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Multinational Corporations in LDCs

At present the position of MCs in developing countries is being discussed passionately. Mr R. Krishnamurti, Director of the Manufacturing Division of UNCTAD, therefore defines his attitude regarding some provocative theses formulated by us. Herr Manfred Holthus, Head of the Department on Foreign Trade and Economic Integration of the Hamburg Institute for International Economics shows some aspects of the political treatment of MCs.

Some Effects of the Multinational Corporations

by R. Krishnamurti, Geneva *

The arguments against the multinational corporations, in the terms in which they have been presented by INTERECONOMICS, are obviously designed to stimulate discussion and counterarguments. Therefore the generalisations in these arguments require to be given further precision, detailed qualification and balanced analysis.

Multinational or international corporations follow a world-wide strategy in the interest of the head office and therefore without any ties to a country. This must necessarily lead to a conflict of interests with the host country.

The nature and degree to which multinational corporations

follow a world-wide strategy vary according to the particular sector or sectors in which the corporation operates, the size of the parent firm and the network of subsidiaries which it has built up in host countries. The degree of control also differs as between various decision-making areas. Broadly, the major decision-making areas are financial policies including capital expansion, export policy, pricing policy, production planning, research and development and personnel policy. The structure and the form of organization of, for example, a large US multinational corporation tends to vary from those of a relatively smaller US corporation or for that matter, of a smaller European Corporation. Nevertheless the large corporations, particularly those of the US and quite a number of the larger European corporations, follow global strategies. Integrated networks of production and

market allocation arrangements form the essential elements of the world strategy of the corporation which is carried out by centralised decision-making. The extent of autonomy which any particular subsidiary may be permitted to exercise would depend on its own size, and the importance of the market or markets for which it caters.

The Multinationals' Objectives in LDCs

The activities of multinationals in developing countries are governed by the following objectives: obtaining, maintaining or expanding a foreign market, securing supplies of raw materials, meeting and overcoming competitive forces in the international market which necessitate the development of foreign bases both at national and regional levels; and taking advantage of low labour costs in

* The views expressed in this paper do not necessarily reflect the views of the UNCTAD secretariat. The author wishes to acknowledge the assistance received from his colleague Mr C. R. Greenhill.

developing countries. When the manufacturing activities of multinationals in a developing country are essentially designed to enter, retain or expand the domestic market, the subsidiary may have a certain degree of autonomy in determining the level of domestic production and pricing policy, as long as it does not enter the international market, and the products in question are simple manufactures not involving the continuing supply of up-to-date technology. But if the subsidiary wants to enter the world market or expand its product lines or obtain up-to-date technology and know-how, or even make substantial capital outlay, considerations of the parent firm's global strategy will surely have a decisive effect. The USA accounts for the largest number of these large corporations, with a significant number coming also from Japan, the Federal Republic of Germany, the UK and France. Other countries, such as the Netherlands and Switzerland, have also a number of large multinationals.

There are a large number of medium and small size enterprises of West European origin with networks of subsidiaries in developing countries. Sufficient evidence is not available on the extent of centralised decision-making policies followed by the medium size and smaller enterprises, as compared with the large corporations. The general impression seems to be that the former probably apply policies which are less tightly knit and enforced from the centre than the latter. This is probably the case with subsidiaries in developing countries, which are themselves well established. Nevertheless, it is unlikely that the parent company foregoes control over major policies even in such cases.

While the world-wide strategies of the multinational corporations may well be drawn up by the

head office in the light of the interest of the corporation as a whole, this does not mean that the strategy is automatically not in harmony with the interests of the constituent parts of the corporation or of the country in which it operates. Obviously the stronger the position of individual subsidiaries, the greater will be their say on the strategy adopted. The decisions will inevitably reflect compromises within the power structure of the corporation.

Necessary Adaptations of Worldwide Strategies

The multinational corporation has necessarily to take into account, to a varying extent, the interests of the governments of both parent and host countries, as expressed in their various laws and policies, namely requirements under anti-trust laws or competition policies, national bans on sales of exports to particular countries, foreign exchange control and other screening procedures, etc. These undoubtedly affect the strategy of the multinational corporation, which is required to adapt its decisions to these legal and policy stipulations of governments. To the extent that these interests are difficult to reconcile, conflicts of interests arise. The question of permanent sovereignty over natural resources, which is generally accepted by the international community under various resolutions of the United Nations General Assembly has often been raised in connexion with cases involving nationalisation.

