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# The Role of Multinationals in the World Economy

by Jan Winiecki, Warsaw\*

**Based on trends observed during the 'sixties, a number of forecasts have projected an increasing domination by multinational corporations of the Western economies. By confronting them with the available empirical evidence of the 'seventies, Dr. Winiecki reveals some striking discrepancies between these forecasts and the realities of the past decade, the interpretation of which may contribute to a more realistic assessment of the future role of multinational corporations.**

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Forecasts of the activities of multinational corporations (MNCs) can be classified almost without exception into one of the following two categories. Either they are extrapolations into the future of the trends observed during the 'sixties, or they are based on analyses of changes in the international environment for MNCs' activities, modifying those trends to a varying extent. It is worth noting that the share of the former notably decreased with the passing of the 'seventies.

Forecasts belonging to the first category have predicted a future domination by MNCs of the economy of the non-socialist world. Such expectations were derived from comparisons of growth rates of direct foreign investments (DFI), which are considered as an indicator of the dynamics of MNCs' activities, with those of international trade and of gross national product (GNP). The higher rate of growth of direct foreign investments (10 % annually as compared to 8 % for international trade and 5 % for GNP) constituted, therefore, according to these authors, a portent of a future dominance of foreign production over foreign trade in international economic relations. With the annual production of MNCs' subsidiaries abroad estimated as equal to twice the value of the

direct foreign investments, the foreign production was therefore destined to take an increasing share of the gross world product<sup>1</sup>.

International environment-based forecasts look into the continuity and change in this environment as determinants of the MNCs' activities. These forecasts, which are more systematic analytically, lead to widely different conclusions – from forecasts of further dynamic expansion of MNCs to their decline (it is characteristic, though, that there are no forecasts envisaging a disappearance of this phenomenon)<sup>2</sup>. A majority of forecasts belonging to the second category reject the notion of the linear growth of MNCs' activities, as measured by the volume of direct foreign investment, and envisage their slow-down or even a decline.

## Doubtful Forecasts

How well fare the forecasts discussed above in the light of the available empirical evidence? A glance at

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\* Department of International Economic Relations, Polish Institute of International Affairs. – This article is a part of a paper prepared for the 2nd Polish-Hungarian workshop on the world economy, Budapest, December 5-8, 1979.

<sup>1</sup> A reasoning of this kind can be found, for example, in: H. Kahn: A View of the Economic World of 1990, in: A Look at Business in 1990. The White House Conference on the Industrial World Ahead, Washington, D. C., 1972, p. 16; R. Lattes: Mille milliards de dollars – Le monde économique de demain, Paris 1969. Polish edition: Warsaw 1973, pp. 21-27, 36, 92-97; J. Polk: The New International Production, in: World Development, Vol. 1, No. 5, May 1973.

<sup>2</sup> Cf. for positions on both ends of the continuum: Synoptic Context One: The Prospect for Mankind and the Year 2000 Ideology, Hudson Institute, Croton-on-Hudson, August 1, 1972; and K. A. Ringbakk: Strategic Planning in a Turbulent International Environment, in: Long Range Planning, No. 3, June 1976.

**PRIVATE INVESTMENT**

**Table 1**  
**Annual Growth Rates of Direct Foreign Investment**  
**in 1967-1973 and in 1973-1976;**  
(Computed on Dollar Basis; in %)

	1967-1973	1973-1976
United States	10.2	10.6
Great Britain	7.4	6.1
Federal Republic of Germany	25.8	18.6
France	6.6	7.8
Japan	37.6	23.4
Switzerland	14.2	18.8
Canada	13.2	12.5
Italy	7.2	-3.2
World	11.2	13.0

Source: Own computations on the basis of: Transnational Corporations in World Development: A Reexamination, New York, United Nations, 1978.

Table 1 may suggest that the protagonists of the extrapolative approach have been right in their projections. The growth rate of world direct foreign investment in 1973-1976 is even a bit higher than in the 1967-1973 period: it rose from 11.2 % to 13 % annually. The growth rate of investments of the main investor abroad, namely the US corporations, increased, too. The same is true for the Swiss and French corporations, as well as for corporations from some other capitalist countries. Only the Italian corporations registered an absolute decline.

However, an increase of investments calculated according to their book value indicates their nominal value at par with the value of the currency in the year of investment. As a result, investments of a given value in 1975 are not equal to investments of the same value in, say, 1965. Moreover, inflation increased sharply during the 'seventies (3.9 % annually in 1965-1970 and 8.5 % in 1970-1975). Corrected for inflation, direct foreign investment dynamics slowed down in the 'seventies.

Forecasts envisaging a future domination of MNCs in the world production and in international economic relations look even more doubtful. Comparative analyses of growth rates of GNP, exports (including those of machinery and equipment) and direct foreign investments calculated at current prices, point at the far reaching changes that took place in the 'seventies.

