Department of Economic and Social Affairs

MULTINATIONAL CORPORATIONS IN WORLD DEVELOPMENT

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NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

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PREFACE

The United Nations Economic and Social Council, in resolution 1721 (LIII) adopted unanimously on 28 July 1972, requested the Secretary-General to appoint a Group of Eminent Persons to study the role of multinational corporations and their impact on the process of development, especially that of developing countries, and also their implications for international relations; to formulate conclusions which may possibly be used by governments in making their sovereign decisions regarding national policy in this respect, and to submit recommendations for appropriate international action.

The present report has been prepared by the Department of Economic and Social Affáirs of the United Nations Secretariat to facilitate the deliberations of the Group of Eminent Persons. The report seeks to clarify various concepts pertaining to multinational corporations, provides basic data on their size, geographical distribution, industrial structure and ownership patterns, and assesses their dimensions in the world economy. The review of the salient characteristics of multinational corporations is followed by a discussion of their impact on international relations, and on home and host countries, including tensions that may develop between them and these countries. An account is also given of the implications of the operations of multinational corporations for the international monetary and trade regimes as well as of jurisdictional issues relating to taxation. In conclusion, the report reviews existing policies in respect of multinational corporations and includes proposals for national, regional and international action. A summary appears at the end of each chapter. In addition, annex I contains excerpts from relevant decisions of United Nations bodies, annex II provides alternative terms and definitions of multinational corporations and annex III contains statistical tables.

In view of the widespread interest in the workings and implications of multinational corporations, this document is being made available to a wider audience in the hope that the information and analyses presented therein will make a useful contribution to the debate on this important phenomenon.

INTRODUCTION

In the past quarter of a century the world has witnessed the dramatic development of the multinational corporation into a major phenomenon in international economic relations. Its size and geographical spread, the multiplicity of its activities, its command and generation of resources around the world and the use of such resources to further its own objectives, rival in terms of scope and implications traditional economic exchanges among nations.

The unprecedented expansion of the multinational corporation has evoked a strong interest in this phenomenon among scholars, the mass media and the general public. While much information and understanding have been gained from this surge in interest, the complexity of the subject and the controversy that surrounds it call for serious analysis lest myths should prove more appealing than facts and emotions stronger than reason. Multinational corporations, which are depicted in some quarters as key instruments for maximizing world welfare, are seen in others as dangerous agents of imperialism. The basic facts and issues still need to be disentangled from the mass of opinion and ideology and a practical programme of action still awaits formulation.

The deliberations of the United Nations on this subject reflect the preoccupations and currents of thought of the times. The United Nations Economic and Social Council, in unanimously adopting resolution 1721 (LIII) in July 1972, formally and explicitly recognized the importance of multinational corporations as a subject for comprehensive study and possible action by the world organization. Many previously adopted decisions had already had some bearing on the matter. Recently the social consequences of the activities of multinational corporations was the theme of a resolution adopted by the International Labour Conference in 1971, and in 1972 the Third Session of the United Nations Conference on Trade and Development adopted a resolution on restrictive business practices (resolution 73 (III)). Many other resolutions and decisions adopted within the United Nations family, on topics ranging from the flow of resources to the developing countries through permanent sovereignty over natural resources and the transfer of technology to the importance of the promotion of exports of manufactures for the over-all strategy of development, are in one way or another related to the present subject. 1/ Partial and indirect investigation, however, is no longer enough. Although progress can often be accelerated by a more limited approach, in this case the full import of the subject can best be appreciated by taking a broad perspective.

The political and social dimensions of the problem of multinational corporations are only too apparent. The United Nations present involvement in the subject was in fact prompted by incidents involving certain multinational corporations. The concern and excitement occasioned by those incidents

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1/ See annex I for excerpts from resolutions of United Nations bodies relevant to the issue of multinational corporations.

testifies that the general public is no longer willing to stand by passively. The degree of uncertainty that exists regarding the way in which the power of the multinational corporations may be exercised and what the reactions and consequences are likely to be is no longer acceptable. Despite the considerable and transnational power which multinational corporations possess they, unlike governments, are not directly accountable for their policies and actions to a broadly based electorate. Nor, unlike purely national firms, are the multinational corporations subject to control and regulation by a single authority which can aim at ensuring a maximum degree of harmony between their operations and the public interest. The question at issue, therefore, is whether a set of institutions and devices can be worked out which will guide the multinational corporations' exercise of power and introduce some form of accountability to the international community into their activities.

The multinational corporations have developed distinct advantages which can be put to the service of world development. Their ability to tap financial, physical and human resources around the world and to combine them in economically feasible and commercially profitable activities, their capacity to develop new technology and skills and their productive and managerial ability to translate resources into specific outputs have proven to be outstanding. The importance of the foreign private sector to the development of developing countries was recognized in the International Development Strategy for the Second Development Decade unanimously adopted by the United Nations General Assembly in 1970. At the same time, the power concentrated in their hands and their actual or potential use of it, their ability to shape demand patterns and values and to influence the lives of people and policies of governments, as well as their impact on the international division of labour, have raised concern about their role in world affairs. This concern is probably heightened by the fact that there is no systematic process of monitoring their activities and discussing them in an appropriate forum.

The important contribution that such firms can make to world welfare needs to be understood in the context of the objectives that they pursue. While their operations are often global, their interests are corporate. Their size and spread imply increased productive efficiency and reduction of risks, both of which have positive effects from the point of view of the allocation of resources. Yet, their predominance can often create monopolistic structures which reduce world efficiency and may displace or prevent alternative activities. The concentration of multinational corporations on the production and promotion of certain types of products and services not only influences consumption patterns but, in developing countries, often responds mainly to the demand of small segments of the population.

The divergence in objectives between nation-states and multinational corporations, compounded by social and cultural factors, often creates tensions. Multinational corporations, through the variety of options available to them, can encroach at times upon national sovereignty by undermining the ability of nation-states to pursue their national and international objectives. Moreover, there are conflicts of interest regarding participation in decision-making and the equitable division of benefits between multinational corporations and host as well as home countries. In recent years the situation has been sharpened, on the one hand by changes in the internal socio-political conditions of many

countries, and on the other, by shifts in bargaining positions. As a result, existing arrangements are frequently questioned and new ones sought.

Although the issues in regard to multinational corporations must be understood within the socio-political context, they are closely bound up with the international economic system. However sacred and inviolable national sovereignty may be from the political point of view, few national boundaries correspond to economic demarcation lines and few states are self-contained economic entities. Most nations would find it both necessary and useful to have some system of international exchange not only for goods and services, but also for finance and technology. While the conditions in the real world hardly permit an ideal system of international exchange and co-operation, a practical economic solution is required in which the political entities, differing widely in endowment, whether by accident or design, can co-operate to reconcile their conflicting interests, harmonize their policies for their mutual benefit, and achieve a greater measure of international distributive justice.

There is, of course, no unique solution whereby the interests of all parties can be reconciled. Nor is there a ready means of attaining the accepted goal of greater distributive justice in the international context. Few can doubt, however, that the issues raised by the multinational corporation have a direct bearing, for good or ill, on international relations and call for urgent international attention. Many will agree that some measure of accountability of multinational corporations to the international community should be introduced. Many will also agree that the vast capabilities of multinational corporations can be put to the service of mankind. Because of the intrinsic difficulty of the subject and the practical obstacles in the way of arriving at speedy solutions, it may be useful to regard the present study as the beginning of a series of efforts. Immediate steps can be taken in the short run where a consensus is found to exist, and at the same time a start can be made towards longer-run measures that will demand further investigation and negotiation. In order to facilitate discussion some possible lines of action are proposed below, preceded by a review of basic information and an assessment of the issues involved.

I. CONCEPTS AND DIMENSIONS

The upsurge in interest in the multinational corporation has been accompanied by an expansion of the vocabulary relating to it. The various terms and concepts used have often been developed to suit particular purposes at hand and are subject to individual preferences. In empirical research, moreover, which in most cases has to rely on data derived from administrative records in which the concepts are not uniform, differing definitions have been employed. A review and clarification of these concepts and definitions will help to avoid unnecessary controversy and facilitate an understanding of the true dimensions of multinational corporations.

Any description, however, of the dimensions of multinational corporations faces manifold problems. The difficulties stem not only from the limited availability of conventional data, but also from the fact that even when they are available the data do not adequately measure the phenomenon of multinational corporations. Neither the number, sales nor earnings of affiliates, nor capital flows and investment stock, particularly taken separately, can fully measure the size of the operations of the multinational corporation. The large incidence of inter-affiliate transactions and attendant transfer pricing can distort the real picture, as can other practices involving capitalization, accounting procedures and control of local resources. Until sufficient methodological work and collection of standard information has been carried out the figures must be treated with caution and their interpretation is subject to a considerable margin of uncertainty.

Definitions 1/

While the terms "corporation", "firm" and "company" are generally used interchangeably, the term "enterprise" is sometimes preferred as clearly including a network of corporate and non-corporate entities in different countries joined together by ties of ownership. In the present context, "corporation" is not used as a legal term but rather in accordance with common usage as reflected in the wording of the Economic and Social Council resolution 1721 (LIII).

The term "multinational" signifies that the activities of the corporation or enterprise involve more than one nation. Certain minimum qualifying criteria are often used in respect of the type of activity or the importance of the foreign component in the total activity. The activity in question may refer to assets, sales, production, employment, or profits of foreign branches and affiliates.

A foreign branch is a part of an enterprise that operates abroad. An affiliate is an enterprise under effective control by a parent company and may

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1/ See selected definitions in annex II.

be either a subsidiary (with majority or sometimes as little as 25 per cent control of the voting stock by the parent company) or an associate (in which case as little as 10 per cent control of voting stock may be judged adequate to satisfy the criterion). In the broadest sense, any corporation with one or more foreign branches or affiliates engaged in any of the activities mentioned may qualify as multinational. More strictly, a particular type of activity (e.g. production), a minimum number of foreign affiliates (e.g. six), or a minimum foreign share of activity (e.g. 25 per cent of sales or assets) may be added as conditions for qualifying for the definition.

Such concepts are amenable to further variations according to the main characteristics and motivations of multinational corporations and may be rather theoretical in character. Some authors emphasize the fact that, despite the growing importance of foreign activities, many corporations are basically home-country oriented concerns that operate abroad, and prefer the terms "international" or "transnational". On the basis of their orientation, corporations are also distinguished into "ethnocentric" (home-country oriented), "polycentric" (host-country oriented) or "geocentric" (world-oriented). When internationalism is taken to the limit the corporation may be considered "a-national" and hence be referred to as "denationalized", "supranational" or a "cosmocorp".

Because of the broad frame of reference of this survey, in accordance with the terms of the Economic and Social Council resolution, the term "multinational corporation" is used here in the broad sense to cover all enterprises which control assets - factories, mines, sales offices and the like - in two or more countries. This definition has the advantage that no important aspect of the phenomenon (e.g. finance or services) or of the problem (e.g. questions associated with nationally-oriented enterprises or small firms) is arbitrarily excluded. It also permits maximum and flexible use to be made of existing data which are variously defined and not generally amenable to reclassification to suit a more restricted definition. At the same time, as the data that follow will indicate, there is a very high degree of concentration in multinational corporations, with a relatively few firms accounting for the bulk of their activities. Thus, a fairly good picture of the situation can frequently be obtained by concentrating on the largest and most important firms, especially those engaged in extractive and manufacturing activities.

One implication of the present definition is that multinational corporations are responsible for most foreign direct investment. Nevertheless, a study of multinational corporations must be distinguished from the study of foreign direct investment, chiefly because the most important questions to be asked in connexion with multinational corporations are not limited to and in some cases are even independent of financial flows. They concern a host of other activities also, such as the transfer of technology as well as goods, the provision of managerial services and entrepreneurship and related business practices, including co-operative arrangements, marketing restrictions and transfer pricing. As the operations of multinational corporations have expanded

and evolved, the elements not directly related to the provision of capital have become increasingly important. Moreover, these operations can only be understood as components of an international corporate system. As will be demonstrated below, parent companies that own foreign-based enterprises typically control these enterprises' activities and determine the way in which financial, technical and managerial resources are allocated around the world and the resulting mix of the entire package.

Size, patterns and trends

Size and concentration 2/

Although quantitative information on multinational corporations leaves much to be desired and the wide disparities in methods of estimation among corporations, economic sectors and countries introduce a considerable margin of error in the interpretation of all the essential economic magnitudes, a few general characteristics are discernible. A central characteristic of multinational corporations is the predominance of large-size firms. Typically, the amount of annual sales runs into hundreds of millions of dollars. Each of the largest four multinational corporations has a sales volume in excess of $10 billion, and more than 200 multinational corporations have surpassed the one billion level.

Indeed, for most practical purposes, those with less than $100 million in sales can safely be ignored. 3/ The very size of these corporations as compared with other economic entities, including the economies of many nations, suggests an important source of power. Moreover, there are strong indications that the multinational corporations have grown dramatically, especially during the last decade. As a result, both their absolute and relative size has expanded. 4/

Closely related to their large size is the predominantly oligopolistic character of multinational corporations. 5/ Typically, the markets in which they operate are dominated by a few sellers or buyers. Frequently they are also characterized by the importance of new technologies, or of special skills, or of product differentiation and heavy advertising, which sustains or reinforces their oligopolistic nature.

2/ See tables 1 to 10 in annex III for sources and explanation of quantitative information cited in this section. Sources for other quantitative information cited in the text and not contained in tables are indicated in separate footnotes in the text.

3/ Raymond Vernon, Sovereignty at Bay: The Multinational Spread of United States Enterprises (New York, 1971), p. 4.

4/ See section on dimensions in the world spectrum, below.

5/ Frederick T. Knickerbocker, Oligopolistic Reaction and Multinational Enterprise (Boston, 1973).

Another characteristic of the very large multinational corporations is their tendency to have a sizeable cluster of foreign branches and affiliates. Although almost half of some 7,300 multinational corporations have affiliates in one country only, nearly 200 multinational corporations, among the largest in the world, have affiliates in twenty or more countries. The establishment of subsidiaries or the making of foreign investments, particularly in industries in which there is a high degree of industrial concentration, generally tends to be bunched in periods of relatively strong economic activity. These activities frequently reflect the need to react to or counter the activities of other multinational corporations.

A further central characteristic of multinational corporations is that they are in general the product of developed countries. Although the non-availability of statistical information on multinational corporations in many developing countries obscures the over-all picture, this fact in itself reflects the high degree of concentration of the location of parent companies in the developed countries. Eight of the 10 largest multinational corporations are based in the United States. All in all, the United States alone accounts for about a third of the total number of foreign affiliates, and together with the United Kingdom, the Federal Republic of Germany and France, it accounts for over three-quarters of the total.

The high degree of concentration of the origin of multinational corporations in the developed countries is even more clearly revealed by the distribution of the stock of foreign direct investment as measured by estimated book value. Of a total estimated stock of foreign investment of about $165 billion, most of which is owned by multinational corporations, the United States accounts for more than half, and over four-fifths of the total is owned by four countries, the United States, the United Kingdom, France and the Federal Republic of Germany.