As far as manufacturing industries are concerned, developing countries account only for relatively small shares of world production and trade. The developing countries' subsidiaries of multinational corporations will therefore have only a very limited influence on the corporations' world-wide strategy and their activities may well be

fitted into a particular strategy agreed upon for the corporation as a whole. Whether this will lead to conflicts of interests between the developing country's government and the multinational corporation will depend on a number of factors, such as

- ☐ commitments by the parent company or head office for plant expansion in other countries,
- ☐ commitments or decisions with regard to exports — for example, agreement that a particular subsidiary should supply particular markets,
- ☐ previous commitments or decisions with regard to the supply of specific raw materials and intermediate goods — for example, the purchasing of such goods within the corporation, rather than using similar domestic goods which are available,
- ☐ decisions to process raw materials extracted by a subsidiary in a developing country in another country.

If conflicts are to be limited both within the corporation and between the corporation and governments, obviously the world-wide strategy of a multinational corporation will need to adapt constantly to changing conditions and policies of governments. Above all, what is important is that multinational corporations should with regard to their activities in developing countries pay greater attention to the interests and desires of these countries for a faster rate of economic expansion and increased foreign exchange earnings.

Multinationals have often used political and economic pressure specially in less developed countries (LDCs), in order to bring about political actions which suit their economic interests.

The application of global policies by the multinational corporations frequently gives rise to

conflicts. Because of the size, power and resources of the corporations, governments, particularly those of developing countries often feel that they do not have the power to deal or negotiate effectively with them. Frequently the domestic jurisdiction of the host country is inadequate. In many developing countries, despite general policies to encourage direct foreign investment, there is often suspicion that the multinational corporation is a foreign agent that tends to acquire control in key economic sectors. Many developed countries also have a similar experience, and like the developing countries, attempt to exercise control over the activities of the multinationals. The political aspect of the relationship of the host country to the corporation and vice versa assumes prominence in connexion with the issues of sovereignty over natural resources and the control of key industries. It also arises when cases of political interference occur and become public. The developing countries generally have weak negotiating power and not infrequently lack necessary information and expertise in their dealings with multinationals. These also create tensions¹.

Debt Problems of Developing Countries

The positive effects of capital transfer by multinational corporations to LDCs is compensated or sometimes even overcompensated through the fact that they induce a high import demand and that they are interested in transferring a large amount of their profits, even against the wish of the host country.

Inevitably multinational corporations when they establish manufacturing facilities in developing countries or establish

sales outlets in developing countries create demands for imports of capital equipment, raw materials and intermediate products and of final goods. The multiplier effect of their investments will often also create higher import demands. In general, the multinational corporation in a developing country, as in other countries, makes and is interested in making sizeable profits. Invariably it expects the host government to provide facilities for the remittance of profits and earnings, and the repatriation of capital. While a part of the profits may be and often is reinvested in the host country, the burden of servicing foreign investments has become extremely onerous for a large number of developing countries and the phenomenon of "reverse flows" has been the subject matter of serious concern not only to the developing countries affected, but also to the investor countries and international institutions². This requires the concerted attention of the international community as it transcends the activities of private corporations.

Some limitations on the remittances of profits and on the repatriation of capital, applied in developing countries, may ease their balance of payments strains. On the other hand, scope exists often for the multinational corporation to transfer funds through transfer pricing by overcharging a subsidiary for imported supplies and by underpaying for the

subsidiary's exports. The parent company can also transfer funds by inflated charges on research, office expenditures, etc.³

Small Research Activity In Developing Countries

Multinational corporations concentrate their research activities to a large extent at the head office and reduce therefore the research opportunities in the host countries.

