

Kebschull, Dietrich

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# Critical Remarks on Multinational Corporations

by Dr Dietrich Kebschull, Hamburg \*

No international enterprise will invest in a developing country for altruistic motives. For one thing, pressure from its stockholders and from its labour force as well will compel the enterprise to avail itself of all opportunities for rationalisation of operations and maximisation of profits; for another, such enterprises are pursuing a long-term strategy of world-wide growth without commitment to the situation in any individual country in which they are established. Many developing countries nevertheless expect investments by these enterprises to provide them with additional capital, improved know-how, increased employment, higher exports or structural benefits. In recent years these hopes have often been disappointed because the two parties pursued divergent aims.

## The Objective: Increased Export Earnings

With regard to the antinomies of objectives to be dealt with in the following it must, however, be taken into consideration that the empirical investigations taken as a basis refer exclusively to US and British firms. Comparable data on the procedure of German investors are not yet available.

The wish to attract international production companies is often connected with a desire to be able to produce more exportable goods. An increase in export earnings is to be accomplished by raising—and for

the most part also by improving qualitatively—the current export supplies as well as by diversifying the range of available export goods. The foreign trade experience of the international enterprises and their extensive knowledge of potential markets can certainly offer favourable conditions for this purpose.

In reality however they are making a much smaller contribution to export expansion and diversification than might be assumed in the light of such simple reasoning. It is true that they are shifting the emphasis in their activities more and more from the production of raw materials to the sphere of manufacturing industry; and this is also reflected by rising exports. But as far as there is a worldwide division of selling markets in favour of the parent company of these firms, a maximum utilisation of the export potential of the establishments located in developing countries will not be achieved. The worldwide orientation of these firms and the fact that they possess a number of establishments usually lead to a division of selling and purchasing markets and thus to curtailment of the export outlets available to the individual country of establishment.

Restrictive practices of this nature manifest themselves in particular in the forms of

☐ Confinement of sales to the domestic market,

☐ Prevention of exports to certain countries,

☐ Restraints on exports to selected markets,

☐ Control of exports by the parent,

☐ Direction of exports towards or through certain enterprises,

☐ Restrictions on the use of trade marks for exports.

## Restrictive Practices in LDCs

More and more developing countries are objecting to such measures, as is shown by the controversies in UNCTAD. Restrictions are playing a major role, as initial investigations in India, the Philippines and Mexico have indicated, especially in the case of minority holdings of international enterprises<sup>1</sup>. Of 737 agreements of international enterprises with subsidiaries or associated companies investigated by March 1969, 381 contained restrictive elements. In 349 cases there were real restrictions on exports. In 285 cases they applied to associated companies<sup>2</sup>.

That restrictive practices affecting the exports of subsidiaries were observed in 64 instances only must not be interpreted as evidence that they are impeded less than the associated companies. A more valid explanation is that the more

<sup>1</sup> See UNCTAD, Report TD/122/Suppl. 1, Restrictive Business Practices, Jan. 7, 1972, p. 41 f.; and UNCTAD, TD/B/C. 2/104 and Corr. 1-4, Chapter II B, UNCTAD Preliminary Report—Restrictive Business Practices.

<sup>2</sup> See UNCTAD, TD/122/Suppl. 1, p. 42.

\* HWWA-Institut für Wirtschaftsforschung (The Hamburg Institute for International Economics).

intimate relationship between parent and subsidiaries and the greater difficulty of control by the host country often make it possible to dispense with formal agreements. Verbal arrangements, which need not be less restrictive, are as a rule adequate. Such verbal arrangements are all the more likely to be operated the more difficult it is to obtain official approval for appropriate agreements. The Indian attitude on this point gives special grounds for assuming that the number of effective restrictions on subsidiaries is far in excess of the ascertained figures.

The effect of a less stringent policy is illustrated by the example of the Philippines where 71 restrictions, including 46 purely on exports, were discovered in 182 agreements. In 35 instances they concerned subsidiaries and in 11 only associated companies.