**Reversed Situation**

In the 1960-1971 period the elasticity of the increase of direct foreign investment with respect to GNP increase was higher than one and fluctuated between 1.51 and 4.22 in all capitalist countries with the exception of France. The situation has almost completely been reversed in 1971-1976. The GNP increase was generally faster than or equal to the increase of the direct foreign investments. The

**Table 2**  
**Increase of GNP, Exports and Direct Foreign Investments in 1960-1971 (1960 = 100) and in 1971-1976**  
**(1970 = 100)**  
(at current prices<sup>1</sup>)

	USA	Great Britain	FR Germany	France	Japan	Italy
<b>1960-1971 (1960 = 100)</b>						
GNP	208.0	215.5	254.6	276.4	518.5	294.4
Exports	213.1	219.0	351.1	300.1	529.3	414.4
Exports of machinery and equipment	278.0	221.0	372.0	409.0	1127.0	532.0
Direct foreign investments	262.8	219.9	752.0	160.6	1567.1	406.1 <sup>a</sup>
<b>1971-1976 (1971 = 100)</b>						
GNP	159.1	214.5	149.1	191.5	204.5	227.9
Exports	260.7	205.3	260.4	271.0	280.0	244.6
Exports of machinery and equipment	256.0	231.0	263.0	294.0	350.0	251.0
Direct foreign investments	159.2	135.4	272.6	163.0	437.5	96.6

<sup>1</sup> DFI according to their book value

<sup>a</sup> in 1962-1971

Source: Own computations; with respect to GNP: (for the US) Economic Report of the President, Washington, D.C., January 1979; (for other countries) International Financial Statistics, various issues; with respect to Exports: Rocznik Statystyczny Handlu Zagranicznego 1976, 1977 (Statistical Yearbook of Foreign Trade, Warsaw 1976 and 1977); with respect to Direct Foreign Investment: for 1960-1971, H. Krägenau: Internationale Direktinvestitionen 1950-1973, Hamburg 1975; for 1971-1976, Statistical Abstract of the United States 1978 (except Japan); for Japan in this period, BIKI, Prilozhenie, No. 3, 1978.

situation was different only in the Federal Republic of Germany and Japan – the two late-comers in the foreign investment area. But even in these countries the elasticity of direct foreign investment with respect to GNP also decreased (from 4.22 to 3.52 and from 3.51 to 3.23, respectively).

An even more marked reversal took place in the relation between direct foreign investments and exports. The elasticity of direct foreign investments with respect to exports decreased for the US from 1.44 to 0.37 and for Great Britain from 1.00 to 0.34. An elasticity higher than one was again maintained only by the Federal Republic of Germany and Japan, but even there the scale of the decrease was substantial – from 2.60 to 1.08 and from 3.42 to 1.87, respectively. Furthermore, if we compare the elasticity of direct foreign investment with respect to exports of machinery and equipment only, i. e. with respect to the most dynamic component of world trade, we would see that generally the coefficient was not higher than one, even in 1960-1971.

We may thus conclude that in the 'seventies direct foreign investments were increasing only as fast or even more slowly than GNP in a majority of home countries. They were increasing at a much slower rate than the exports of those countries.

It should also be added that, when relating world direct foreign investments to world exports, at any given point of time, we notice a regular decrease of the ratio between the two, starting already in the mid-'sixties (from 0.49 in 1967 to 0.29 in 1975-1976). The ratio is also decreasing for the United States and Great Britain – the two countries where it was higher than one during the 'sixties (from 1.85 and 1.25 in 1967 to 1.16 and 0.70 in 1975, respectively.).

The question ought to be asked whether we are facing here a deviation from the trend or a major discontinuity. The data presented here support, in our opinion, the latter explanation: the changes are slow, but they all point in the same direction.

#### Sources of Error

The sources of error in forecasts envisaging a continuous growth of the share of MNCs in the gross world product of the non-socialist countries<sup>3</sup>, as well as the replacement of world trade as the dominant sphere of international economic relations by direct foreign investment are, in the main, as follows.

□ First, we are witnessing a process of increasing knowledge of the functioning of MNCs and a growing

capability of governments to control and regulate their activities. The impact of these changes on MNCs' behaviour has not been taken into consideration in the forecasts of the linear growth of MNCs' activities, although, it should be underlined, the opposite was the case with respect to those international environment-based forecasts which envisaged a decline of the rate of growth of the MNCs' activities.

□ Secondly, the impact of changes in the GNP production structure on the ratio of direct foreign

<sup>3</sup> Traditionally an estimate of the value of foreign production of MNCs' is done by multiplying the value of direct foreign investments by a factor of two, both in scholarly papers and in official documents. This coefficient derived from the ratio between investments of American MNCs and their foreign production in the 1966-1970 period has never been verified for foreign production of MNCs from other countries. On the other hand, it ceased to reflect even the reality of American MNCs during the 'seventies, growing rapidly to 3.7-3.9 in 1974-1975.