It is true that for a variety of reasons multinational corporations concentrate their research activities to a large extent in the parent country, if not exactly at the headquarters. In a large number of cases the research activities have been built up as the company grew from a purely national into a multinational corporation. In this connexion, it may be pointed out that the basic scientific and technological research, from which commercially profitable products and processes are developed by the multinational corporation is to a significant extent financed by governmental expenditures undertaken elsewhere in research institutions and organizations. However, the multinational corporations, by advantage of their size and resources, are able to commercialise the results of basic research into new products and processes. Thousands of patents relating to products and processes are controlled by the multinational corporations. Most of the research activity, as indicated, is concentrated in the home country; some part is carried out in the subsidiaries of developed host countries. Expenditures on research and development of subsidiaries located in developing countries are indeed very small and probably most of them have hardly any research activity worth mentioning.

Since the research and development activity of the subsidiaries in developing countries

¹ In this connexion see "Multinational Corporations in World Development", document ST/ECA/190, United Nations, New York, 1973. Chapter III entitled: "Impact and Tensions".

² See documents: TD/118/Supp. 6: Financial Resources for Development - Debt problems of developing countries. Report by the UNCTAD secretariat; and TD/134/Supp. 1: Financial Resources for Development - Private foreign investment in its relationship to development, Report by Sanjaya Lal (Institute of Economics and Statistics, Oxford).

³ See the report of the UNCTAD Ad Hoc Group of Experts on Restrictive Business Practices, op. cit., paragraph 46 which states "The Group agreed that transfer pricing within the multinational corporation has in various cases detrimental effects on developing countries. It recognizes that transfer pricing policies were linked in many cases to the question of the movement of funds between currencies to take advantage of high interest rates and to take advantage of possible changes in the values of currencies....".

is very small, the technologies and processes which are transferred from the developed countries to the developing countries may not always be appropriate to the economic conditions of the developing countries, particularly since the factor endowments are very different. Obviously it may not be feasible for major research activities to be transferred by the multinational corporation to its subsidiaries in the developing world. The developing countries would lack a number of basic facilities for this purpose, including technical personnel, laboratories, etc. At the same time, certain research activities could possibly be carried out in developing countries without undue extra cost or without loss of efficiency. The developing countries feel that the multinational corporations have not given sufficient attention to these possibilities. It would therefore be highly advantageous if the parent companies could examine these possibilities and also make deliberate efforts to evolve technologies more appropriate to the circumstances of the developing countries.

Complexity of Adequate Technology

Through the application of modern, inappropriate technologies they only contribute to a very small extent to the solution of the underemployment problem.

The technologies transferred to developing countries are essentially based on the experience of the multinational corporations in the developed world. Research and development in the developed countries is highly capital intensive. The nature of the technology, in particular its capital intensive character, is determined in a large number of cases by the technical conditions of production. Certain products can be manufactured only by capital intensive methods: labour inten-

sive methods would simply not be applicable. However, in other cases it might be advantageous for the developing countries to apply intermediate technologies. The contribution of multinational corporations to the creation and introduction of intermediate technologies for the benefit of developing countries has not been significant, as one would have hoped it to be. When the subsidiary of a multinational corporation operating in a developing country aims essentially at import substitution or catering to the domestic market, a less capital intensive technology could be more appropriate. On the other hand, if the subsidiary desires sooner or later to compete in the world market and sell its products, technical conditions of production, as well as world demand conditions, might point to the essentiality of applying, even from the outset, the more sophisticated and up-to-date technology. Indeed, often a complaint made by several developing countries is that the multinational subsidiaries bring in only out-of-date technology in such cases and do not bring the continuing results of more recent research and technology undertaken by the parent company. Admittedly this complex problem does not lend itself to a simple generalisation.

The contribution of technology to the creation of employment opportunities in the developing countries through the multinational corporations cannot be regarded as substantial or significant, either in absolute numbers or as a proportion of the working force in the developing countries concerned. However, it should be recognised that in developing countries with heavy demographic pressure, the creation of adequate employment opportunities for the constantly increasing labour force is extremely complex and difficult and industrial development of any pattern, be it highly capital intensive or

labour intensive or a varied mix of both, can only make a certain contribution. If full employment or a high level of employment of the working force is to be achieved in a developing country experiencing high demographic pressure, one solution might well be to resort to the highly labour intensive methods of production which will have to be followed by low levels of *per capita* output. This being said, the multinational corporations can undoubtedly contribute more to employment opportunities by deliberately developing intermediate and relatively less capital intensive technologies and also utilising significant labour elements, even in capital intensive methods of production, without loss of quality and productivity, in developing countries.