A glance at the overall exports of foreign enterprises also indicates that the establishments in developing countries are taking a relatively less active part in exports. In 1968, when exports by US subsidiaries in industrialised and developing countries accounted for 22 p.c. of all their sales, the figure for Latin America was only 10 p.c. and for other developing countries no more than 9 p.c. In contrast, the corresponding figure for Canada was 28 p.c. and for the EEC area 26 p.c.<sup>3</sup>

### Induced Import Demand

The lower export intensity of foreign subsidiaries in developing countries must not only be considered in connection with restrictive business practices. The pronounced orientation towards the domestic market might also be a symptom of a successful import substitution.

The positive effect of this import substitution strategy as pursued by many developing countries may, however, be limited inasmuch as investments of foreign enterprises may also induce a high import demand. US, British and German studies have shown in common<sup>4</sup> that accessory supplies to establishments abroad have a tendency to rise and in many instances exceed the invested capital. On balance the developing countries may thus suffer an outflow of foreign currencies. This must be set off against the additional exports in order to assess the effect on the balance of trade and payments in each specific case. Transfers of capital are another debit item for the balance of payments. Outflows connected with the activities of international enterprises occur primarily in the form of dividends, interest payments and amortisation. Besides, capital can be transferred, to give examples, by means of excessive management charges, licence fees or overpricing of supplies.

Even though the extent of the capital outflows is liable to substantial regional and inter-sector fluctuations, the evaluation of different balance of payments statistics shows as a common feature that the earnings of foreign enterprises in developing countries (oil companies included) are currently about twice as large as the amount of funds flowing in from outside. A recent German study gave a ratio of 1.5 : 1 for the relation of profit transfers—including interest and amortisation (oil companies excluded)—to new investment<sup>5</sup>.

The return flow from British investments (oil companies excluded) in 1961–69 was about twice the amount of new investment during the same period<sup>6</sup>. US enterprises in the sixties increased their investments in Latin America from US\$ 8 to US\$ 15 bn, but on average withdrew two dollars for each dollar they invested<sup>7</sup>. These figures however do not allow for profit taxes and similar charges in the country of origin.

### Impact Doubtful

As shown by the developing countries' balances of payments the improvements hoped for owing to direct investments frequently do not come to pass. Moreover, the effects on employment may also be uncertain. The international enterprises will train labour, but such training is oriented entirely to particular operations and not aligned to the aims of the host countries. As the enterprises are often not properly integrated with the economy as a whole (enclaves) and lack close contact with other industries, even well trained staff cannot have a great generative effect. Besides, big enterprises tend to employ their own management staffs in their establishments. As a rule personnel from the developing countries may at best perform middle management work. Really first-rate people in developing countries are often transferred to central administration in the industrial-

<sup>3</sup> See D. Schumacher, *Direktinvestitionen in Entwicklungsländern — Umfang, Verteilung und Bestimmungsgründe* (Direct Investments in Developing Countries — Extent, Distribution and Determining Factors), in: *Wochenbericht des DIW*, No. 45, Berlin 1971.

<sup>4</sup> See D. Schumacher, *Erträge aus Direktinvestitionen* (Proceeds from Direct Investments), in: *Entwicklungspolitik* (Development Policy), Materialien No. 34, Federal Ministry for Economic Cooperation, Bonn 1972.

<sup>5</sup> See F. Church, *Der Dritten Welt keinen Dienst erwiesen — Die Amerikaner üben Selbstkritik* (No service rendered to the Third World — Americans engage in self-criticism), in: *Handelsblatt*, No. 78, April 21/22, 1972.

<sup>3</sup> See UNCTAD, TD/122/Suppl. 1, p. 26.