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investment (or foreign production) to GNP was not appreciated in this context. As a result of a steady increase of the share of the service sector, the share of GNP produced in mining and manufacturing, the principal areas of the MNCs' expansion, has been gradually shrinking. Thus, even if MNCs are increasing their share in the value added in industry of capitalist countries, it is a growth of the share in a shrinking sector. The increase of the share of the service sector is particularly rapid when it is expressed in current prices, due to the specific character of inflationary processes in the Western world, generating a more rapid growth of prices in this sector<sup>4</sup>. As a result we observe here a simultaneous increase of the penetration by MNCs of manufacturing industries of many capitalist countries (as measured by the value of their output) and a stagnation or a decline of their share in the GNP of these countries.

□ Thirdly, after the 1973 jump in oil prices, an emergence of current account deficits in many Western countries established, in a few cases, a tendency to more stringent control of the outflow of new foreign investments to equilibrate the basic balance.

The causes of the changes in the relationship between foreign direct investments and exports are much more complex. We should note, however, that the trend discontinuity has taken place in both respects.

### A Global Divestment Process?

To sum up, if we consider the empirical evidence of the 'seventies as being of a more long-lasting value, we may conclude that the domination of the economy of the non-socialist world by MNCs should not be regarded as highly probable. It is not likely either that foreign trade will be superseded by direct foreign investments and foreign production as the main sphere of international economic relations. They will be still expanding but their rate of growth in real terms will be lower than in the past. On the other hand, we should not expect an absolute decline of direct foreign

investment in nominal terms, i. e. a kind of global divestment process as prophesied sometimes as an outcome of growing regulatory activities of host countries, and, in particular, as a result of nationalizations and expropriations in the Third World<sup>5</sup>.

The divestment process should be looked upon from a proper perspective. Best known – and therefore exerting the strongest impact on the views in this respect – are the so-called forced divestments – nationalizations, expropriations, etc. More or less exact data on the divestment process are scarce and deal nearly exclusively with American corporations, but the conclusions from that limited evidence are telling: cases of forced divestment constituted in 1967-1971 only 4 % and in 1972-1975 5 % of the total<sup>6</sup>. This means that forced divestments occurred on the average only once in twenty cases of divestments, the remaining 19 cases being the result of economic considerations. Most of the divestments occur in Western Europe where the slow-growth environment results in sometimes very far-reaching reassessments of the profitability of subsidiaries. If the journalists' reports are to be believed, divestments in that region exceeded new investments in 1978 (as measured by value of DFI<sup>7</sup>).

Foreign investments, therefore, are obviously subject to periodical reassessments and negative opinions on their profitability are reflected sometimes in a discontinuation of foreign operations. Forced divestments were extensive only in the petroleum industry and only in the sphere of crude oil production where the share of private corporations fell sharply from 73 % in 1972 to 30 % already in 1975<sup>8</sup>.

It is more difficult, however, to answer the question whether the divestment process is gaining strength or not. On the one hand, estimated in terms of value the ratio of divestments to new investments has been fluctuating, more or less, within the same range (4.5 – 9.0 % in 1967-1971 and 4 - 8 % in 1972-1975)<sup>9</sup>. On the other hand, the ratio of the divestment cases to the number of new investments or expansions showed a continuous increase (from 9.2 % in 1967 to 36.6 % in 1973)<sup>10</sup>.

<sup>4</sup> On this subject see J. Winiecki: Sources of Inflation in the Western Economies. Some Theoretical Considerations, in: *Maandschrift Economie*, No. 11-12, 1978.

<sup>5</sup> Cf. for example, gradually more pessimistic assessments by E. Rose in "Fortune" of September 15, 1968, August 1973 and August 1977, and in particular his most recent assessment: Why the Multinational Tide is Ebbing, pp. 111-114, 116, 118, 120.

<sup>6</sup> See J. Chopra, J. J. Boddewyn, R. L. Torneden: U. S. Foreign Divestment: A 1972-1975 Updating, in: *Columbia Journal of World Business*, Spring 1978, No. 1, p. 17.

<sup>7</sup> *Business Week*, July 9, 1979, p. 51.

<sup>8</sup> Excluding investments in North America. See G. Chandler: The Innocent Oil Companies, in: *Foreign Policy*, Summer 1977, No. 27, p. 60.

<sup>9</sup> J. Chopra, J. J. Boddewyn, R. L. Torneden, op. cit., p. 17.

<sup>10</sup> Coefficient derived from dividing the number of divestments (see J. Chopra, J. J. Boddewyn, R. L. Torneden, op. cit., p. 16) by the number of new subsidiaries and expansions (see J. B. Rhodes: U. S. New Business Activities Abroad, in: *Columbia Journal of World Business*, Summer 1974, No. 2, p. 100).