Restrictive Business Practices

Because of restrictive business practices and market arrangements the Multinationals tend to contribute to a much lesser degree than possible to the increase of developing countries' export earnings.

Case studies in a number of developing countries of Latin America and Asia undertaken by the UNCTAD secretariat indicate that frequently firms in these countries are subject to a wide variety of restrictions on exports. These restrictions which are introduced partly through licensing contracts for patents, know-how and trademarks, and partly through internal decisions between the parent and the subsidiary, have often the effect of restraining exports of developing countries — especially of manufactured products. While some of the restrictions are defended under industrial property rights, a large number of them go well beyond those rights. Total prohibition on exports, permission to export to only certain countries, prior approval for export, constraint upon the use of brand

names, obligation to observe specified distribution channels and prices — all such restrictions are wide-spread. Another frequently observed restriction is that of tied purchasing arrangements especially for raw materials and intermediate goods⁴. Several developing countries have instituted legislative and administrative controls and screening procedures with a view to eliminating some of these restrictions and increasing their own exports⁵.

Subsidiaries of multinational corporations in developing countries have only achieved limited success in expanding the exports of the developing countries, particularly of manufactured products. Production and market allocation arrangements of the multinational corporations, applied on a world-wide basis, assign only a limited place for the subsidiaries in developing countries. A number of developing countries, particularly the more advanced among them industrially and technologically, feel that the export contribution of the multinationals could be substantially larger than is the case the present time.

Possible Policy Conflicts

Multinationals concentrate in the main on profitable growth

⁴ The UNCTAD Ad hoc Group of Experts on Restrictive Business Practices, at its meeting in March 1973, classified a large number of restrictive business practices affecting the trade and development of developing countries into two categories, namely: Category A, i.e. where the restrictions on the basis of knowledge and past experience are likely to have significantly adverse effects whether in developed or developing countries; Category B, i.e. where the adverse effects are less clear and may be offset by corresponding advantages and therefore more complete economic analysis is required. For a discussion of these restrictions, see paragraphs 8-24 of their report, op.cit.

⁵ See the following UNCTAD reports: "Restrictions on exports in foreign collaboration agreements in the Republic of the Philippines", TD/B/388, UN sales publication E.72.II.D.8; "Restrictions on exports in foreign collaboration agreements in India", TD/B/389, UN sales publication E.72.II.D.7; Interim report by the UNCTAD secretariat, "Restrictive Business Practices", TD/B/C.2/104/Rev.1, UN sales publication E.72.II.D.10; and Report by the UNCTAD secretariat "Restrictive Business Practices", TD/122 and Supp.1.

industries and raw materials' production, which runs contrary to the structural policy aims of the LDCs.

It is largely true that the activities of the multinational corporations are concentrated in the growth industries and in the area of raw materials, whether this be in developing or developed countries. Such concentration can lead to conflict of interests especially where a developing country wishes to process further its raw material resources. Although the situation is changing, still a large proportion of the raw materials extracted in developing countries are exported for processing in one form or another to the parent companies and affiliates located in the developed countries. Most developing countries depend upon a few agricultural or mineral products, for example, copper, tin, petroleum, bauxite, coffee, cocoa, tea, etc., for their export earnings. Where a small number of multinational corporations control the production of such commodities in a particular developing country, obviously their power is immense and they become a natural object for calls of nationalization once a country is independent and wishes to follow an independent course or policy. The wish for national control over the exploitation and development of domestic resources, both natural and physical, is a phenomenon which is manifest not only in developing countries but also in a number of developed countries, for example the situation in Australia, Canada, France and Japan.

Their contribution to the improvement of the socio-economic and political conditions in LDCs is nearly nil; sometimes they even consolidate existing conditions.