Moreover, foreign direct investment tends to be concentrated in a few firms within each home country. For the United States, about 250 to 300 firms account for over 70 per cent. For the United Kingdom, over 80 per cent of the total is controlled by 165 firms. For the Federal Republic of Germany, 82 firms control over 70 per cent and the nine largest foreign investors alone control 37 per cent of the total. In the case of Japan, although there are some giant firms active abroad, many small firms appear to have participated in foreign investment activities.

The size of affiliates varies with the sector and area of operation. In the natural resources sector, for example, affiliates appear to be three to four times larger than in manufacturing. In the petroleum sector and in trade the average size of affiliates is somewhat larger in developing countries than in developed. In manufacturing, the size of affiliates in developing countries is only half that in developed, whereas in public utilities it is double.

Some changes in this pattern appear to have occurred over the last two decades. The size of United States affiliates in developed market economies doubled between 1950 and 1966. In the European Community the increase was almost threefold and in Japan more than fourfold. On the other hand, no change was recorded in the average size of United States affiliates in developing countries, except in Africa where the United States presence had previously been very limited. A similar trend suggests itself among United Kingdom affiliates,

where an increase in average size in the developed market economies has not been matched by an increase in the size of affiliates in developing countries. The pattern reflects the fact that affiliates in developing countries often serve the local markets only, especially in the case of import-substituting manufactures, while the relatively larger affiliates in developed countries frequently serve bigger regional as well as national markets.

The dramatic growth of multinational corporations in the postwar period has been accompanied by unprecedented growth in the number of affiliates, the levels of capital flow and the stock of investment. Between 1950 and 1966, the number of United States affiliates increased three times, from 7,000 to 23,000. The number of affiliates of the 187 main United States multinational manufacturing corporations increased almost 3.5 times during the same period. The growth of United Kingdom affiliates during this period was less dramatic, possibly a reflection, among other factors, of the sluggish growth of the economy and the longer history in the United Kingdom of direct investment abroad. In the first twenty years after the Second World War, the number of affiliates less than doubled. In contrast, the more recent entry of Japan into the field has been marked by a rapid rate of growth in the number of affiliates. Although no precise data exist, there are indications that the growth of French affiliates was somewhat higher than those of the United Kingdom, while affiliates of the Federal Republic of Germany are growing more rapidly than those of the United States.

The growth of foreign affiliates has been accompanied by an increase in direct investment and the accumulated stock of foreign direct investment. During the last decade, the flow of direct investment from 13 countries of the Organisation for Economic Co-operation and Development rose from $2.9 billion to $7.9 billion a year. Among the countries with an above-average rate of increase were Japan, the Federal Republic of Germany, Italy, the Netherlands and the Scandinavian countries.

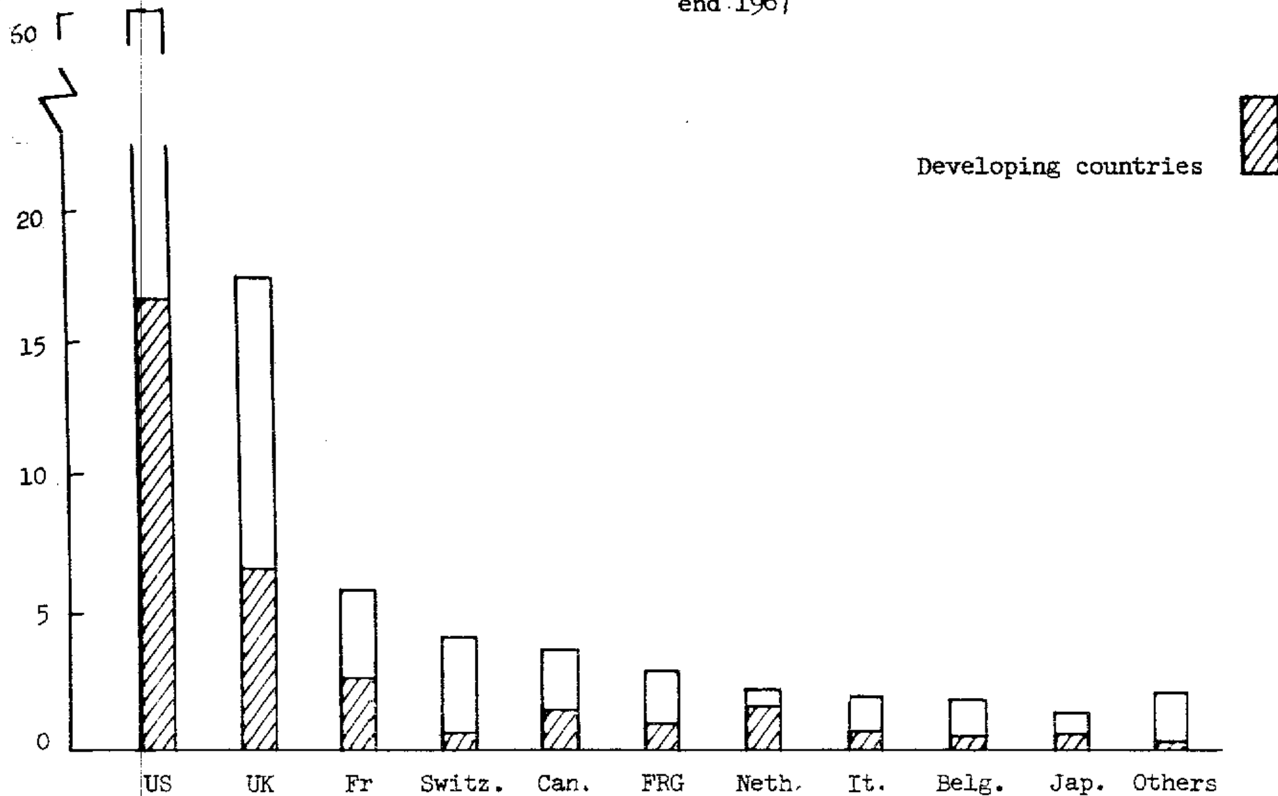
The growth of investment flow has been reflected in the increase in its cumulative stock. Between 1960 and 1971, the book value of United States direct investment increased from $33 to $86 billion and that of the United Kingdom from $12 to $24 billion. The most dramatic increase, from less than $300 million to approximately $4.5 billion, was registered by Japan - a fifteen-fold rise. Recent indications show that this pace has continued if not accelerated. Almost equally impressive was the performance of the Federal Republic of Germany, which exhibited an almost tenfold increase of investment stock to $7.3 billion by 1971.

Geographical distribution[6]

Although the network of multinational corporations is world-wide, the bulk of their activities is located in the developed market economies. Over two-thirds of the estimated book value of foreign direct investment is located in this area where the advanced economic level and similarities in institutional and social structures have facilitated the spread of the multinational corporate system.

6/ See also tables 11 and 12 in Annex III and figures 1 and 2 in the text. The discussion of the distribution of affiliates in this section refers to affiliate "links" as defined in the tables, except in the case of the United States.

Figure 1. Developed market economies (DAC countries): estimated stock of foreign direct investment by country of origin and area of investment, end 1967



Source: Table 12.

Figure 2. Developed market economies (DAC countries): distribution of estimated stock of foreign direct investment by developing region, end 1967
(Percentage distribution)

Source: Table 14.

Although the developing countries have received only about a third of the total estimated stock of foreign direct investment, that is, only half as much as the developed countries, the presence of foreign multinational corporations in the developing countries is generally of greater relative significance, since their economies account for much less than half of that of developed market economies.

Among the developing countries, the western hemisphere has attracted an estimated 18 per cent of the total stock of foreign direct investment, Africa 6 per cent, and Asia and the Middle East 5 and 3 per cent respectively. The distribution of affiliates (links) is roughly similar. Country variations reveal certain special relationships between the multinational corporations of some developed market economies and countries of investment.

The corporations of some of the smaller European countries with no colonial experience, such as Austria, Switzerland and the Scandinavian countries, have a limited spread in the developing world. Faced apparently with a limited domestic market, and at times with trade barriers, corporations in these countries have invested in other developed countries with a view to enlarging the market for their products. On the other hand, the developing countries' share in the number of affiliates as well as the estimated stock of investment is relatively high for Portugal, France, the United Kingdom, Italy, Belgium and the Netherlands. This pattern of distribution reflects the importance of former colonial ties. Thus, two-thirds of the French and Belgian affiliates in developing countries are in Africa, most of them in French-speaking countries. The more balanced distribution of the network of affiliates and stock of investment of the United Kingdom parallels to a large extent the geographical spread of the Commonwealth. One third of United Kingdom affiliates, for instance, are in developing countries, 40 per cent of them in Africa and 32 per cent in Asia. Of the total stock of United Kingdom direct investment, 38 per cent is in developing countries and is similarly geographically diversified. Sixty per cent of it is equally distributed between Asia and Africa, 26 per cent is in the western hemisphere and 13 per cent - above the average of 9.5 for all Development Assistance Committee countries - is in the Middle East. The Japanese presence in the developing countries is also pronounced. Sixty per cent of affiliates and investment stock is located in these countries, with a strong concentration in Central and South America and Asia. Central and South America is also the preferred region for affiliates as well as book value of investment in the case of the Federal Republic of Germany. Canada, in particular, and Switzerland also, shows a high concentration in the developing countries of the western hemisphere, while the Australian presence is felt almost exclusively in Asia.

A little more than one quarter of United States affiliates and of the stock of direct investment is located in developing countries. Central and South America account for about 70 per cent of the number of United States affiliates and of the book value of investment in developing countries, with the rest more or less equally distributed among Africa, Asia and the Middle East.

Further light can be shed on this distribution of foreign direct investment among developing areas and the pattern of relationships between home and host countries by examining the distribution of investment by industrial sector.

Distribution by industry: natural resources and manufacturing 7/

Historically, the activity of multinational corporations developed in the extractive and public utility areas before it became prominent in manufacturing. By the turn of the century, European and North American investors, attempting to secure their markets in petroleum, a field in which oligopolistic conditions were soon formed, had extended their vertical integration from the source of the supply to marketing. The entrenched United Kingdom and French positions in the Middle East were successfully challenged by United States corporations. Cartel arrangements concluded between multinational corporations before the Second World War were weakened in later years as the discovery of rich new fields in various parts of the world, in developing countries especially, encouraged the entry of new corporations into the field and brought about a large degree of market interpenetration among the largest multinational corporations in petroleum. 8/ As the technology of production has become standardized and patents have expired, national corporations in developing countries, operating independently or in joint ventures with foreign multinational corporations, have been moving increasingly towards downstream vertical integration.

Market interpenetration and partnership have diluted the pre-war international cartels in other extractive industries also, but the growth of multinational corporations experienced in the petroleum sector has not been matched by most metal industries. Where technology, economies of scale and market control by the multinational corporations do not constitute formidable barriers, and the geographical distribution of the raw material source is limited, as in the case of copper, host countries have at times succeeded in increasing their participation or even wresting control from foreign multinational corporations. In other industries, such as aluminium, where not all these conditions are present, multinational corporations continue to play a primary role.

Manufacturing activities abroad, on the other hand, appeared later than operations in natural resources, either as the processing of raw materials or as the production of consumer goods. It appears that, initially, manufacturing operations increased faster in developed countries, later in developing countries, and in the last ten years their growth has again been more dynamic in developed countries, especially in western Europe. Industrial sectors involving high technical skills have witnessed the fastest growth.

Manufacturing is at present the major activity of multinational corporations. It represents a little more than 40 per cent of the total estimated stock of foreign direct investment of the main developed market economies. Petroleum

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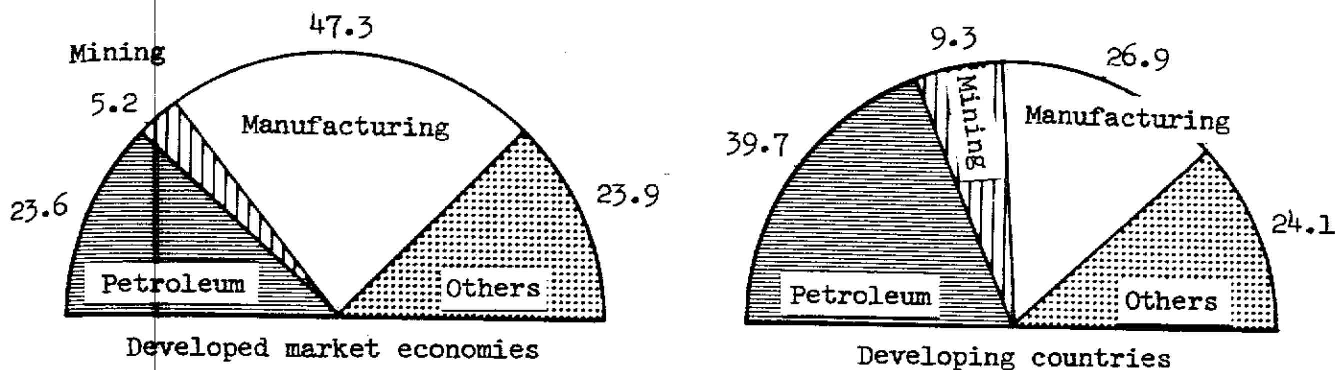
7/ See also tables 13 to 15 in annex III for sources and explanation of quantitative information cited in this section. See also figures 3 and 4 in the text.

