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Multinationals in Focus

During the last years the role of multinational enterprises in the world economy has become a matter of an intense discussion. The particular problems that arise from their operations within the EEC, however, have so far been somewhat neglected. The following contributions concentrate on this special aspect.

Multinational Enterprises in the EEC

by Manfred Holthus and Georg Koopmann, Hamburg *

More multinationals have their home in the EEC than in any other region of the world: of 7,300 companies which operated in 1969 in at least one other country beside their country of origin over half (about 4,000) were domiciled in EEC countries, some 2,500 were of US origin. The 7,300 multinationals together had at least 27,300 foreign subsidiaries – 14,936 belonging to EEC firms and 9,691 to US companies¹.

Much of the capital invested in these subsidiaries however was held by a relatively small number of big investors². If the analysis is confined to the largest multinationals, the USA is found to rank ahead of the EEC: of the 211 enterprises with a

turnover of more than \$ 1 bn in 1971, 59 had their domicile in the EEC and 127 – more than half – in the USA³.

This is also the order applying to the value of direct investments: of a 1971 total estimated at about \$ 165 bn about \$ 80 bn (= 48.5 p.c.) belonged to US firms and about \$ 50 bn (= 30 p.c.) to enterprises of EEC origin. Half of the latter sum belonged to British firms which ranked second as investors after the USA.

The development from 1967 to 1971 shows however that the EEC firms achieved an above-average expansion outside their own countries (+55 p.c.) whereas US direct investment (+44.6 p.c.) lagged behind the international growth rate for direct investments which was 52.5 pc.⁴.

The result was that not only did the number of multinationals

increase but their foreign operations tend to weigh more heavily in the ambit of their overall activities. To give an example, the foreign productions of the eight most important German investors abroad in 1971 accounted for 19 p.c. of their global sales; in 1966 it had only been 13.8 p.c.

The operations of the foreign subsidiaries increased also much more than the exports from the home country: while the eight firms did not quite double their exports from plants in the home country, the output of their foreign subsidiaries increased nearly threefold. The ratio of foreign production to exports rose from 40.3 to 59.3 p.c. For German industry as a whole a UNO estimate for 1971 put production abroad at 37.4 p.c. of exports.

Key Sectors and Regions

Firms in other EEC countries, Denmark excepted, undertook much heavier commitments relatively – i.e. in relation to ex-

* The Hamburg Institute for International Economics.

¹ cf. United Nations, *Multinational Corporations in World Development*, New York 1973, p. 138.

² cf. *ibid.*, p. 7 and R. Jungnickel, G. Koopmann, K. Matthies, R. Sutter, *Die deutschen multinationalen Unternehmen* (The German multinational enterprises), ed. Manfred Holthus, Frankfurt 1974, p. 147.

³ cf. United Nations, *ibid.*, p. 130 ff.

⁴ cf. United Nations, *ibid.*, p. 139.

ports — through foreign production companies than did the German companies. The total production of all foreign establishments of EEC enterprises in 1971 was estimated at over \$ 100 bn, which was equivalent to over 80 p.c. of exports but still left the EEC companies lagging far behind the US firms which in 1971 produced abroad nearly four times as much as they exported from the USA. The trend of direct EEC investments which are growing at a distinctly faster rate than the exports suggests however that EEC foreign outputs will soon at least draw level with exports. World-wide this was already the situation in 1971⁵.

The multinationals from EEC countries are still concentrating in their international activities more strongly on manufacturing and service industries than do those from other countries. The share of manufacturing industry in the direct investments of British firms, for instance, rose in 1960–72 from 41.0 to 45.2 p.c. and that of German firms from 56.7 to 64.7 p.c.⁶.

The direct investments in the manufacturing sector are chiefly concentrated in growth industries: 59.5 p.c. of all direct investments by German industrial firms abroad until the end of 1972 went into the chemical, electrotechnical, motorcar and mechanical industries⁷.

