the internationalisation of the enterprises promotes or restricts competition. The author has dealt with this question in greater detail elsewhere, with particular reference to intra-group subsidisation policy, the stifling of local competition and the deterrence of potential newcomers.⁹ The weightier arguments suggest in fact that competition is intensified, as multinationals are better able to overcome barriers to market entry and to survive the difficult phase of establishing a foothold in the market owing to the availability and mobility of their resources. According to empirical studies, the number of enterprises competing against one another in domestic markets has increased considerably as a result of internationalisation.

Economic policymakers would therefore be well advised to pursue a logical competition policy, that is to say one that prevents restrictions on competition as far

⁹ Cf. Ehrenfried Pausenberger: *Multinationale Unternehmungen und wirtschaftliche Konzentration*, in: *Konzentration und Spezialisierung im Agrarbereich*, published by Gesellschaft für Wirtschafts- und Sozialwissenschaften des Landbaues e. V., Münster-Hiltrup 1979, pp. 449-467; here, see p. 453.

as possible, in order to make use of the constraints on power exercised by the principle of competition.

Counterweight of the Trade Unions

For years the trade unions have been attempting to establish a counterweight to the power of the multinational corporations.

At the national level, or to be more precise in the Federal Republic of Germany, the multinationals' lead in the power stakes is seen as grounds for demanding "a democratic structure under the control of the public"¹⁰ for these enterprises. The present economic crisis and the threat of plant closures have recently given rise to more insistent demands for the German rights of worker participation in management to be extended to all EEC countries.

At the international level the trade unions intend to limit the multinationals' ability to react to strikes and other forms of union action. The European Trade Union Confederation has declared that "The international trade union movement has set itself the aim of opposing the uncontrolled power of the multinational corporations with the power of the international solidarity of the workers and their trade unions".¹¹

In a few cases the solidarity they have sworn to show has in fact been able to prevent production being shifted abroad in the event of a strike. However, these ad hoc demonstrations of solidarity have been neither very frequent nor particularly successful, but this was to be expected in economically difficult times. Cynics have therefore described it as "fine weather solidarity".

In addition to ad hoc co-ordinated action such as sympathy strikes, many efforts have been made to institutionalise the trade union counterweight:

In some multinationals the works councils of the various group member companies have combined to form a global works council; this is the case in the chemical group Solvay-Laporte, which employs 60,000 workers in 40 countries.

Help in this respect has been provided by the International Federation of Chemical and General Workers' Unions, which is organised on an industry basis in the same way as the many International Professional Secretariats and protects the international interests of the workers.

¹⁰ Ernst Piehl: *Multinationale Konzerne und internationale Gewerkschaftsbewegung*. Ein Beitrag zur Analyse und zur Strategie der Arbeiterbewegung im international organisierten Kapitalismus insbesondere in Westeuropa, Frankfurt 1974, p. 344.

¹¹ European Trade Union Confederation: *Multinationale Unternehmen in der Europäischen Gemeinschaft*, Brussels 1973.

There are also worldwide umbrella organisations such as the International Confederation of Free Trade Unions, the World Federation of Trade Unions and other bodies whose activities are confined mainly to declarations and appeals to international institutions.

Overall, the creation of an international trade union counterweight to the power of multinational corporations has not progressed far to date. The vital interests of national trade unions are often opposed when it comes to international economic processes; the example of the expansion of capacity and of plant closures in international groups provide ample proof in this respect.

Conclusions

It is beyond dispute that multinational corporations possess considerable potential economic power. Like all power, it too is ambivalent – it can be abused, but it can also contribute to the benefit of others.

The scope for abuse is reduced to an acceptable minimum by means of the instruments for controlling and limiting power that have been described; any further restriction of the multinationals' opportunities for development would also curtail the positive effects they have.

According to the theory of competition, the most important contributions that an enterprise can make to the development of an economy are the stimulation of technological and economic progress, the optimum allocation of resources and the elimination of sub-standard products and outdated production methods. And it is precisely in these three effects that the special advantages of multinational corporations reside:

They are undeniably the most efficient channels for the transfer of technological and management know-how between economies and thus make a contribution to development that it would be hard to exaggerate.

On account of their power potential multinationals are in a position to overcome high barriers to market entry, penetrate ossified markets and drive out inefficient firms and outmoded products.

Thanks to their global business policy and the international mobility of their production factors, multinational corporations improve the worldwide allocation of resources.

In the face of a world divided into nation states in which the overcoming of boundaries has its problems, multinational corporations promote the international division of labour and hence – to quote Adam Smith – foster the "wealth of nations".