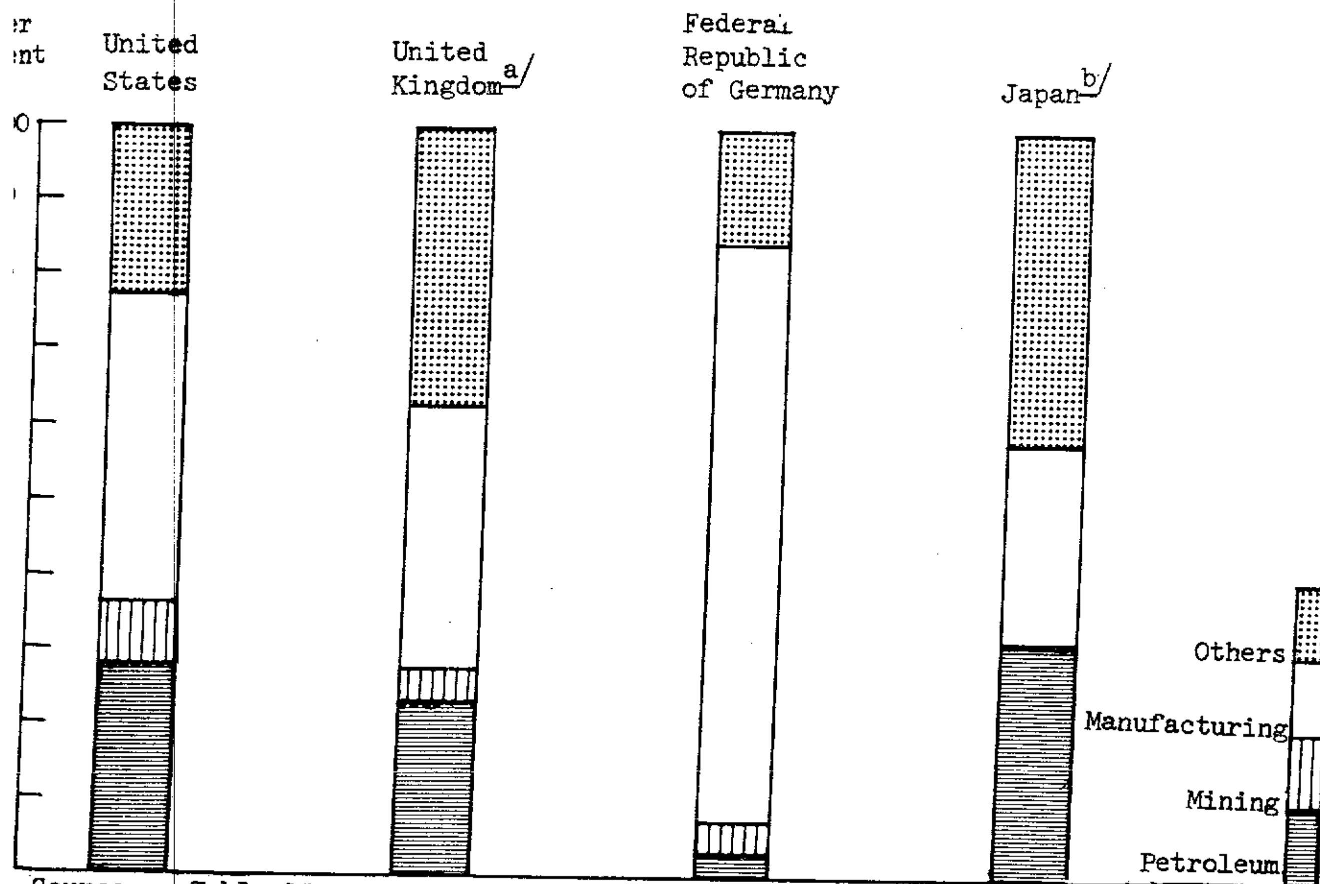
8/ The nine largest United States multinational corporations in petroleum had crude oil operations in 1938 in 40 countries and in 1967 in 96 countries. Over the same period their subsidiaries in all types of operations related to petroleum increased from 351 to 1,442. Vernon, *op. cit.*, p. 32.

Figure 3. Developed market economies (DAC countries): estimated distribution of estimated stock of foreign direct investment by sector and area, end 1966
(Percentage distribution)



Source: Table 13.

Figure 4. Selected developed market economies: stock of foreign direct investment by sector, 1970 *
(Percentage distribution)



Source: Table 15.

Footnotes

a/ 1965.

b/ Petroleum and mining combined.

accounts for 29 per cent, mining and smelting for 7 per cent and other industries for 24 per cent. A similar picture emerges from the distribution of United States affiliates among industrial sectors.

There is an asymmetry in the industrial distribution of multinational corporation activities in developed and developing countries. Whereas in developing countries half of the estimated stock of investment is in extractive industries and a little more than a quarter in manufacturing, in developed market economies half of it is in manufacturing, and about 30 per cent is in extractive industries. 9/

Within a particular industrial sector, pronounced concentration in a few home countries is evident. Four-fifths of the estimated stock of investment in petroleum and in manufacturing originates in the United States and the United Kingdom.

Significant variations exist among major investing countries in the distribution of the stock of investment by sector. Although the largest investing countries, namely the United States and the United Kingdom, have a similar pattern in industrial distribution (one-third in extractive industries and 40 per cent in manufacturing) both Japan and the Federal Republic of Germany show a different pattern of concentration; the former in trade and extractive industries, the latter in manufacturing. Japan's foreign direct investment appears to be aimed at securing raw material sources and export markets for the parent corporations. Even its investment in manufacturing (one quarter of the total) is relatively heavily concentrated in lightly processed raw materials such as lumber and pulp and low technology industries such as textiles and steel and non-ferrous metals. In contrast to the Japanese structure, almost 80 per cent of the foreign direct investment of the Federal Republic of Germany is in manufacturing and high technology products such as chemicals, electrical products and transport equipment. When compared with the dominant position of the United States and the United Kingdom in petroleum, the Federal Republic of Germany's investment in this area is almost negligible (3 per cent in petroleum and 5 per cent in mining). 10/

Concentration in high technology industries is also a characteristic of United States investment and to a lesser extent that of the United Kingdom.

9/ Investment in petroleum in developed market economies is mainly in refining and distribution.

10/ The radically different foreign direct investment structures of these countries reflect, to a certain extent, differences in endowments of factors and natural resources, in industrial competitiveness and in business traditions and orientation. In the case of Japan, the re-emergence of large trading companies and the desire to secure raw materials have played a determining role; in the case of the Federal Republic of Germany, the major factors were the competitive strength of the IG-Farben successor corporations and apparent disinterest in building up a major domestically-owned petroleum industry (approximately 90 per cent of the petroleum industry of the Federal Republic of Germany is foreign-owned).

Chemicals, machinery, electrical products and transport equipment account for half of all the manufacturing investment of the United Kingdom and almost 60 per cent of that of the United States. The technological strength of United States multinational corporations in the major chemical and automotive industries has given that country a dominant position in these fields. Much of the expansion of United States manufacturing affiliates abroad has been in the production of "skill-oriented" products, in which research and development is relatively a high percentage of sales and where an oligopolistic structure is prevalent. 11/

Multinational corporations have also been active recently in the service sector, especially in banking, tourism and consulting. Banking in particular has grown spectacularly in recent years. Between 1965 and 1972, United States banks more than tripled their foreign locations from 303 to 1,009. In 1972 alone, United States banks opened 106 foreign locations (i.e. branches, representative offices and agencies, affiliates and subsidiaries) while in the same year Japanese banks opened 25 new facilities, bringing the total to 145. The total number of foreign facilities of United Kingdom banks in 1972 amounted to 192, those of the Federal Republic of Germany to 103 and those of France to 91. 12/ Foreign deposits represent an increasing share of total deposits of United States multinational banks. For example, for the larger New York-based banks foreign deposits increased from 8.5 per cent of the domestic deposits in 1960 and 33.6 per cent in 1968 to 65.5 per cent in 1972. 13/

The expansion of the Eurocurrency market to $100 billion by the end of 1972, coupled with the phenomenal expansion of overseas branches, especially of United States banks, provides a readily available source of funds that can be shifted internationally, as well as the mechanism through which such shifts can be made. At the same time, they provide an important source of credit in several areas of the world, over and above what can be supplied by local banks. The potential implications of these sources of funds are discussed in greater detail in Chapter III.

Ownership patterns 14/

By and large, multinational corporations exercise effective control over their foreign affiliates through complete or majority ownership, although at times such control can be exercised from a minority position. At least 80 per cent of United States affiliates and 75 per cent of United Kingdom affiliates are either wholly-owned or majority-controlled. In terms of stock of investment, these two countries have placed about 90 per cent in affiliates which are at least majority-owned. This desire for majority ownership and

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11/ Vernon, op. cit., p. 63, and also the section on technology and skill below.

12/ Data supplied by the Chase Manhattan Bank.

13/ Frank Mastrapasqua, U.S. Expansion via Foreign Branching: Monetary Policy Implications (New York, 1973), pp. 23-25.

14/ See also tables 16 to 18 in annex III and the section on profit management and ownership policies below.

control appears to be a general characteristic of multinational corporations from other home countries, except in the case of Japanese multinational corporations, where a somewhat more sizeable proportion of affiliates and stock of investment are minority-owned joint ventures. This difference in the ownership pattern is apparently influenced by differences in methods of control as well as in the industrial and the geographical distribution of foreign activities. The predominance of trading activities and light industries in the case of Japanese multinational corporations suggests that relatively small affiliates may be adequate in many cases. Moreover, since a relatively high proportion of Japanese investment - made mostly in recent years - is located in developing countries, the ownership pattern may also have been influenced by a tendency of some Japanese multinational corporations to maintain a relatively low profile in some of those countries. This geographical influence on ownership patterns is also suggested by the somewhat lower share of wholly-owned affiliates in the total number of affiliates of United States corporations in developing countries as compared with that in developed countries. Over the last three decades, a slight increase in the proportion of minority ownership, particularly in developing countries, is suggested by United States data. There is also an indication that the longer the life of an affiliate, the more likely is it to be wholly-owned. This tendency can, of course, be offset by pressures from host countries, as exemplified by recent trends towards increased local ownership in the OPEC and other countries.

Dimensions in the world spectrum[15]

The enormous size and steadily growing importance of multinational corporations are clearly revealed when viewed in the context of world economic activities. Although the usual comparison of gross annual sales of multinational corporations with gross national product of countries exaggerates the relative importance of the activities of multinational corporations, the general conclusion that many multinational corporations are bigger than a large number of entire national economies remains valid. Thus, the value-added by each of the top ten multinational corporations in 1971 was in excess of $3 billion - or greater than the gross national product of over 80 countries. The value-added of all multinational corporations, estimated roughly at $500 billion in 1971, was about one-fifth of world gross national product, not including the centrally planned economies.

International production, defined as production subject to foreign control or decision and measured by the sales of foreign affiliates of multinational corporations has surpassed trade as the main vehicle of international economic

15/ See also table 19 in annex III.

exchange. It is estimated that international production reached approximately $330 billion in 1971. 16/ This was somewhat larger than total exports of all market economies ($310 billion).

Since the rate of growth of international production is estimated to have exceeded that of world gross domestic product or world exports, an increasing share of world output would be generated by the foreign production of multinational corporations if recent trends were to continue. 17/ However, future developments will depend very much on the extent to which the problems raised by the operations of multinational corporations are dealt with by appropriate national and international measures which will permit continued growth in desired areas and directions, or by restrictive measures which will obstruct further growth. In addition, changing relationships between different groups of countries, for example increased co-operation and exchange between developed market economies and centrally planned economies, will influence the direction of multinational corporation activities.

16/ Estimates of international production made in the literature vary according to the methodology used. J. Polk, on the basis of sales associated with direct investment and portfolio investment, estimates international production at $420 billion for 1968, see Judd Polk, "The Internationalization of Production", mimeo (United States Council of the International Chamber of Commerce, 1969); J. Behrman, on the basis of sales associated with direct and portfolio investment as well as licensed rights, estimates international production at $450 billion for 1971, see J.N. Behrman, "New Orientation in International Trade and Investment" in Pierre Uri, ed. Trade and Investment Policies for the Seventies: New Challenges for the Atlantic Area and Japan (New York, 1971).

Both authors, without adjusting for value added, evaluate the internationalized gross domestic product of market economies to be 23 per cent for 1968 (Polk) and 22 per cent for 1971 (Behrman). If the adjustment is made these shares would be considerably lower. S. Robock and K. Simmonds in calculating foreign production do not include portfolio investment or licensed rights; their figure for foreign production for 1970 is $230 billion, representing approximately 11 per cent of market economies' gross domestic product. See S.H. Robock and K. Simmonds, International Business and Multinational Enterprises, (Homewood, Illinois, 1973).

17/ Whereas between 1961 and 1971 gross domestic product of market economies at current prices rose at an annual average rate of 9 per cent, international production, estimated on the basis of sales at current prices of United States foreign affiliates between 1962 and 1968, rose at an annual average rate of about 13 per cent.

Dimensions in developed market economies[18]

If the world-wide integrative role of the multinational corporation is debatable, its importance to the inter-relationship of the developed market economies is beyond doubt. Most of the developed market economies serve simultaneously as home and host countries. The United States, however, acts primarily as a home country, while certain others, such as Cyprus, Greece, Spain, Turkey, New Zealand and South Africa, are almost exclusively hosts to foreign multinational corporations.

During the period 1968-1970, inward direct investment flows were on the average only 20 per cent of the outward flows for the United States, 30 per cent for Japan, 63 per cent for the United Kingdom and the Federal Republic of Germany and 90 per cent for the Netherlands. The reverse is the case with most of the other countries. In France inward direct investment flows were almost twice as high as the outward flows, in Italy and Canada a little more than twice, in New Zealand, three times higher, in Belgium, four times and in Australia, Spain, Portugal and South Africa, 7.5 to 12 times greater than outward flows.

As far as the United States is concerned, the preponderant position in the economy is occupied by domestic multinational corporations, rather than foreign multinational corporations whose presence is not as yet significant. More than one-third of the manufacturing output of the United States is represented by the top 187 United States multinational manufacturing corporations. In certain industrial sectors, such as automotive, pharmaceutical and fabricated metal products, the consolidated sales of these corporations account for more than three-fourths of the sales of all United States firms, and in petroleum refining, chemicals, rubber and electrical machinery, for more than one-half. A larger group, of 264 multinational corporations, is responsible for half of all United States exports of manufactures. In 1971, United States multinational corporations generated an outflow of capital of $4.8 billion for direct investment abroad and an inflow of approximately $9 billion in interest, dividends, royalties and management fees. Furthermore, given the practice of extensive local borrowing, their control of overseas assets is substantially higher than the book value of long-term equity and debt held abroad. [19]

18/ See also tables 20 to 25 in annex III.

19/ United States net capital exports for direct investment abroad as a share of investment outlays of United States affiliates vary considerably by year, sector and area of investment. In 1968, in western Europe, the share was less than one-third; in a sample of 125 large multinational corporations (representing one-sixth of United States industry's ex-factory sales) only 6.7 per cent of gross foreign investment was financed through a net capital outflow from United States parent companies, the principal source being foreign depreciation reserves, earnings and borrowings. Business International, The Effects of United States Corporate Foreign Investment, 1960-1970, (New York, 1972).

In contrast, the relative importance of foreign multinational corporations in the United States is limited. Foreign investment in the United States, while far from negligible, is mainly portfolio investment. The European investment in the United States, for instance, is about as high as the United States investment in Europe; but whereas 80 per cent of the latter is in direct investment, 70 per cent of the European investment in the United States is in portfolio form, almost equally divided between stocks and bonds. Thus, the book value of United States direct investment in other developed countries, with the exception of the Netherlands, is several times higher than the book value of direct investment of those countries in the United States. 20/ Multinational corporations from the United Kingdom, the Netherlands and Switzerland are the leading investors in the United States, accounting for about 60 per cent of total direct foreign investment. Although European and, more recently, Japanese corporations have penetrated the petroleum industry, manufacturing and the service sector in the United States, there is no single industry in which they have assumed a preponderant role.

With the exception of Japan, the reverse is true in the case of the other developed economies, where foreign affiliates account for an important share of output, investment, employment or exports.

In Japan, where regulatory policies have restrained foreign entry, firms with foreign capital participation represented in 1968 only 2.3 per cent of total fixed assets and 1.65 per cent of total sales in manufacturing. The share was much higher in the oil industry (60 per cent) and in rubber (19 per cent). 21/ Given the recent Japanese liberalization measures, the share of foreign affiliates (more than half of which are joint ventures) must certainly have increased.