Regionally the EEC direct investments are clearly centred on the industrial countries: 70 p.c. of all foreign investments by German multinationals up to June 30, 1974 were made in other industrialised countries⁸;

⁵ cf. United Nations, *ibid.*, p. 159.

⁶ cf. H. Krägenau, *Umfang der multinationalen Investitionen* (Extent of the multinational investments), in: D. Kerschull, O. G. Mayer (eds.), *Multinationale Unternehmen* (Multinational enterprises), Frankfurt 1974, p. 30 f., Table 9.

⁷ cf. *Bundesanzeiger* (Federal Journal), No. 70, April 10, 1973, p. 2.

⁸ cf. *Bundesanzeiger* (Federal Journal), No. 192, October 12, 1974, p. 2.

the corresponding figure for British firms at the end of 1971 was 72.1 p.c. Moreover, the share of the industrialised countries has been increasing steadily: in 1962 it had been only 62.6 p.c. in Great Britain and 61.5 p.c. in the Federal Republic. The structure and trend of capital investments by other investing countries — except Japan — was similar⁹.

The EEC as an Investment Area

It follows that the EEC is not only important as the home of many multinational companies but is an attractive area for investments as well. It is such for firms from third countries as well as for enterprises domiciled inside the EEC.

As for third countries, it can be said that all investing countries of importance are represented in the EEC area. US firms however are clearly dominating the field. Of all direct investments by third countries 66.6 p.c. of those made in Germany until June 30, 1974 and 73.8 p.c. of those in Great Britain by the end of 1971 originated in the USA¹⁰. In 1966 US companies were represented in the then EEC of the Six by 4,063 subsidiaries; in 1957, when the EEC came into being, the number had been only 1,225¹¹. The book value of the US capital investments in the EEC (not counting Denmark and Ireland) amounted to \$ 25.3 bn in 1972, which was over a quarter of all US direct investments abroad¹². The EEC is thus becoming the most important investment area of US companies.

⁹ cf. for details S. v. Saldern, *Internationaler Vergleich der Direktinvestitionen wichtiger Industrieländer* (International comparison of the direct investments of important industrialised countries), *HWWA Report No. 15*, Hamburg 1973.

¹⁰ cf. *Bundesanzeiger*, No. 192, October 12, 1974, p. 2; and *Book Values of Overseas Investment*, in: *Trade and Industry*, Vol. 13, No. 7, November 15, 1973, p. 368 f., Table 1.

¹¹ cf. United Nations, *ibid.*, p. 143.

¹² cf. L. A. Lupo, *US Direct Investment Abroad in 1972*, in: *Survey of Current Business*, Vol. 53, No. 9, September 1973, p. 23 ff., Table 7.

The Americans have indeed engaged more heavily in the EEC than the EEC countries themselves. In Great Britain the EEC share of 13.1 p.c. in direct investments at the end of 1971 compared with a US share of 64.2 p.c. In Germany 42.8 p.c. of the net capital received by June 30, 1974 had come from the USA and 35.7 p.c. from other EEC countries¹³. In 1966–71, 38.2 p.c. of the direct investment inflows into the original EEC originated in the USA and 26.0 p.c. in the EEC area¹⁴. On the other hand it is to be noted that the proportion of internal link-ups increased between 1966 and 1971 from 35 to 41 p.c. while those involving third-country participation declined from 65 to 59 p.c.¹⁵.

Characteristic of the internal investment and production linkages inside the EEC of the Six — as shown by the net capital flows for direct investment in 1962–71 — is that

the largest number of direct investments was recorded in Germany and German firms are the most important "intra-investors";

Belgium-Luxemburg has — to judge from the proportion of intra-EEC-investments in the total of direct inward and outward investments — reached the highest degree of EEC integration;

France, Italy and Belgium-Luxemburg are net recipient and Germany and Holland net donor countries.

Internationalisation of Market Relations

As the multinationals extend their production abroad, an increasing proportion of the international trade will be carried

¹³ cf. *Bundesanzeiger*, No. 192, October 12, 1974; and *Book Values of Overseas Investment*, *ibid.*

¹⁴ cf. Statistical Office of the EC, *Balances of Payments*, Brussels 1966–72.