In a number of developing countries the subsidiaries or affiliates of the multinational cor-

porations have introduced wages and other working conditions higher than those prevailing in comparable sectors of the national economy. At the same time they have created problems of competition with local enterprises which cannot compete on equal terms with the multinational's subsidiary. Furthermore, so far as the managerial and skilled technical personnel are concerned the multinational subsidiary creates a category of executives receiving substantially better remuneration and conditions of work than available to comparable executives in purely domestic enterprises. This also gives rise to problems of competition. At the same time, in those developing countries where adequate labour standards are not laid down, the multinational corporations should be under an obligation to make the necessary contribution to social conditions.

As regards the political conditions, the multinational corporations should play a neutral and non interfering role and should not exercise their power to influence the course of political decisions.

In the interest of their global strategy the multinational corporations do not wish to be subjected to too many restrictions in the host country. On the other hand the developing country has social and economic objectives and plans to implement. There could be conflicts of interest. The multinational corporations might be tempted in such situations to promote policies in developing countries more advantageous to their global strategy. In presenting their testimony in September 1973 to the United Nations Group of Eminent Persons to study multinational corporations, a number of United States business leaders stressed that the multinationals were becoming increasingly aware of the social and economic aspirations of the

developing countries and were trying to adapt their methods to those aspirations. As a recent United Nations study has put it, "Host developing countries are, moreover, suspicious of the multinational corporations' style of doing things. Their financial power and easy access to the top hierarchy of government and

business may be used, openly or covertly, to influence the domestic political process to their liking. Such alien influence is especially resented by local élite groups, such as intellectuals, government cadres, labour and business leaders, who see themselves as contenders for power and guardians of the values and

heritage of the country. The multinational corporations, through their tacit alliance with certain social groups, may even be regarded as obstacles to appropriate social and political development."⁶

⁶ In this connexion see "Multinational Corporations in World Development", document ST/ECA/190, United Nations, New York, 1973, page 57.

Aspects of Foreign Investment Policies

by Manfred Holthus, Hamburg

Experiences made in the "First Decade of Development Aid" clearly show that the provision of capital has so far not proved to be an effective remedy. Apart from the fact that the envisaged amount of capital flow was not achieved, the industrialisation effect was obviously also smaller than had originally been expected. A drop of the LDCs' share in world exports followed more or less automatically. Foreign exchange proceeds were not realised and balance-of-payments deficits became more severe.

It has become clear that the prevailing situation keeps an extension of development aid within narrow bounds. From this aspect, private direct investments are gaining increasing importance. Their special advantages for the recipient countries are due to their contribution to cover capital requirements, discharge of the balance-of-payments, transferring know-how and technology, creating jobs, contribution towards diversification of the production and export structure.

However, apart from these favourable effects of direct in-

vestments there are negative ones, too, viz.:

☐ The foreign enterprises might be an economic and political factor of power and exercise an undesired influence on the policy of the country concerned.

☐ The possibility exists that the investors make too high profits, which they transfer abroad and thereby cause a negative balance-of-payments effect and, moreover, practise a sort of exploitation.

The LDCs' Dilemma

It follows therefrom that the LDCs in consideration of their development policy must offer incentives to as many foreign investors as possible for starting or extending production, on the one hand, and should eliminate, or at least minimise, possible negative effects of such investments, on the other hand.

Although these objectives are clear and plausible, it is difficult to materialise them. For measures which offer the required investment incentives, frequently favour the undesired practices and behaviour of enterprises. Conversely, measures which are to

eliminate negative effects of direct investments, possibly prevent foreign enterprises altogether from making investments in the country concerned.

The policy of most of the LDCs is highlighted by this dilemma. Some aspects of this policy are worth to be analysed in detail with a view to their efficiency. The measures most frequently applied to avoid possible negative effects of direct investments are regulations limiting the share of foreign capital at 49 p.c., at most. One accepts knowingly that the propensity of foreign enterprises to invest in this country will probably diminish, but one feels that this disadvantage is made up for by the fact that part of the capital proceeds will remain in the country and that the new corporation will be subject to domestic control.

It cannot be assumed in general that advantages and disadvantages are always well balanced. The market concerned must be very attractive, indeed, and hold out excellent prospects and high profitability rates for investments so as to avoid that the propensity to invest ceases completely. This implies that the