In Canada, at the other end of the spectrum, the presence of foreign multinational corporations is pervasive, representing one-third of total business activity. Foreign affiliates account for 60 per cent of manufacturing output and 65 per cent of output in mining and smelting. The United States accounts for 80 per cent of total direct foreign investment and the United Kingdom for most of the rest. In the United Kingdom, United States affiliates represent almost 70 per cent of the total stock of foreign direct investment. They account for 13 per cent of total manufacturing output, employ 9.2 per cent of the labour force and are responsible for one-fifth of all manufacturing exports. 22/ In Belgium, foreign affiliates are responsible for a quarter of the gross national

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20/ The United States' stock of direct investment in the European Community is 3.5 times higher than the Community's investment in the United States; it is 7 times more in the case of Canada and almost 70 times more in the case of Latin America. Rainer Hellmann, The Challenge to United States Dominance of the Multinational Corporation (New York, 1970).

21/ Japanese Trade and Industry Ministry, Special Report on Foreign Owned Firms in Japan (Tokyo, 1968).

22/ John Dunning, United States Industry in Britain (London, Economists' Advisory Group Research Study, Financial Times, 1972).

product, one-third of total sales, 18 per cent of employment and 30 per cent of exports. More than half of the total foreign direct investment is accounted for by United States-controlled affiliates. 23/ In the Federal Republic of Germany, Italy and France, foreign penetration is less pronounced, with the United States accounting for at least half of it, except in the case of France where its share is less than a third. 24/

The importance of multinational corporations in the developed market economies varies considerably by industrial sector. There is a high concentration in a fairly small number of industrial sectors characterized by fast growth, export-orientation and high technology, sectors which are also regarded as key sectors by the host countries. It appears that in most of the developed market economies foreign-owned firms own very high (75 - 100 per cent) or high (50 - 75 per cent) sector shares in industries characterized by high technology. Thus, there is very high or high foreign presence in the oil refining industry in Canada, the Federal Republic of Germany and Japan. Chemicals are under very high foreign ownership in Canada, high in Australia, and medium (25 to 50 per cent) in the Federal Republic of Germany and Norway. The computer and electronics industries are under very high foreign ownership in the Federal Republic of Germany and the United Kingdom. Transport equipment is under very high foreign ownership in Canada and Australia, and medium in the United Kingdom. Electrical machinery is highly owned by foreign corporations in Austria, the Federal Republic of Germany and Canada.

The presence of United States multinational corporations is also more pronounced in some sectors than in others. For instance, they control more than half of the petroleum industry in Belgium, approximately three-fifths of the food, tobacco, oil-refining, metal manufacturing, instrument engineering, computer and technical manufacturing industries in the United Kingdom, and more than 15 per cent of the production of semiconductors and 80 per cent of computers and electronic data-processing equipment in the European Community. In the service sector, the United States presence is considerable in the hotel and recreation industries, consulting, public relations and banking. It is estimated that in 1970 there were more than 30 United States banks operating in Europe, many of them having established affiliates jointly with European banks.

23/ D. Van den Bulcke, The Foreign Companies in Belgian Industry (Ghent, Belgian Productivity Centre, 1973).

24/ The foreign share in the total nominal capital of firms in the Federal Republic of Germany was 19 per cent at the end of 1968, and in Italy in 1965 15 per cent. In France, out of a total of $707 million of direct foreign investment in 1967, the United States accounted for 30 per cent, the European Community countries for 29 per cent, and Switzerland for 22 per cent. G. Bertin, "Foreign investment in France", in Foreign Investment: The Experience of Host Countries, I. Litvak and C. Maule, eds. (New York, 1970).

Another indication of the importance of United States affiliates in developed countries is their share in the gross fixed capital formation of these countries. In Canada in 1970 it amounted to one-third, in the United Kingdom to one-fifth, in Belgium and Luxembourg and the Federal Republic of Germany to between 12 and 13 per cent, and in France 6 per cent. In certain industries, the share was much higher, e.g. in Canada it was more than 50 per cen in chemicals, fabricated metals, machinery and transportation equipment.

Dimensions in developing countries 25/

In 1968 developing countries accounted for about one third of the book value of foreign direct investment as opposed to only one sixth of world gross domestic product and one fifth of world exports, not including centrally planned economies. Half of foreign direct investment in developing countries was in the development of natural resources, a little less than one-third in manufacturing and the rest in trade, public utilities, transport, banking, tourism and other services.

Generally speaking, the relative importance of the multinational corporation in developing countries is rising in the manufacturing and services sectors and declining in the primary industries, in particular those connected with agriculture (plantations). On balance, the over-all importance of the multinational corporation is growing. As a source of the net flow of resources to developing countries, private direct investment flows from such corporations represented about one-fifth of the total in the 1960s. During the same period, this flow increased at an average annual rate of 9 per cent. In 6 out of the 12 developing countries for which data were available, the stock of foreign direct investment increased faster than that of gross domestic product. In the second half of the 1960s, the slow growth of investment in some countries is attributable to the liquidation of foreign investment through nationalization.

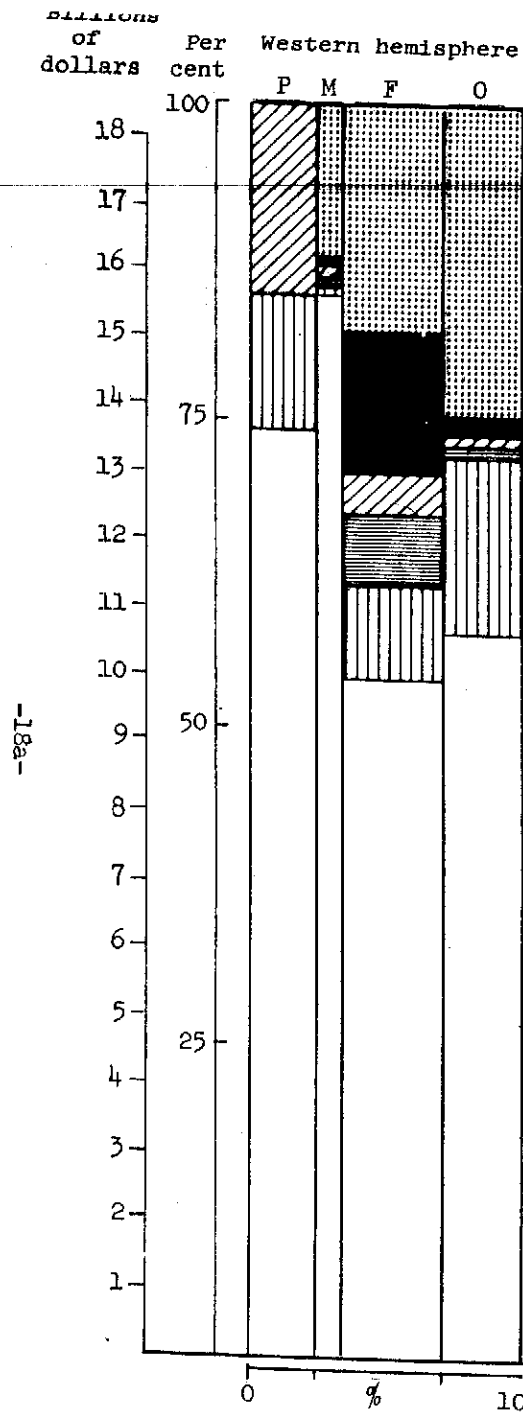
The relative size of the accumulated stock varies by industrial sector and country, and the share of foreign affiliates' activity in output, employment or exports varies accordingly. In some countries, the foreign content of the local economy is very high and at times concentrated in one sector, while in others it is less significant or more diversified.

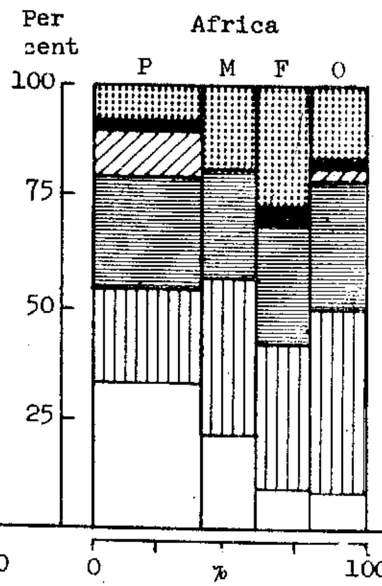
In the Middle East, which accounts for 9.4 per cent of the total foreign direct private investment in developing countries, petroleum accounts for approximately 90 per cent of the total stock of foreign investment. 26/ In South America (36 per cent of the total), on the other hand, 39 per cent of

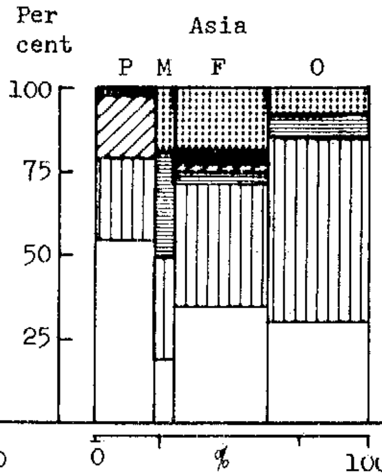
25/ See also tables 26 to 35 in annex III.

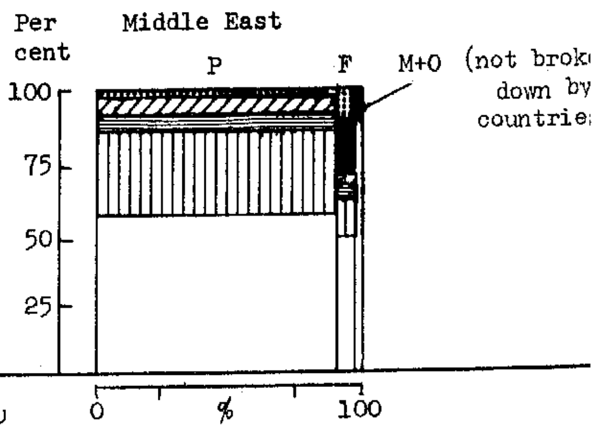
26/ The discussion on the distribution of stock of foreign direct investment in developing countries is based on rough estimates made by the Organisation for Economic Co-operation and Development. See OECD, Stock of Private Direct Investments by DAC Countries in Developing Countries, end 1967 (Paris, 1972).

Figure 5. Developing regions: distribution of stock of foreign direct investment by sector and country of origin, end 1967
(Billions of dollars and percentage shares)









KEY

Investing country

- Other
- Federal Republic of Germany
- Netherlands
- France
- United Kingdom
- United States

Sector

P = Petroleum
M = Mining and smelting
F = Manufacturing
O = Other

Source: Tables 31 to 34.

foreign investment is in manufacturing, 28 per cent in petroleum and 10 per cent in public utilities. In Africa (20 per cent of the total), 39 per cent is in petroleum, 20 per cent in mining and smelting and 19 per cent in manufacturing. In Asia (15 per cent), manufacturing has attracted 30 per cent, petroleum 22 per cent and agriculture 18 per cent of the total foreign investment stock. In Central America (19 per cent of the total), manufacturing has attracted 31 per cent, petroleum 16 and trade 13 per cent of the total.

This aggregate picture, however, does not reveal the fact that multinational corporations have tended to concentrate in a few developing countries. Only a few developing countries have a stock of direct investment of more than $1 billion. Thus, Argentina, Brazil, India, Mexico, Nigeria, Venezuela and certain Caribbean islands, 27/ account for 43 per cent of the total stock of investment in developing countries, which is roughly the same proportion as that of their combined gross domestic product to the estimated total for all developing countries. According to OECD estimates for the end of 1967, in another 13 countries 28/ in various developing regions the stock of investment was between $500 million and $1 billion, accounting for nearly another 30 per cent of the total stock of investment in developing countries. This concentration is related to the sector in which foreign investment is predominant. In African countries and in Central and South American and Middle Eastern countries (Algeria, Libya, Nigeria, Zambia, Jamaica, Netherlands Antilles, Trinidad and Tobago, Peru and Venezuela, Iran, Kuwait and Saudi Arabia), it is the extractive industries which predominate. In all these countries, the stock of investment in either petroleum or mining exceeds $200 million. In several other countries, manufacturing is the predominant sector, more than $200 million being invested in manufacturing in Argentina, Brazil, India, Mexico and the Philippines. In India and Malaysia, investment in agriculture exceeds $200 million.

The activities of United States multinational corporations represent half of the total stock of foreign direct investment in developing countries. In certain regions, however, such as Central and South America, the United States accounts for almost two-thirds of the total stock of foreign direct investment. The rest of the stock is represented by the United Kingdom (9 per cent), Canada (7 per cent), Netherlands (5 per cent) and the Federal Republic of Germany (4 per cent). In Africa, on the other hand, the United States accounts only for one-fifth of the total stock; the United Kingdom predominates with 30 per cent, France following with 26 per cent. Belgium, the Netherlands and Italy account for 7, 5 and 4 per cent respectively. In the Middle East, the United States accounts for 57 per cent, the United Kingdom for 27 per cent and the Netherlands and France for approximately 5.5 per cent each. In Asia, the United Kingdom has the largest share (41 per cent), the United States follows with 36 per cent, France with 7 per cent and the Netherlands with 5 per cent.

27/ Leeward Islands, Windward Islands, Bahamas, Barbados and Bermuda.

28/ Algeria, Libya, Jamaica, Panama, Trinidad and Tobago, Chile, Colombia, Peru, Iran, Kuwait, Saudi Arabia, Malaysia and the Philippines.

In some developing countries where the stock of investment exceeds $500 million, the foreign affiliates of a single developed market economy account for more than 80 per cent of the stock of total investment. 29/

Data on the share of foreign multinational corporations in local production is limited. In Singapore, in 1966, affiliates from the main investing countries are estimated to have contributed one-third of the total value added in manufacturing. 30/ It has been estimated that in the mid-1960s, sales of United States enterprises alone represented 17 per cent of the gross value of industrial production of Mexico, 13 per cent of that of the Philippines and 11 per cent of that of Argentina and Brazil. 31/ In Central America, the output of foreign affiliates is estimated at 30 per cent of the output of the manufacturing sector. Among the 500 largest manufacturing firms in Brazil, foreign affiliates controlled 37 per cent of total assets. 32/ In Mexico, among middle and large-sized firms, weighted average foreign participation reached 45 per cent in 1970. Foreign participation in the output of Mexican manufacturing industries, however, reached 100 per cent in rubber products and transportation materials, and a weighted share of more than 75 per cent in industrial chemicals and tobacco in 1970, while foreign participation in textile production was only 8 per cent. 33/

Expenditures of multinational corporations on plant and equipment represent a varying share of the total gross fixed capital formation of developing countries. In 1970, the share of such expenditures by United States manufacturing affiliates was 9 per cent in Mexico and 18 per cent in Brazil. In some cases, such as electrical machinery in Brazil, the expenditure of United States affiliates on plant and equipment accounted for more than half of the total fixed capital formation in the industry. 34/

29/ In 1968, in Chile, Colombia, Panama, Peru, Philippines and Saudi Arabia, more than 80 per cent of the stock of foreign investment was owned by United States affiliates. In Zaire, 88 per cent of total investment was made by Belgian affiliates.

30/ H. Hughes and You Poh Seng, eds., Foreign Investment and Industrialization in Singapore, (Canberra, Australian National University Press, 1969), p. 192.