¹⁵ cf. EC Commission, *Second Report on Policies Concerning Competition*, Brussels-Luxemburg 1973, p. 163, Table 2.

out in the organisational framework of multinational enterprises. There are indications to suggest that this applies to the EEC trade even more than to foreign trade in general. A Report of the Hamburg Institute for International Economics about the internationalisation of the German chemical industry has shown that in 1971 the German firms received about one third of their imports from their foreign subsidiaries. More than 90 p.c. of these deliveries came from EEC countries. Against this the internal exports are subject to a broader regional distribution. Of these in 1971 equal shares went to EEC countries, other industrialised countries and LDCs¹⁶. Thus a mutual division of labour of greater dimensions can be found only within EEC. Even though the German chemical industry cannot be regarded as representing the situation in other industrial branches or countries it becomes clear after all that the division of labour in the EEC is no longer effected entirely by trade at arm's length between independent enterprises but the ramifications between firms in different countries and internal group exchanges of goods and services are of growing importance.

This internalisation of market relations can, on the one hand,

increase economic efficiency while, on the other, the narrowing of those sectors of the economy which are still ruled by free market competition, contributes substantially to the problems that are being raised in connection with the spreading of multinational enterprises.

Dangers to Competition

The problems confronting the EEC countries as a result of the internalisation of market relations are to some extent due to the multinationals' conduct in the market and their attitude to competition. Competition is not necessarily ruled out by their superiority to local firms. On the contrary, the foreign newcomer may "stir up established conduct patterns and increase the amount of independent (as opposed to interdependent) behaviour"¹⁷ by making use of new price and product strategies. Problems will however arise if

- multinationals do not enter the market by setting up new enterprises but by taking over existing firms;
- their superiority to local firms rests on greater power and not on greater efficiency.

¹⁶ cf. R. Jungnickel, Die Internationalisierung der Chemischen Industrie und ihre Aktivitäten in ausgewählten Entwicklungsländern (The Internationalisation of the Chemical Industry and its Activities in Selected LDCs), HWWA Report No. 29, Hamburg 1974.

A Harvard Business School study covering the 187 largest US and 226 largest non-US multinationals showed that in 814 of 1,451 instances (= 56.1 p.c.) in the nine EEC countries up to January 1, 1968, the US companies had bought their way into existing companies instead of establishing new enterprises. Non-US firms chose this form of gaining access to a market even more often: until January 1, 1971, 1,073 of 1,694 new entries (= 63.3 p.c.) in the EEC were made through the take-over of existing firms¹⁸.

The empirical evidence concerning power-related entry into a market is scanty. Certain is only that the typical multinational is a big company and that the largest multinationals are widely represented in EEC countries. To illustrate the point, at the end of 1973, 78 of the 100 foreign-domiciled groups with the largest international sales in the world were represented in the Federal Republic by 678 establishments. They accounted for more than 40 p.c. of the capital resources of all German companies with foreign shareholders¹⁹.

¹⁷ cf. R. E. Caves, International Corporations: The Industrial Economies, Vol. 28, No. 149, p. 15.

¹⁸ cf. J. Vaupel, J. Curhan, The World's Multinational Enterprises, Geneva 1974, p. 330 ff.

¹⁹ cf. Eine Welle ausländischer Neugründungen (A wave of new foreign companies), in: FAZ, No. 269, November 19, 1974.

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How far the foreign-owned enterprises draw on the potential of their groups for purposes of competition is a moot point but even by themselves they are certainly holding important competitive positions. In Germany, for instance, almost half the direct investment capital from abroad has gone into companies with a nominal capital of \$ 100 mn or more; in 1970 there were 59 such companies²⁰. In Italy the foreign-owned joint stock companies are on average four times larger than the indigenous companies. In Belgium 28.6 p.c. of the enterprises with 1,000 workers or more are foreign while representing only 1.6 p.c. of all firms; 37 p.c. of the foreign enterprises in Belgium have no competitor inside the country, and 19 p.c. face competition only from other foreign firms²¹.