<sup>4</sup> See G. C. Hufbauer, F. M. Adler, *Overseas Manufacturing Investment and the Balance of Payments*, US Treasury Department Tax Policy Research Study, No. 1, 1968; W. B. Reddaway, *Effects of U.K. Direct Investments Overseas*, Cambridge 1967; I. v. Jacoby, *Direktinvestitionen und Export, Grundlagen — Zusammenhänge — Auswirkungen* (Direct Investments and Exports, Foundations — Connections — Repercussions), Hamburg 1972.

ised country. This brain drain is playing an increasingly important role<sup>8</sup>, in particular in the states of Latin America.

The wish for an improved array of professional skills in their labour force apart, the developing countries have a special interest in enlarging the occupational opportunities open to their superabundant manpower. Although international enterprises automatically contribute to increasing employment, here, too, the total potential will not be utilised. Seen from the developing countries international enterprises would in the main have to employ labour-intensive technologies in their areas. As however profit considerations impel them at the same time to operate at the lowest possible costs, they tend to utilise the technical advances achieved in industrialised countries which lead to progressive capital-intensity. In consequence, less employment is generated in the developing countries than would be the case with a similar volume of production obtained by alternative technologies adapted to the specific requirements of these countries. So far the systematic involvement of specially adapted technologies by international enterprises has been confined to a few isolated instances.

#### **Antinomy of Fundamental Objectives**

The antinomy of the fundamental objectives of the international enterprises and the developing countries manifests itself in many other aspects as well as in the aforementioned fields. In regional policy, for example, the principal aim of the young states is the creation of new development axes and avoidance of excessive agglomerations so as to ensure an even

spacial development. Foreign enterprises however will concentrate their activities in advanced areas, unless their location is predetermined by deposits of certain raw materials, because these offer the greatest advantages to them. The choice of such locations magnifies regional imbalance and frequently results in additional public sector expenditure in the agglomeration centres which it is often almost impossible to finance.

As regards their distribution over the various industries, the international enterprises show a bias towards concentration on the growth industries, where their competition quite often overwhelms indigenous industries, while they fail to engage in less profitable industries in which the developing countries would like them to operate.

Finally, it may be noted with regard to the aim of an even distribution of incomes and wealth that insofar as the international enterprises exercise an influence, it is if anything in the opposite direction. Inasmuch as they have to share their profits from joint ventures with private persons in the developing countries, the proceeds go to the circle of the privileged. Existing disparities are in most cases magnified because the international enterprises do not help to change the income distribution by simultaneously raising the wages.

Beyond doubt capital and know-how provided by private direct investment will continue to be required for the developing countries' economic progress. But it would be wrong to assume that investors, whose objective is the growth of their enterprises, will completely adopt the investment countries' developments targets.<sup>9</sup> Insofar the antagonistic situations described in this context do not justify on principle a

condemnation of the international enterprises' procedures. To extol the international enterprises would be as wrong as to condemn them out of hand. There will be need in future for their closer integration with the evolutionary processes in the host countries. In this context attention might be given to:

#### **Tasks for the Future**

- ☐ Greater regard for national objectives including the priorities of development planning,
- ☐ Long-term commitments by the international enterprises,
- ☐ Voluntary self-restraint to the earning of "reasonable" profits,
- ☐ A high reinvestment ratio and limited transfer-back of resources,
- ☐ Development of highly competitive efficient technologies,
- ☐ Cooperation with indigenous enterprises,
- ☐ Priority for domestic accessory suppliers and limitation of imports,
- ☐ Emphasis on exports,
- ☐ Research and development activities in the host country,
- ☐ Cession on favourable terms of patents, licences and technical know-how,
- ☐ Curtailment of the number of expatriate staffs (among operatives, in the offices and in management),
- ☐ Training of indigenous personnel for executive positions.

In order to obtain these objectives considerable efforts in the national economic policy mainly of the investment countries but also of the mother-countries are required.

<sup>8</sup> See H.-D. Ortlieb, Brain Drain from the Third World, in: INTERECONOMICS, No. 6, June 1972, p. 162.

<sup>9</sup> The forthcoming passage of Guidelines for International Investment by the International Chamber of Commerce seems to indicate that the development policy requirements of foreign investments are increasingly acknowledged also by the enterprises.