31/ Economic Commission for Latin America, Economic Survey of Latin America (United Nations publication, Sales No. E.72.II.G.1), p. 293.

32/ F. Fajnzylber, Sistema industrial y exportación de manufacturas: análisis de la experiencia brasilera, Economic Commission for Latin America, November 1970.

33/ See C. Vaitsos, "The changing policies of Latin American Governments towards economic development and direct foreign investment", forthcoming in Journal of World Trade Law; Carlos Bazdzeseh Parada, "La politica actual hacia la inversión extranjera directa", Comercio Exterior (Mexico City, 1972), p. 1012.

34/ United States Senate, Committee on Finance, Implications of Multinational Firms for World Trade and Investment and for United States Trade and Labor (Washington, D.C., 1973).

In addition to their dominant role in the export of products of the extractive industries, multinational corporations are in general playing an increasingly important part in the export of manufactures from developing countries. 35/ There is evidence of an over-all increase in the exports of affiliates, both as a share of total sales and as a share of total exports by the host country.

Thus, exports of United States manufacturing affiliates in Central and South America accounted for 4 per cent of their total sales in 1957, 7.5 per cent in 1965 and 9.4 per cent in 1968. 36/ Their share in the total exports of manufactures from these regions, which was 12 per cent in 1957, reached 41 per cent in 1966. This share varies by country; thus, in Argentina, between 1965 and 1968, exports of United States affiliates accounted for 14.5 per cent of total exports. In Mexico, in 1966, United States manufacturing affiliates accounted for 87 per cent of exports of manufactures, and in Brazil they represented 42 per cent.

Sporadic data suggest that despite their visibility and presence in key sectors, the contribution of foreign affiliates to the total gross domestic product of developing countries remains relatively small in most host countries. This is because the bulk of the gross domestic product of most developing countries originates in agriculture and the service industries where, on the whole, the presence of the multinational corporation is relatively limited.

Dimensions in centrally planned economies

Although the centrally planned economies have attracted only a very small amount of direct investment and very few affiliates of multinational corporations, they are more involved in the activities of these corporations than a cursory examination of the standard data might indicate. The form in which the multinational corporations extend their operations in these economies differs from that taken in others. Equity participation in countries in which the private ownership of means of production is not congruent with the system is naturally uncommon. The major exceptions are a limited number of sales offices of multinational corporations and some minority participation, which is permitted by law in Romania and, on a very limited basis, in Hungary. 37/

35/ The relative contribution of foreign affiliates may be affected by their orientation towards import substitutión, which is enhanced by the restrictive tariff policies of host countries, and by the type of products manufactured in developing countries in connexion with the global requirements of multinational corporations.

36/ United States Department of Commerce, United States Business Investment in Foreign Countries, 1960 (Washington, D.C. 1960) and Survey of Current Business, October 1970.

37/ Yugoslavia is a special case. It was the first socialist country to permit minority participation by foreign enterprises. A constitutional amendment of 1971 goes so far as to offer a guarantee against subsequent expropriation and nationalization, once a joint venture contract has come into effect.

Yet, apart from straightforward trade, the relationship between multinational corporations and the centrally planned economies has often involved co-operative arrangements in production, the development and transfer of technology, and marketing. Most of these arrangements are relatively recent in origin, reflecting the general trend in the centrally planned economies towards more outward-looking policies and a new emphasis on economic co-operation. Typically, a complex set of arrangements provides for technical help by the multinational corporation in plant construction (e.g. Occidental Petroleum and the proposed fertilizer complex in the USSR), exports and imports (e.g. the purchase by Occidental of the products of the plants, and sales to the USSR of Occidental products) and trade credit.

It has been estimated that there were about 600 industrial co-operation agreements with the developed market economies in force in Eastern European countries at the beginning of 1973. About one-third of these agreements have been concluded within the last two or three years, and continued fast growth is indicated. On the whole, these agreements account for a relatively small proportion of total trade with developed market economies. In some Eastern European countries, however, they already account for 10 to 15 per cent of exports to the developed market economies in some branches of industry. In Hungary, for example, they are responsible for one-sixth of engineering exports to developed market economies. 38/

Similarly, while these agreements do not account for a significant share of the total output of Eastern European countries, they are important for certain branches. These are mostly industries requiring high technology or large investment. For example, over half of passenger automobile production in the USSR in 1975 is expected to come from Fiat, under one of the first industrial co-operation agreements negotiated with Italy. The current figure for Poland is two-fifths.

More recently, the role of multinational corporations in the exploitation of natural resources in the USSR has assumed particular importance. The copper project in Eastern Siberia being negotiated with multinational corporations would involve an investment of $1 to $2 billion, with an annual production of several hundred thousand tons. The natural gas project in Siberia, also involving the active participation of multinational corporations, would account for a major part of the entire natural gas production of the USSR by 1980. Moreover, as exports of these natural resources would continue to flow long after the initial foreign investments were paid off, import capacity would be correspondingly expanded. A further implication of these projects is that because of the vast outlay and the scope of activities involved, they will probably require the participation of very large multinational corporations or consortia of a number of them. Moreover, since many of these arrangements involve large deferred payments beyond the capacity of multinational corporations to finance, they will require finance from banks or export credit institutions.

38/ United Nations Economic Commission for Europe, Analytical Report on Industrial Co-operation among ECE Countries (mimeographed document, E/ECE/844, 14 March 1973).

Similar co-operative agreements have also been made between enterprises of the centrally planned economies and developing countries. Here, on the other hand, the centrally planned economies are usually the providers of technical aid, machinery and equipment and credits, to be paid off with the products of the newly set-up plant.

In recent years, such co-operation has become a rapidly growing source of development assistance from socialist countries. Among the socialist countries' main partners are India and the countries of North Africa. Since 1971, there has been a tendency for a rapid spread to new partners in other regions and continents. 39/

39/ For further information, see "Centrally Planned Economies and the International Development Strategy" in Implementation of the International Development Strategy: Papers for the First Over-all Review and Appraisal of Progress during the Second United Nations Development Decade, vol. II (United Nations publication, Sales No. E.73.II.A.3).

Summary

The term "multinational corporation", used in accordance with the wording of the Economic and Social Council resolution, is employed in the report in a broad sense to cover all enterprises which control assets - factories, mines, sales and other offices - in two or more countries. Under this definition, multinational corporations are responsible for most foreign direct investment, and such investment is used as one of the measurements of the size of the activities of multinational corporations. Since a relatively small number of firms are responsible for the bulk of multinational corporation activities, a description of these firms gives a fair picture of the characteristics of multinational corporations.

The typical multinational corporation is a large-size, predominantly oligopolistic, firm with sales running into hundreds of millions of dollars and affiliates spread over several countries. Another relevant feature is that most parent companies of multinational corporations are located in the developed countries. The United States accounts for more than half of multinational corporations having total annual sales of manufactures of more than $1 billion, and also for more than half of the total estimated book value of investment, which by 1971 had reached approximately $160 billion. The United States, together with the United Kingdom, France and the Federal Republic of Germany, accounts for 80 per cent of foreign activities by multinational corporations.

Multinational corporations, especially those of Japan, the Federal Republic of Germany, and the

United States, have grown dramatically in the last two decades, reflecting rapid post-war economic growth, technological advances, the intensified search for sources of raw materials and market outlets, and shifts in the relative economic power of major industrial countries. Although during the 1960s multinational corporation activities grew faster in developed host countries than in developing, and although the latter have received only half as much of the total estimated stock of direct investment as the developed countries, the presence of foreign multinational corporations in developing countries is generally of greater relative significance, since their economies together account for much less than half of the total of developed market economies.

The distribution of investment in developing countries still reflects historical ties, some of a formerly colonial nature. Multinational corporations were active in the extractive, agricultural and public utility areas, where at present they still account for nearly two-thirds of the stock of direct investment, before becoming prominent in manufacturing and recently in the service sector, especially banking. In the developing countries the share of manufacturing is no more than a quarter, while in developed market economies it represents half of the total investment in these activities.

Through its capacity to move capital, technology and entrepreneurship across national frontiers, the multinational corporation has become the main vehicle for the internationalization of production, which is acquiring growing importance in international economic relations. Indeed, international production (defined as sales by foreign affiliates of multinational corporations to non-affiliates), estimated at

approximately $330 billion in 1971, has equalled and in some countries even surpassed trade as the main channel of international economic exchange. Whether an increasing share of world output will be generated by multinational corporations will depend very much on the direction and effectiveness of national and international regulatory measures.

If the role of the multinational corporation in the rational allocation of resources on a world-wide basis is debatable, its importance in intertwining the economies of most developed countries is beyond doubt. Many of these countries serve simultaneously as home and host, but any symmetry is interrupted in the case of the United States which is primarily a home country and by the southern European and southern hemisphere countries which are mainly host countries.

The importance of multinational corporations in the developed market economies varies considerably by country and industrial sector, with a high concentration in a fairly small number of sectors characterized by fast growth, export orientation and high technology, some of them regarded as key sectors by host countries.

In many developing countries, the presence of multinational corporations is of increasing significance relative to total capital flows from industrial countries and to the output of the domestic sector. The preponderant position of multinational corporations in the extractive industries seems to be declining but in manufacturing and other sectors there is a rising trend.

In the centrally planned economies, the modest but growing presence of multinational corporations has taken a different form, reflecting the local political and economic system. While minority equity participation

is allowed in only a few countries, the relationships of multinational corporations with the centrally planned economies have usually involved industrial co-operative arrangements, the transfer of technology and marketing, chiefly in the areas of the exploitation of natural resources and high technology.

II. THE NATURE OF MULTINATIONAL CORPORATIONS

The enormous size and importance of multinational corporations and their very high rates of growth during the last two decades have been indicated in the foregoing description and analyses. Sheer size and importance combined with rapid growth have caused concern about their influence. Any useful action concerning multinational corporations, at a national or international level, must be based on a thorough understanding of the nature of these corporations.

While some salient characteristics of the operations of multinational corporations have been revealed by aggregate data, a deeper understanding of their nature can be gained by examining the multinational corporation at the micro-level. Clearly, differences in the strategies of particular multinational corporations in particular countries will have an important bearing on their precise impact. Government policy with respect to the operations of multinational corporations, whether in home or host countries, must therefore be based on an analysis of the multinational corporation in various circumstances in some detail.

Development of raw materials and manufacturing

Firms invest abroad for a variety of reasons. Although the pursuit of profits is a major motivating factor, there are others equally important. Firms subject to oligopolistic competition frequently reach abroad in the effort to capture large shares of world markets. Reduction of uncertainty in their market environment and continuous growth are other strong objectives. The relative importance of these and other factors varies of course from firm to firm and over time, depending upon the particular circumstances and pressures.

Despite the voluminous literature on the subject, it is clear that the available data are incomplete and that conceptual limitations persist. Nevertheless, several general considerations have been established.

Raw materials

One of the earliest motivations to invest abroad was the desire to control sources of raw materials. In the second half of the nineteenth century, European and North American businessmen laid the foundations of many of today's major multinational corporations which are concerned primarily with the extraction, transportation and processing of raw materials. Whereas a few decades ago foreigners dominated virtually all the raw materials industries, they are today far less prominent in the agricultural industries and their presence has also somewhat diminished in mining, as governments become increasingly successful in gaining control over their natural resources from foreign investors.

Throughout the development of sources of raw materials there has been considerable tension between foreign investors and host governments. 1/ Today, the investor is usually one of a small group of huge firms, all attempting to achieve stable and predictable growth under oligopoly conditions. Although this goal may be shared by host or home governments, tension arises between them in the struggle to attain the respective objectives and to divide the rewards. The outcome of this struggle varies from industry to industry and also over time, according to the relative power of the two sides.

Because of the special nature of the raw materials industries, the points of tension and the steps taken in the struggle have differed considerably from those encountered in manufacturing industries.

The recent decline of the domination of multinational corporations over a number of raw materials sectors, especially petroleum, reflects the gradual diminution of their initial advantages as suppliers of funds, technology and skills not easily available elsewhere. Furthermore, these firms have been losing some of their original power of control over export markets, as governments have gained greater access to foreign consumers or have clubbed together to co-ordinate their export strategies. The reaction of some corporations has been to strengthen their position by offering new advantages, such as local processing, new technology, marketing outlets and new ownership schemes. These reactions suggest their considerable flexibility and resourcefulness.

Manufacturing

Foreign direct investment in manufacturing was stimulated at first by a desire to protect markets originally developed by exports and subsequently threatened by increasing barriers to trade, by other multinational corporations or by local competition. 2/ More recently, the growing practice of world sourcing by multinational corporations, especially in such industries as transport equipment and electronics, has given new importance to cost advantages.

Among many United States manufacturing industries which are characterized by a high degree of research effort, foreign investments have tended to follow a common pattern. 3/ Innovations in these industries are nurtured by the high per capita income level in the home market, which gives United States exporters a temporary advantage at the early stage. As foreign markets expand, and as technology becomes widely known and economies of scale assume primary importance, production begins in foreign countries. The first few production sites are

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1/ R.F. Mikesell and others, Foreign Investment in the Petroleum and Mineral Industries (Baltimore, 1971).

2/ For survey data on this point, see Emergency Committee on American Trade, The Role of the Multinational Corporation in the United States and World Economies (Washington, D.C., 1972).

3/ L.T. Wells, The Product Life Cycle and International Trade (Boston, Harvard Business School, 1972).

generally in advanced countries with a demand pattern closely resembling that in the United States. Eventually, as the particular product reaches maturity, United States and other multinational corporations in foreign countries export to the world from foreign bases. At a later stage still, production starts in developing countries. For a few products, such as textiles and electronic components, a further stage seems to exist: the primary source of production shifts away from the United States and Europe to developing countries, which then supply the advanced markets.

This pattern of development, which applies mainly to the experience of United States firms, especially in industries such as automobiles, chemicals, and engineering, has undergone changes in more recent years. Some firms have built elaborate networks of specialized factories producing components or a part of a product range in investment countries, for shipment to other locations, under the stimulus of tariff advantages. 4/ A less developed host country may thus be engaged in the production of fairly sophisticated products with the traditional stages of development not being followed. Moreover, investment decisions are based on a conception of the firm as a global entity and are less dependent on local resources than in the case of industries processing raw materials, or on the local market, as in import-substituting industries. As a result, each affiliate in such a network becomes subject to a greater degree of centralized control by the parent company.

Multinational corporations of other national origin have experienced different patterns of foreign expansion. United Kingdom-based multinationals, for example, have not depended to the same extent as those of the United States on the possession of distinctive technology. Many of the largest United Kingdom firms long confined their foreign manufacturing investments to Commonwealth territories rather than investing in countries with similar per capita income levels. 5/ French multinational corporations have followed patterns largely similar to those of the United Kingdom, 6/ while the primary motivation of Japanese multinational corporations was initially the establishment of low-cost production sites for supplying home and world markets, and more recently the control of raw materials and markets. 7/

4/ G.K. Helleiner, "Manufactured exports from less developed countries and multinational firms", Economic Journal, March 1973; United States Tariff Commission, Economic Factors Affecting the Use of Items 807.00 and 806.30 of the Tariff Schedules of the United States (Washington, D.C., 1970).