Problems of Technological Dependence

The competitive strength of the multinationals is not entirely due to their size and worldwide ramifications. Decisive is often their technological lead, which means for the host countries of multinational companies that, on the one hand, they can share in the "fruits" of technical progress. On the other, the major part of all research and development work is done in the multinationals' home countries.

The licence-fee "balance-sheet" of the foreign firms operating in Germany, for example, showed a heavy deficit in 1969: outgoings of DM 500 mn compared with earnings of DM 5 mn (a similar calculation covering all firms showed a surplus: outgoings of DM 200 mn against earnings of DM 300

²⁰ cf. German Federal Bank, *Ausländische Beteiligungen an Unternehmen in der Bundesrepublik* (Foreign holdings in enterprises in the Federal Republic), in: *Monatsberichte der Deutschen Bundesbank*, 24th year (1972), No. 1, p. 33.

²¹ cf. EC Commission, *The multinational enterprises in the framework of the Community's regulations*, Brussels 1973, p. 25 f.

mn)²². There is great concern therefore that the multinationals may actually be widening the "technological gap" instead of closing it, since the host countries are prevented from undertaking technological efforts of their own.

Stronger Agglomeration Tendencies

There is evidence of regional concentration by the multinationals on the most important markets alongside their concentration on the "high-technology" sectors. Although substantial incentives are being offered for investment in lagging EEC regions, the central zone of the EEC, the Belgium-Luxemburg/Holland/Germany triangle, and the area around London are in fact the main investment areas of the multinationals. An explanation is supplied by various studies of the motives for foreign investments which show that sales-related considerations are the chief determinant for investment decisions. The aim is to gain a foothold in expanding markets, maintain market positions endangered by trade obstacles and rivals and ensure better market penetration. Differences in the relative factor prices, on the other hand, have so far not been a major investment inducement.

Foreign Trade and Balance of Payments

Multinational enterprises account for a substantial part of the foreign trade of the EEC countries. The German multinationals, for instance, supplied 36.7 p.c. of all exports by industry in 1972. Adding the share of the German subsidiaries of foreign multinationals (11.7 p.c.), nearly half of all German industrial exports were handled by multinationals, and 43.4 p.c. of this half consisted of intra-

²² cf. EC Commission, *The multinational enterprises in the framework of the Community's regulations*, *ibid.*, p. 25.

group deliveries (44.3 p.c. in the case of the German multinationals and 40.8 p.c. in that of the subsidiaries of foreign multinationals). Intra-group exports thus accounted for 21 p.c. of all industrial exports²³.

In Great Britain foreign-owned subsidiaries are supplying 24 p.c. of the exports of finished manufactures; 41.7 p.c. of this (= 10 p.c. of all exports) is going to group companies in other countries. Another 12 p.c. of British exports is sent by British multinationals to foreign subsidiaries. In Belgium 30 p.c. of all exports of finished manufactures is supplied by foreign-owned companies which are sending one-third of their exports to group companies²⁴.

Intra-group deliveries play an even greater role on the import side. That is true at least of the foreign companies operating in Germany: while intra-group exports accounted for 40.8 p.c. of the total exports of the 57 firms with an annual turnover of DM 200 mn or more in 1972, 76.1 p.c. of their imports came from companies in the same groups; 10.4 p.c. of all German imports of industrial products were thus intra-group imports by subsidiaries of foreign firms²⁵.

Internalisation implies that the foreign trade relations are largely determined by the allocation interests of the whole group rather than directly by market data. The export performance of the foreign enterprises is nevertheless often better or at least not much worse than that of native firms. In Holland foreign subsidiaries are effecting 55 p.c. of their sales outside

²³ cf. The Hamburg Institute for International Economics, *Die Rolle der multinationalen Unternehmen im Zusammenhang mit der deutschen Währungspolitik* (The role of the multinational enterprises in connection with German monetary policy), Hamburg 1974, p. 58.