5/ For some details of the strategies of international expansion of these firms, see J.M. Stopford, "British-Based Multinational Firms: External Influences on Strategy and Style", paper presented to NATO Symposium, Brussels, April 1973.

6/ A detailed exposition of the patterns of foreign investment by a large sample of firms and their stated reasons for moving abroad is contained in C. Michalet and M. de la Pierre, "Les facteurs de constitution des enterprises multinationales françaises", Centre d'Etudes et de Recherches sur l'enterprise multinationale, (Paris, 1972), mimeographed.

7/ See, for example, G. Adam, "New trends in international business: world-wide sourcing and domiciling", Acta Oeconomica, Vol. 7, 1971, and M. Yoshino, "Japanese Foreign Direct Investment", a paper commissioned by the Committee for Economic Development (forthcoming, 1973).

There have been some exceptions to the general pattern of development of non-United States multinational corporations. A few firms have made large investments in the United States in order to exploit research-based or other oligopolistic advantages, or to acquire knowledge through direct exposure to the United States market. Thus several large European and Japanese firms have been impelled to protect their market positions by direct investment in the United States. It is these firms which, resembling their United States competitors, have created global networks of the type described earlier. The others have preferred to remain primarily dependent on affiliates with a lower degree of specialization in production. Since the number of firms which are likely to make a major assault on the United States market in the foreseeable future is limited and since they will take some time to assume predominant importance, it is probable that the current asymmetry of investment flows between the United States and other advanced economies will persist for a period. There are, however, indications that this asymmetry may not be permanent. 8/ There are also indications that United States investments in the less developed world are likely to remain distinctive in scope and strength for some time, despite faster rates of growth of other foreign investment there and some divestment by the United States.

Organization and control

Organizational structure

The increasing size and complexity of multinational corporations has forced managers constantly to seek new ways of maintaining an adequately efficient scheme of organization. Corporate growth has produced a web of powerful and often opposing forces within each enterprise. The methods of organization and control devised to counteract these pressures without unduly diminishing the local initiative of foreign subsidiaries have been closely related to the strategies of expansion and have varied according to the national origin of the parent company.

An analysis of the organizational development of 170 United States-based multinational corporations suggests that the firms have adopted their formal structures of organization in several fairly discrete stages. 9/ From an initial period of uncontrolled experimentation, which gave considerable autonomy to the subsidiaries, and the subsequent establishment of international divisions which curtailed this autonomy to some extent, many multinational corporations moved eventually to dismember their international divisions and create either worldwide product divisions or area divisions, depending on the firm's strategy of expansion. Other corporations found a combination or "mixed" structure, consisting of some world-wide product divisions and some area divisions, to be a more appropriate

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8/ F. Root, International Trade and Investment (Cincinnati, 1973), pp. 541-544.

9/ J.M. Stopford and L.T. Wells Jr., Managing the Multinational Enterprise, (New York, Basic Books, 1972).

structural arrangement for their particular strategy. 10/

These reorganizations have been accompanied by considerable changes in the attitudes of top management: assumptions that business abroad is fundamentally different from business at home have been replaced by a global perspective and recognition of the need to integrate closely related domestic and foreign units. At the same time, the organizations have developed new skills and control procedures appropriate for global operations.

Co-ordination problems still persist, however, in these 'global' structures. Such problems appear in acute form for those firms with widely diversified product lines and extensive geographical coverage. A few firms are attempting further structural adaptations to handle the problems. 11/ In addition, many firms are relying increasingly on improved training procedures to maintain co-ordination. Such training, designed to induce managers and employees to behave in predictable ways consistent with parent company policy, helps to reduce the need for continuous consultation with the centre and thus to reduce the costs of co-ordinating staff groups. 12/ The responsiveness of firms to new challenges of international business continues unabated.

Whereas United States-based multinational corporations have developed carefully designed formal organizations, those of other national origin have tended to rely more on informal procedures. A keynote in the procedures linking the affiliates to both United States and European parent companies has been reliance on the loyalty and esprit de corps of the affiliates' managers. Changes in procedures have occurred not in discrete stages but rather in the form of continuous adaptations. The reasons for the differences are as yet imperfectly understood, but they clearly involve historical, cultural and institutional factors, and attitudes towards competition. 13/

With increasing competition, and also increasing scale and complexity, European-based multinational corporations have increasingly been forced to employ

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10/ The "world-wide" product division structure is related to a strategy having a wide diversity in products, while the "area division" is related more to a strategy based on taking a narrow line of products into more and more foreign countries.

11/ These adaptations take the form of imposing dual or triple lines of reporting and control in a 'grid' structure. See Stopford and Wells, op. cit., Ch. 6. See also M.Z. Brooke and H.L. Remmers, The Strategy of Multinational Enterprise (London, Longman, 1970), for similar observations.

12/ Some evidence of this factor is contained in J.H. Dunning, American Investment in British Manufacturing (London, Allen and Unwin, 1958), p. 112; A.E. Safarian, Foreign Ownership of Canadian Industry (Toronto, McGraw Hill, 1966), pp. 88-93; and I.W. Meister, Managing the International Financial Function (New York, National Industrial Conference Board, 1970), pp. 94-95.

13/ Van der Haas, The Enterprise in Transition, (London, Tavistock Press), provides an interesting exploration of the effect of these variables on European firms.

more formalized procedures of organization and control. During the late 1960s, many developed structures that resemble the United States type. The resemblance is closest among those with integrated networks of specialized production abroad because it is there that managerial tasks are most similar: a high degree of central planning and advance scheduling of product flow is essential if the economic gains from reduced costs are to be realized. Nevertheless, in general, non-United States multinationals probably preserve a greater degree of local autonomy, or at least decentralization, than do United States-based multinationals.

Control procedures

As organizational changes occur in multinational corporations, so changes are introduced into operating policies regarding corporate planning, control, finance, measurement of performance and manpower, which in turn indicate the degree of autonomy enjoyed by the subsidiary. 14/

In the early years, control of foreign subsidiaries is often minimal or restricted solely to the screening of capital projects. The need for greater centralization, set off by the creation of an international division or by some traumatic event such as a devaluation or the write-off of a capital project, leads to the establishment of a strong central finance and control group. 15/ This group introduces procedures for optimizing the cash flows of the entire global system. Decisions about hedging on foreign exchange, borrowing, declaring dividends and so on, are taken centrally. The effect is to subordinate the interests of the subsidiary to those of the corporation as a whole. Consequently, the profits reported for local tax purposes may be understated and measures of performance may become meaningless unless appropriate adjustments are made to allow for the distortions associated with global optimizing decisions.

Despite these major efforts to centralize the financial decision system, the continued growth of foreign subsidiaries has at times been accompanied by a loosening of the financial reins. Part of the reason appears to be the realization that the system can be overmanaged and a high cost of overhead can be added without a proportionate return in the form of improved decisions.

Financial control can be achieved by various means and few foreign subsidiaries are allowed to set their own financial policies. Apart from direct control, the enterprise has developed a corps of trained men attuned to a common

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14/ Changes in operating policies regarding control and finance in United States-based multinationals are described in considerable detail by S.M. Robbins and R.B. Stobaugh, Money in the Multinational Enterprise: A Study of Financial Policy (New York, Basic Books, 1973).

15/ A common response to past error, and one not restricted to multinational corporations, is to tighten the control system. For observations of such a response on the part of United States firms in Australia, see D.T. Brash, American Investment in Australian Industry (Cambridge, Harvard University Press, 1966), p. 120.

set of policy guidelines and standard procedures. 16/ Similarly, in other functions, common procedures are enforced. Product choices for the subsidiaries are almost always limited to those products manufactured in the home country, especially in the case of the United States. 17/ Marketing procedures, long considered to be the function immune above all others to efficient centralization, are in some firms becoming standardized. Manpower policies regarding key managerial positions are, as a result, being constantly adapted in order to select and train men of different nationalities who can work within this new style of management and at the same time provide an adequate response to governmental pressure for local representation.

Profit and ownership policies 18/

Profit management

Dividends and royalty payments are not the only means whereby multinational corporations withdraw profits from a foreign subsidiary. Profits can be recorded in other units of a global system, including holding companies located in tax havens, through control of the transfer prices for goods and services supplied by the parent company or exports to other affiliates.

The importance of these controls in influencing the net profit before local taxes depends largely on the proportion of total purchases and sales tied to other affiliates. Import purchases, which are usually tied in, though large in absolute terms for all multinationals taken together, are generally small relative to purchases from local sources. 19/ This percentage tends to decline as the local economy develops, but it increases as firms develop networks of specialized, interrelated production. Exports to other affiliates, though subject to controls and allocations among all the affiliates, are becoming increasingly important, particularly as the networks are developed.

Prices charged for tied imports have been shown in some instances to be far above prevailing "world"prices, 20/ and conversely those for exports have been below world prices. As already noted, overpricing, particularly for wholly-owned

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16/ J.M. McInnes, "Financial control systems for multinational operations: an empirical investigation", Journal of International Business Studies, Fall, 1971, provides detailed evidence of the use of highly systematized sets of accounting statements and control techniques.

17/ Stopford and Wells, op. cit., pp. 36-38.

18/ See tables 36 and 37 in annex III.

19/ In Central and South America, import payments of United States manufacturing subsidiaries were 10 per cent of total sales. See, Raymond Vernon in Restrictive business practices, UNCTAD, TD/B/399, 1972, Table 9. A similarly low percentage was reported for United Kingdom manufacturing and mining subsidiaries in 15 countries by W.B. Reddaway, The Effects of United Kingdom Direct Investment Overseas: An Interim Report (Cambridge, Department of Applied Economics, University of Cambridge, 1967), Chapter 6.

20/ See C. Vaitsos, Income Generation and Income Distribution in the Foreign Investment Model, forthcoming, Oxford University Press.

affiliates, has been used as an alternative to royalty payments. Considerable variation exists, however, in the amount of overpricing or underpricing and its over-all frequency is not known. There is some evidence to suggest that overpricing has been reduced both by governmental pressure and by problems of internal control. 21/ The alternatives are complex and their effects little understood. Nevertheless, the issue makes for considerable tension between host and home governments and foreign investors, as will be shown later.

A further aspect of profit management that generates tension is the recorded profitability of foreign subsidiaries. The apparent high profitability of foreign affiliates of multinational corporations needs to be examined carefully: not only are the profit figures liable to distortion but also the capital base of the affiliate has many discretionary components. Some aspects of the discretionary practices can be deduced from examining different procedures generally adopted for wholly-owned affiliates as opposed to joint ventures. The capital structure of a newly established subsidiary generally has a large proportion of locally raised debt if it is a joint venture, much less if it is wholly-owned. 22/ Studies of United States investment in Australia and Japan have shown that contributions of technology are likely to be capitalized in joint ventures, but not in wholly-owned subsidiaries. 23/ This difference may partly explain why wholly-owned subsidiaries have generally reported a higher return on book equity than joint ventures. 24/ Further differences in financial policy are evident, especially in the early years of existence: wholly-owned subsidiaries are provided with special support services at low or zero cost; royalty payments are temporarily forgiven; dividends are postponed. On the other hand, in later years, parent companies expect to be able to move funds between subsidiaries on demand. 25/

These qualifications should be kept in mind in analyzing data on the recorded profits of foreign affiliates. Aggregate data conceal variations by sector and area of investment whereas rates of return depend on the accuracy

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21/ J.S. Arpan, International Intercorporate Pricing (New York, Praeger, 1971).

22/ See United States Department of Commerce, United States Direct Investments Abroad, 1966, Part II: Investment Position, Financial and Operating Data (Washington, D.C., Social and Economic Statistics Administration, Bureau of Economic Analysis, 1972), Group 2, BEA-SUP 72-01, Table 6. See also, for United Kingdom practice, Brooke and Remmers, op. cit., pp. 203-206.

23/ Brash, op. cit., p. 77, and W. Winiata, "United States Managerial Investment in Japan, 1950-1964, An Interview Study", unpublished doctoral dissertation, University of Michigan, 1966.

24/ See, for example, Reserve Bank of India, Foreign Collaborations in Indian Industry (Bombay, Examiner Press, 1968).

25/ For a comprehensive analysis of financial practice, see Robbins and Stobaugh, op. cit.

and relevance of figures on stock of direct investment. Thus, in the period 1965-1968, United States multinational corporation operations were twice as profitable in developing countries as in developed countries. If petroleum is excluded, the difference is smaller both for the United States and the United Kingdom. This reflects the fact that the profitability of petroleum operations is several times higher in developing countries than in developed market economies. This difference is partly explained by the oil companies' preference for declaring profits, for tax purposes, in the producing countries rather than in the countries where they refine and market their products. This example highlights, once more, the flexibility with which multinational corporations conduct their global operations and indicates that data on earnings should be interpreted with caution.

Ownership policies

Profit management is closely related to ownership policies. As has been shown earlier, multinational corporations generally prefer their foreign affiliates to be wholly-owned. Control is the variable that leads to this preference. Nevertheless, there are many firms that actively search for joint venture partners. It is the strategy of expansion which generates the particular ownership policy adopted by any one firm. 26/

Some strategies require such tight, centralized control that conflicts with local partners would be intolerable to the parent company. For example, strategies dependent on cost-reduction through the building of specialized networks rely on the ability of the firm to subordinate the affiliates' interest to that of the whole. Strategies emphasizing the exploitation of new technology create such serious problems of reaching agreement with local partners on what constitutes a fair return for the technology contributed and such problems of controlling proprietary knowledge that joint ventures are avoided. 27/

When innovation in production is the basic strategy, firms prefer to capture themselves the monopoly rents from their technological lead. Furthermore being sole owners of the technology, such firms retain a strong bargaining position vis-à-vis a host government. 28/ Once the technology slips out of the innovator's hands, this advantage is eroded. In the chemical industry, for example, there is evidence that firms can insist on complete ownership only for products at the beginning of their life cycle; for more mature products firms can do so less frequently, because of the number of competitors willing to grant licences. 29/

26/ See Stopford and Wells, op. cit.

27/ For a discussion of this aspect of the problem, see Junta del Acuerdo de Cartagena, Transfer of Technology, UNCTAD, TD/107, 1971.

28/ For examples drawn from IBM activities in India and Japan, see J. Baranson, "Technology transfer through the international firm", American Economic Review, May 1970.

29/ R.B. Stobaugh, "The Product Life Cycle, United States Exports and International Investment", unpublished doctoral dissertation, Harvard Business School, 1968.

While multinational corporations following any of the above strategies do not find the contribution of a local partner especially useful, other multinational corporations following alternative strategies might regard such a contribution as valuable. For instance, firms actively diversifying their product lines abroad turn to local partners for marketing skills appropriate to the new lines. Such partners can often increase the speed of entry into the local market and can also increase the number of markets that can be tackled simultaneously. Where the diversified lines abroad differ from those at home, particularly for some United Kingdom-based multinationals, central supervision is much looser than for other lines. 30/ In such cases, local partners can be readily accepted. Multinational corporations in raw materials industries, though they prefer wholly-owned subsidiaries for the extractive operations, sometimes turn to local partners when they enter local manufacturing operations. Oil companies, for example, will share ownership of refineries, particularly if that is the only way in which they can obtain continued access to the local market.

As corporations shift their strategies, so their ownership policies change. An increase in centralization of control, particularly when accompanied by an organizational change to area divisions, has tended to reduce the propensity of firms to enter new joint ventures and increase the propensity to buy out existing partners. 31/ This tendency towards "denationalization" has given rise to tensions in some host countries. As firms continue to expand and develop their foreign interests, it is likely that ownership policies will continue to be adapted to new requirements.

It is probable that many more firms, at present oriented mainly or exclusively to their home markets, will be drawn into the international arena. Most of these firms will be based in developed countries, but firms based in developing countries may increasingly follow suit. Already the beginnings of such a trend are observable in Latin America and the petroleum-exporting countries. These newcomers are likely to encounter the same problems as those faced by others before them and to respond accordingly.

Multinational corporations with extensive foreign interests will most probably continue to grow and to diversify their product lines. To do so without allowing diseconomies of scale to overwhelm their special skills, they will be forced to experiment with new forms of organization. The recent reorganizations referred to above are the beginnings of such experimentation. Their success is far from certain, however, and other approaches will undoubtedly be tried. A large increase can be expected in expenditure on communications and training in order to enhance the abilities of firms to harmonize their policies. And, as firms promote to senior positions foreign nationals who do not share the attitudes and objectives of their 'home' country colleagues, the need for meetings will become even greater.

30/ See, for example, Safarian, op. cit., p. 93.

31/ L.G. Franko, Joint Venture Survival in Multinational Corporations (New York, Praeger, 1972), Ch. 4.

Advances in data processing and in techniques for transmitting information will help to speed this trend towards greater harmonization of policy throughout complex global systems. These advances will be particularly important for firms which are building specialized networks of interrelated production. Many more firms will be forced to specialize production within free trade areas and some will attempt greater specialization on a global scale. As these trends develop, manufacturing firms may find joint ventures harder to live with and attempts may be made to buy out existing partners and to own new facilities outright.

The vertically-integrated multinational corporations are likely to present a complex change in ownership policies. Until recently, they have generally used wholly-owned facilities in the extractive and primary processing operations, and joint ventures for downstream operations (at the final stages of fabrication and distribution) where control is less critical than access to markets. But many are losing their oligopoly positions, as new entrants or governments become able to set up their own extractive or processing facilities. In order to re-establish some barriers to competition, these firms will probably try to develop a greater degree of control at downstream stages, for example by developing new technology. Thus, joint ventures may become increasingly acceptable to these multinational corporations at upstream stages and less so downstream. 32/

The general trend towards centralization and tighter control indicates increased conflict with governments as they become more insistent upon a greater degree of local participation and influence. Although changes in the relationships between foreign investors and host governments are indicated, the nature of these changes is as yet uncertain. Most probably, in any given country, there will be combinations of various alternatives, depending upon the power and the contribution to the local economy of the investor concerned.

Increasingly novel forms of ownership arrangement will come into being. Multinational corporations may be allowed unambiguous control for as long as they make a critical contribution that cannot be made by others. As that contribution diminishes, so local control will increase. Various 'fade-out' arrangements have already been implemented and more are appearing in the legislation of developing countries. There are many problems in identifying contributions with sufficient clarity for the purposes of writing a contract, but doubtless these will be overcome as the multinational corporations realize from experience that ownership for a limited time is not necessarily against their interests.

The use of management contracts is also likely to become more frequent. Here the multinational corporation can make a contribution and at the same time earn profits without having the tie of owning physical assets. Such contracts are already widely used by consortia of construction firms in developing countries. Some, particularly marketing contracts, are appearing in the manufacturing sector. Management contracts in production may be closely tied to new forms of royalty agreement.

32/ See Stopford and Wells, op. cit.

The resourcefulness of multinational corporations in the face of changing attitudes and regulatory legislation is boundless. They will most probably continue to expand on some fronts, retreat on others, and to develop new types of links. But the increasing power of host governments individually or as members of a regional group to insist on participation if not outright control, the growing sentiment in some home countries for stricter scrutiny of multinational corporations, and the fact that first tentative steps towards some form of international action have been taken, suggest that the days are gone when it could be predicted with some justification that the world economy would eventually be dominated by a handful of giant firms.

Summary

The enormous size and spread of multinational corporations and their high rates of growth during the last two decades have dramatically expanded the areas in which corporations can affect international relations and economic development. Any action in respect of multinational corporations, however, must be based on a thorough understanding of their nature and motives and ways of behaviour.

Corporations become multinational for a variety of reasons, usually connected with the protection of their oligopolistic position. Reduction of uncertainty, continuous growth and the retention or enlargement of their share of the market may be as important as the pursuit of immediate profits. Originally the desire to control raw materials was reflected in a dynamic expansion in the area of natural resources. The decline in their dominant position in this field reflects the gradual diminution of their initial advantage as suppliers of funds, technology and skills, as well as action by many host countries.

In manufacturing, investment abroad was stimulated by increasing barriers to trade which threatened exports. In industries where a high degree of research effort is employed, it may appear more advantageous during the later life of a product to invest abroad than in the country of the original innovation. More recently, however, specialized factories producing components for shipment to other countries, based on cost considerations, have assumed increasing importance.

The rapid expansion of multinational corporations has required complex schemes of organization. In most cases, more flexible systems have been replaced by greater centralized control. The centralization is stricter in some areas, such as financing, although variations exist by product, nationality and area. In a global context, the free movement of funds is the bloodstream of the corporation. It is achieved through various methods, not all of them obvious - dividends and royalty payments being only two. Transfer pricing and other practices are also extensively used to achieve the same purpose. Methods and organizational schemes are constantly being adapted. The need to exercise control is reflected in the preference of multinational corporations for wholly-owned subsidiaries, although control can at times be achieved through joint ventures and even minority positions. Often the strategy of expansion generates the particular ownership policy adopted by any one firm.

On the whole, the manifested resourcefulness and flexibility of multinational corporations in the face of changing internal and external forces underlines their almost boundless capacity for adaptation. This attribute should permit them to adjust to new realities in the light of efforts by governments at the national, regional and international levels to prevent multinational corporations from exerting undue influence.

III. IMPACT AND TENSIONS

The multinational corporation in international relations[1/]

Contemporary international relations take place on different stages and involve many actors. Although the nation-state is the most important participant, there are others, including non-governmental entities, which interact and compete with governments in shaping and participating in international relations.

Non-governmental bodies can participate in international relations by influencing the policies and actions of their own governments, or by influencing the policies and actions of foreign governments, either directly or through non-governmental entities in those countries. In the latter case they bypass their own governments, although the consequences may affect those governments' policies and actions. Furthermore, modern communications permit non-governmental entities to affect the environment in which international relations take place by influencing tastes, values and attitudes.

Given their world-wide spread and significant role in the world economy, multinational corporations are one of the main non-governmental participants in international relations. Yet, despite the fact that their activities cover many countries, that they participate in diverse economic and social systems, and that their interests extend around the globe, there are no "world citizens" by whom multinational corporations can be staffed. The equity of such corporations and the top management of their global operations tends to be in the hands of citizens of their home countries. At the same time, their interests do not necessarily coincide with those of the home country, but rather reflect the particular objectives of the corporation.

As has been suggested above, multinational corporations can participate in and affect international relations in various ways. Multinational corporations link the managerial and other personnel employed by them in home and host countries in transnational structures. Given the strong and sometimes even dominant role of these individuals in both home and host countries, and the relations established by multinational corporations with local groups and élites having similar interests, these corporations are often close to the centres of political power and can thus influence the affairs of nations. This influence can also extend directly or indirectly to the distribution of income and the allocation of resources.

1/ For a discussion of this subject, see, among others, J.S. Nye and R.O. Keohane, "Transnational relations and world politics", Introduction, International Organization, vol. 25, 1971; Aldo Ferrer, "El capital extranjero en la economia argentina", El Trimestre Economico, April-June 1971; T.H. Moran, "Transnational strategies of protection and defence by multinational corporations: Spreading the risk and rising the costs for nationalization in natural resources" in International Organization, vol. 27, Spring 1973, pp. 273-289; J.N. Behrman, National Interests and Multinational Enterprise: Tensions among the North Atlantic Countries (Englewood, N.J. , Prentice Hall, 1970), pp. 101-113.

Multinational corporations can also have an impact on international relations by contributing towards placing countries in interdependent or dependent positions from which governments may find it difficult to extricate themselves except at considerable cost. To a large extent such dependence and interdependence results from the fact that the operations of the multinational corporations are controlled from outside the territory of the host country and that the policies of the multinational corporations are based on considerations which transcend those of host as well as home countries. 2/ Sometimes the reluctance of governments to pursue policies in respect of multinational corporations that are desirable from their national point of view may be due to their concern about the repercussions which may result from the reactions of home governments. Such inhibitions may also stem from arrangements which multinational corporations might enter into to protect their interests. These can result in bringing pressure to bear on a particular government by influencing foreign official or private lending and insurance agencies, customers, and other firms.

Multinational corporations can also wilfully or involuntarily affect the relations between the governments of home and host countries. Problems experienced by a multinational corporation in a particular host country may in some cases have a determining influence on the policies of the home government. In other instances, multinational corporations may be used by home governments as vehicles for the implementation of their foreign policy.

Multinational corporations not only participate in and affect international relations, but are also themselves affected by the pressures and limitations that arise out of the interaction of other actors, chiefly governments. Foreign operations by governments with respect to anti-trust measures, strategic export controls, foreign investment (balance of payments) controls, etc. may prompt conflicts among states which can significantly affect multinational corporations.

The nation-state and the multinational corporation

The global operations of multinational corporations within the framework of nation-states frequently give rise to conflicts. While conflicts arising out of divergencies between the private objectives of a profit-making firm and the social welfare goals pursued by a government can apply to domestic as well as national corporations, there is an important difference in the capacity of governments to resolve such conflicts. Those of a purely domestic nature can be settled by the "pouvoir supérieur souverain" of the government through its policies and regulatory machinery. Given the nature of the multinational corporation, however, conflicts between governments and such corporations assume greater and more complex proportions. Governments often feel a lack of power to deal effectively with powerful multinational corporations. Indeed, no single national

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2/ For example, the quasi-official Watkins report on Canada stated that "the most serious cost for Canada resulting from foreign ownership is the intrusion of (foreign) law and policy into Canada. For Canada, the essential feature of the problem is not the economic cost, but the loss of control over an important segment of Canadian economic life." Foreign Ownership and the Structure of Canadian Industry, (Ottawa, 1968), p. 345.

jurisdiction can cope adequately with the global phenomenon of the multinational corporation, nor is there an international authority or machinery adequately equipped to alleviate the tensions that stem from the relationship between multinational corporations and nation-states.

The possibility of conflict is most apparent in host countries. Differences in objectives are exacerbated by the location of the decision-making apparatus of the multinational corporation in foreign centres. In many developing host countries especially, the suspicion is often expressed that the multinational corporation serves as an alien agent to extend "imperialistic" domination and to perpetuate politico-economic dependencia . 3/ Even in developed host countries, foreign control of key sectors by multinational corporations is regarded in many quarters as a serious infringement upon political independence, and even sovereignty itself. 4/

In spite of such strong reservations, however, the majority of governments of host countries have, on the whole, encouraged foreign direct investment. Indeed, through their offers of generous incentives, governments at times appear to be bidding against each other in efforts to attract multinational corporations. In encouraging the entry of multinational corporations, host governments seem to look upon their contribution as positive, although at the same time they tacitly attempt to obtain an acceptable trade-off between political, economic and socio-cultural costs and benefits. Since such calculations have usually been made ex post and especially during the later life of an investment, when costs appeared to supercede benefits, tensions have often been generated. Furthermore, recent changes in world economic structures, which have resulted in wider options being made available to developing countries, together with political changes within these countries and enhanced knowledge about the operations of multinational corporations have frequently led to a re-evaluation of "trade-offs", and to the adoption of new policies towards foreign direct investment, including the renegotiation of contracts and fade-out of participation arrangements.

When considering economic costs and benefits, governments are sometimes faced with a dilemma. On the one hand, they judge that multinational corporations can contribute to the rate of increase of income and exports, and can raise the level of technology, employment and managerial know-how. On the

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3/ O. Sunkel, "Intégration capitaliste transnationale et désintégration nationale en Amérique Latine", Politique Etrangère, No. 6, 1970, and "Big business and 'dependencia': a Latin American view", Foreign Affairs, vol. 50, 1972; Celso Furtado, "La concentración del poder económico en los EE.UU. y sus proyecciones en America Latina", Estudios Internacionales, Año I (Santiago, 1968).

4/ See Foreign Ownership and the Structure of Canadian Industry, Report of the Task Force on the Structure of Canadian Industry, Privy Council Office, (Ottawa, 1968), p. 339, and J.J. Servan-Schreiber, Le Défi Américain (Paris, 1967).

other hand, they recognize that multinational corporations can also undermine governmental priorities, fiscal and monetary policies, and income distribution policies, and may have an unfavourable effect on the balance of payments. The dilemma is a function of the difficulty of grasping all the implications and also of maintaining an adequate perspective on differing long and short-term effects. Small developing countries are the most vulnerable to this dilemma, given their limited expertise, the inadequacy of the information available to them, and their limited political bargaining power.

By contrast, most developed host countries belong to a network of advanced economic, and even political, relationships which allow for more successful economic and political bargaining. Possession of scarce resources is, of course, an added advantage and one that is increasingly being used in the bargaining process between host governments and multinational corporations.

The political aspect of the host country-multinational corporation relationship is assuming greater importance as multinational corporations continue to expand and as national independence in many countries has lent immediacy to the issue of sovereignty over natural resources and key industries, and as episodes of disguised or overt political interference have come to light. Another source of tension lies in the introduction by multinational corporations of foreign cultural values and the dilution of the host country's heritage.

In home countries, an old debate has recently been rekindled concerning the economic and political implications of investing abroad. The beneficial effects on employment and balance of payments have been disputed by various groups, particularly by organized labour. Governments of the home countries have also found, at times, that multinational corporation activities tend to circumvent or even disrupt their trade, fiscal or monetary policies.

Political ramifications in home countries arising out of the operations of multinational corporations have also come under increasing scrutiny, as they can lead to conflict with other governments. Such tensions between governments arise not only from political confrontations in support of multinational corporations, but also from jurisdictional problems. Although issues of jurisdiction are common in international economic relations, multinational corporate activities have magnified the problems of extraterritoriality, and of tax loop-holes or of overlapping taxation. 5/

Some sources of tension can be clearly identified from the existing evidence, some are still largely a matter of conjecture. But the pervasiveness of tensions suggests that the sources are not imaginary. Further studies on the impact of multinational corporations in fields where the present evidence is inadequate, such as employment and the development path, would contribute to a better understanding of the problem and probably aid in efforts to establish a new modus vivendi in which tensions could be reduced and interests reconciled.