²⁴ cf. EC Commission, *The multinational enterprises in the framework of the Community's regulations*, *ibid.*, p. 22 f.

²⁵ cf. The Hamburg Institute for International Economics, *ibid.*, p. 58.

the country, compared with 38 p.c. in the case of the Dutch-owned firms²⁶. In Germany the establishments of US multinationals in manufacturing industries in 1970 placed 15.8 p.c. of their sales abroad, which was slightly less than the average for the whole manufacturing industry²⁷.

Exploitation of Dissimilar Economic Policies

There is a danger of the effectiveness of national economic policies being impaired because multinational companies pursuing a uniform strategy in their operations in different countries have more room for manoeuvring than the authorities which have to make the political decisions, and can exploit differences in regard to political regulations and measures between the various national economies to their advantage and thereby frustrate national economic policies in important spheres.

Different anti-trust policies may prompt multinationals to concentrate their external growth in the more "liberal" countries. In the EEC where trade barriers have been largely removed this may lead to increased concentration, so that as a rule there will be fewer potential suppliers and less choice for the consumer even in the markets of the more "restrictive" countries. Individual states can do very little to check this development by national measures to encourage competition because of the territorial limits to their effective application.

Monetary and Fiscal Effects

Similar considerations apply to monetary policy. If a country pursues a restrictive money and credit policy, multinational enterprises can draw on credit-lines and balances in other

countries which pursue an "easier" money policy. The transfer of such funds presents no problem where capital movements have been liberalised. Multinationals are in a position to side-step controls over capital transfers by modifying credit terms, manipulating the prices for goods and services supplied from one country to another, etc. In most cases however their far-reaching financial capabilities are not fully utilised out of regard for local banking connections. The multinationals largely confine themselves to transactions aiming at the avoidance of exchange risks²⁸.

Taxation policy is another critical sector of economic policy. Multinational companies can exploit tax differentials resulting from differences between tax systems in two ways: they can site production facilities where the tax burden — allowing for all other locational factors — is lowest; and if the location is predetermined, they can manipulate the prices in intra-group exchanges of goods and services, allocate overheads, interpose basis companies, etc., in such a way that the profits accrue where they are subject to relatively low taxes.

Empirical studies have shown that multinational companies attach considerable importance to "tax planning". Internal difficulties however often prevent rigorous exploitation of all the available opportunities.

The state authorities are not alone in fearing that their freedom of action may be impaired by the multinationals. The trade unions feel that their bargaining power is decisively weakened by the impenetrability of the man-

agement set-up in the multinationals and by their international mobility and flexibility.

Second Best Solutions

The analysis has yielded the following results:

- The division of labour within the EEC as well as that between the EEC and the rest of the world is to a large extent determined by the activities of multinational enterprises.
- This development can substantially contribute to the integration process. At the same time however it raises new problems for the politically responsible persons and the social groups.
- These problems result, on the one hand, from the marketing and competition strategies of multinational enterprises.
- On the other hand, the problems are traceable to different national regulations.

The "first best solution" of the problems would require an adaptation of the nationally limited area of control of the governments and social organisations to the international options of the multinational enterprises. An internationalisation of control must, however, remain illusory, since governments are not prepared to accept a world-wide reduction of their sovereignty, and an international cooperation of trade unions also meets with many opposing powers. Approaches to deal with the problems must therefore be sought "in the grey areas of second best solutions". In the EEC it will be of particular importance to improve the tools for common anti-trust, industrial and regional policies and to make further progress on the way to a harmonisation of international economic policies.

²⁶ cf. EC Commission, *The multinational enterprises in the framework of the Community's regulations*, *ibid.*, p. 22.

²⁷ cf. The Hamburg Institute for International Economics, *ibid.*, p. 50.

²⁸ cf. The Hamburg Institute for International Economics, *ibid.*