5/ See, among others, A. Fatouros, "The computer and the mud hut: notes on multinational enterprise in developing countries", Columbia Journal of Transnational Law, vol. 10 (1971); D.F. Vagts, "The multinational enterprise: a new challenge for transnational law", Harvard Law Review, vol. 83, (1970).

The multinational corporation and the host country

Sovereignty

In a certain sense, the manifold operations of foreign-based multinational corporations and their pervasive influence on the host country may be regarded as a challenge to national sovereignty. The challenge has, moreover, economic, social, political and cultural dimensions which are frequently inseparable from one another. The tensions and conflicts thus generated are, likewise, the result of complex interaction between many agents in many areas.

Frequently, the multinational corporation is perceived as capable of circumventing or subverting national objectives and policies. 6/ While foreign affiliates can and often do choose to integrate their activities with national plans, the mere possibility of their being able to choose - and to afford to do so - is unsettling for host countries, developed as well as developing. 7/

Generally, the powerful multinational corporations possess a variety of options in response to governmental policies. This is particularly so in the case of manufacturing affiliates for which locational advantages are not rigidly determined. In contrast, affiliates involved in the field of natural resources have more limited locational options, since they are tied to the sources of raw materials, and hence are more susceptible to governmental incentives or pressures.

On the other hand, it is the operation of the multinational corporations in the field of raw materials which gives most immediacy to the issue of sovereignty, especially in developing countries. The presence of multinational corporations in the extractive industries is highly visible; they own land in the host country and they make decisions involving the extraction of usually non-renewable natural resources.

The principle of permanent sovereignty over natural resources, generally accepted by the international community, 8/ is raised when disputes arise over the control and distribution of benefits. Similarly, foreign plantations and land operations pose particularly sensitive issues of foreign intrusion. When nationalization is resorted to, the question of adequate compensation frequently arises. In some cases, attempts by multinational corporations to seek better compensation through legal action and sanctions by governments and financial institutions tend to escalate the conflict.

6/ See, J.N. Behrman, National Interests and Multinational Enterprise, op. cit.

7/ According to the Report of the Task Force on the Structure of Canadian Industry, op. cit., "The tendency inherent in direct investment to shift decision-making power in the private sector outside Canada, has on occasion posed serious problems for those responsible for formulating Canadian policy, and has created widespread unease among Canadians as to the continuing viability of Canada as an independent nation-state."

8/ See General Assembly resolutions 525 (VI) of 12 January 1952, 626 (VII) of 21 December 1952, 1314 (XIII) of 12 December 1958, 1515 (XV) of 15 December 1960; 1803 (XVII) of 14 December 1962, 2158 (XXI) of 25 November 1966 and 2692 (XXV) of 11 December 1970; and General Principle Three, adopted at the first session of the United Nations Conference on Trade and Development (UNCTAD).

National objectives and planning

The issue of sovereignty is related to the ability of the host country to shape its own objectives. These objectives may be explicitly formulated in a national plan. Differences in both scope and content between national and corporate planning are sources of conflict. 9/ It is not certain whether affiliates of foreign multinational corporations will sacrifice essential needs of the corporate global strategy in order to fulfil the requirements of the national plan. For instance, where the focus of the national plan is on rural development, or on the traditional sector, multinational corporation operations may concentrate on urban areas or on the modern sector. Where the national plan aims at more equal distribution of income, the effect of multinational corporations may be to accentuate inequality. Where the creation of employment is a major goal, the techniques and products introduced by the multinational corporations may be largely labour-saving. Moreover, the creation of wants similar to those of the developed societies through advertising may create a pattern of consumption that is unfavourable to development.

At the same time, the difficulty of reconciling national and corporate objectives may be partly due to deficiencies in the national plan. In many cases, plans fail to provide adequate guidance for the activities of the private sector, whether domestic or multinational corporations. When plan objectives are clearly stated and concrete measures are put into effect, multinational corporations may in fact be responsive to them. 10/

Pattern and process of development

Often it is not the divergency in explicit objectives but the subtle impact of the multinational corporation on the process and pattern of development that is the source of tensions and conflicts.

To begin with, the operations of multinational corporations may be destructive of the local economy. For instance, the introduction of machine-made goods may contribute to net output but only at the expense of displacing handicraft products. Although this is a common phenomenon in the process of modernization, caused also by domestic enterprises, the ousting of local products by the output of multinational corporations and the displacement of indigenous entrepreneurs by foreigners are highly visible and much resented.

9/ In contrast to the national private sector, managers of foreign corporations do not usually participate in the preparation of the plan, either because they are not thought to share national aspirations or because they are not given the authority by the parent company to commit it on essential issues.

10/ According to Behrman, there is evidence that multinational corporations have in many cases responded favourably by locating in depressed areas, e.g. Firestone, Goodyear and Courtaulds settled in depressed areas of France. See, J.N. Behrman, United States International Business and Governments (New York, 1971), p. 36.

On the other hand, when a multinational corporation operates in a more or less self-contained fashion, without any significant change in the old order, as though an oasis had been created in a desert, the question arises as to whether much benefit can be derived from the "enclave". Indeed, the enclave-type of activity may be considered a typical case of "growth without development", in the sense that fundamental economic structural transformation fails to take place on a broad basis.

In practice, even a foreign enclave has some links with the local economy. The linkages of multinational corporations with the host country economies, however, may sometimes be tenuous or limited. Recent studies suggest that almost half the inputs of foreign firms are supplied locally. The ratio is lower for export products than for those oriented toward the local market. Although the local share is not insignificant in most cases, it may fall below the host country's expectations.

From the point of view of the process of development, it is not only the amount of local inputs but also the type that is important. This depends on the activities of the foreign affiliates themselves. It is often observed that foreign affiliates tend to be "truncated". In other words, they do not "carry out all the functions - from the original research required through to all the aspects of marketing - necessary for developing, producing and marketing their goods. One or more of these functions are carried out by the foreign parent". 11/ Thus, research and development, and components and services, especially the more sophisticated, may be procured from the parent company or elsewhere. While such practices may be rational from the point of view of the global strategy of the multinational corporation, they are seen by some as an instrument for increasing the dependence of the periphery on the centre. More generally, the structure of industries in the host country may be so lopsided as to hinder sustained development. 12/ This is most glaring in cases where activity is highly concentrated in those sectors, such as luxury articles catering for the few, which have limited prospects of interaction with the rest of the economy. 13/ Indeed, not enough has been done either by the multinational corporations themselves or by governments to channel corporate production towards satisfying basic consumption needs in nutrition, health and housing.

11/ Government of Canada, Foreign Direct Investment in Canada (Ottawa, 1972), p. 405.

12/ H.G. Johnson, "The multinational corporation as an agency of economic development: some exploratory observations" in B. Ward, L. d'Anjou and J.D. Runnals, eds. The Widening Gap: Development in the 1970s (New York, 1971).

13/ S.H. Hymer, "The efficiency (contradictions) of multinational corporations", American Economic Review, LX No. 2, May 1970.

Technology and skills [14]

It has long been recognized that private direct investment through the multinational corporation is unique in providing from a single source a package of critical industrial inputs: capital, technology, managerial skills and other services required for production and distribution.

The scale requirements of present research and development activity, the decrease of technological and commercial risks in the development of new products and processes through multi-product and/or multinational operations, as well as the specific organizational requirements for the application of science and technology to economic needs, give a particular comparative advantage to the multinational corporation. Quite often this advantage has rested on its ability to combine for commercial use different developments in science and technology for which the basic research was undertaken elsewhere.

Indeed, multinational corporations generally do not undertake major innovative research without visible prospects of a substantial market, unless they are subsidized. Thus, although a large part of commercialized technology is in the hands of multinational corporations, the basic knowledge often originates in government-financed research and training centres. 15/ The contributions of multinational corporations derive from their ability to combine different kinds of lasting knowledge into commercially viable processes and products. In other words, the expenditure on technology financed by the corporation is in most cases related to practical development rather than to basic research. 16/

The part of research and development expenditures undertaken by the business enterprise sector appears to be concentrated in a few firms. For example, in 1964 in the United States, of more than 2,000 firms which reported research and development activities, 28 accounted for about 63 per cent of the total. Similarly, in France, 16 out of 440 enterprises accounted for 43 per cent of total research and development expenditure. 17/

14/ See tables 38 to 40 in annex III.

15/ According to the Organisation for Economic Co-operation and Development, a significant part of the research and development performed in the business enterprise sector was quite often financed by governments. For example, during 1963-64, of the total business enterprise research and development undertaken in the United States, 51.2 per cent was financed by defence, space and nuclear agencies. The equivalent percentages for other countries were as follows: United Kingdom 32 per cent (1964-65); Sweden 25.8 per cent (1964); France 24.9 per cent (1964); Federal Republic of Germany 13.5 per cent (1964); Austria 10.7 per cent (1963). See Organisation for Economic Co-operation and Development, Gaps in Technology, Analytical Report (Paris, 1970).

16/ In 1965 in the United States, out of total company-funded activities only 6.5 per cent went to basic research. See Organisation for Economic Co-operation and Development, op. cit., pp. 130 and 165.

17/ See Organisation for Economic Co-operation and Development, Gaps in Technology: General Report (Paris, 1968), p. 15.

Furthermore, the bulk of the research and development financed by corporations is done by the parent corporation or in the home country of the parent. For instance, in 1966 only 6 per cent of the total research and development budget of United States multinational corporations engaged in manufacturing was spent abroad.

As far as developed economies, which serve as both home and host countries, are concerned, technology flows and payments for them move in both directions between buyers and sellers, with different net effects depending on their relative magnitude. For developing countries on the other hand, the flow is predominantly or exclusively in one direction.

The significance of this one-sided flow is illustrated by data on six developing countries in the late 1960s. 18/ Payments by these countries for patents, licences, know-how and trademarks, as well as management and service fees, amounted to approximately 7 per cent of their combined exports and to a little more than half of 1 per cent of their combined gross domestic product. The total cost for such payments for 13 developing countries, representing 65 per cent of the total population and 56 per cent of the total gross domestic product of developing countries, is estimated at approximately $1.5 billion, which amounts to more than half of the flow of direct private foreign investment to developing countries. These payments are growing steadily at a rate which is estimated by the UNCTAD Secretariat at about 20 per cent per annum on the average and are absorbing an increasing proportion of the export earnings of developing countries. 19/

Estimates of royalties, however, may distort the true payments for know-how in various ways. The distortion may take the form of overpricing of intermediate products and capital goods, which are tied to the imports of technology, or the underpricing of exports to the suppliers of the technical know-how. Since royalties constitute only one of the channels of effective income remission, especially in the case of wholly-owned subsidiaries, changes in royalty payments do not necessarily imply changes in technology flows. They may simply reflect a readjustment in the distribution of returns among the different channels of income remission as a result of corporate strategy and government policies.

The effect of technological advances on the international market, given the existing concentration of products and know-how in the hands of the multinational corporations, has become one of the main causes of monopoly or oligopoly control. This is reinforced by the existence of specific legislative provisions, such as the patent laws, which give exclusive power over the use or licensing of certain innovations. The dedication of significant amounts of resources by the multinational corporations and their corporate commitment to technology is largely induced by the expectation of monopoly

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18/ Argentina, Brazil, Colombia, Mexico, Nigeria and Sri Lanka.

19/ See United Nations Conference on Trade and Development, Transfer of Technology, TD/106, 10 November 1971.

rents from new products and processes, as well as from the need to match the efforts of other such firms in order to protect their market participation and share. Since the technology supplied by the multinational corporations is proprietary and part of it is patented, an issue arises about the justification and impact of the system of patents and trade-marks. 20/

It should be noted that an important part of the technology required for most industries in developing countries is not subject to patents; the critical limitation these countries face is access to proprietary know-how. There is now a significant tendency to modify and strengthen the apparatus of national and international patent institutions into vehicles for the storage, retrieval and dissemination of industrial information and for facilitating direct contacts with licensors and other sources.

Multinational corporations are only one source from which enterprises in developing countries may acquire proprietary technology and management. For some technologies the options may be limited, but the situation is continually changing. Host developing countries are increasingly taking steps to reappraise the changing supply conditions for technology with a view to obtaining technology which will yield a larger measure of social benefits, as well as replacing imported proprietary technology and other factors with local inputs.

The policy objectives of host countries in this area have been multiple. The aim has frequently been to capture a larger share of a given net benefit in the use of technology from the local affiliates of foreign firms and/or to increase the total size of the benefit to be divided by promoting greater domestic value-added and various socially desirable "externalities", such as local skill formation. Another strategy has been to explore the possibility of disaggregating the package of foreign inputs, particularly by obtaining technology and management through commercial channels separately from capital. Among the alternatives are foreign minority joint ventures, licensing of proprietary information and management contracts, sometimes in various combinations or, in the case of so-called direct or "embodied" imports of know-how, by contracting for the construction and running-in of "turnkey" plants and by the direct purchase of specialized industrial equipment. 21/

Apart from reflecting negative attitudes towards control by the multinational firm and other motivations, the search for alternative vehicles for the acquisition of proprietary technology implies a recognition, particularly

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20/ The positions taken range from the extreme view of denying the economic justification of the patent system on the grounds of a theoretical "first best" welfare alternative of state ownership and distribution of all such industrial technology, to the advocacy of some tightening of regulations over the award to and use by licensors of such legal rights.

21/ "Turnkey" arrangements refer to contracts with foreign enterprises whereby the role of the latter is limited to establishing and bringing the plant into a position to begin operations.

by governments of developing countries, that the market conditions under which such technology is available, whatever the transfer mechanism, are those of an imperfect competitive market reflecting, on the one hand, a degree of market control or oligopoly by the suppliers and, on the other, various limitations on the bargaining power of enterprises in the host country and of the government of the home country itself. 22/

Another and increasing concern of the developing countries is whether the technology obtainable through the multinational corporation and other commercial channels is appropriate to their conditions. This is only part of the larger issue of the development and choice of appropriate technology - particularly in relation to the problem posed by superabundant labour and scarce capital and by the limited size of domestic markets - but the prominence of the multinational firm as a delivery vehicle for such technology and as a major agent of centralized research and development activity naturally focuses attention in respect of this problem on the performance of multinational corporations.

Employment and labour 23/

On the whole, the net employment impact on the host countries is positive since extreme cases of destruction of local industries and wholesale displacement of labour are rare. At the same time, the direct employment contribution by foreign affiliates is modest in a global perspective. 24/ This is indicated by data from the United States which is the largest contributor. In 1970, the total number of employees of United States majority-owned foreign affiliates amounted to about 3 million. When direct employment by foreign affiliates of other countries as well as other United States-controlled affiliates is added, it is probably no more than 13 or 14 million; this is a small fraction of total employment in market economies.

The indirect employment effects, largely arising out of the use of local suppliers, distribution channels and ancillary services, are, of course, much larger, but the total employment impact, while significant for the modern sector, is still modest in the context of the total economy.

For the developing countries as a whole, the employment contribution of foreign affiliates is small in relation to the massive employment problem.

22/ See Walter A. Chudson, The International Transfer of Commercial Technology to Developing Countries, United Nations Institute for Training and Research (UNITAR), Research Report No. 13 (New York, 1971) and a series of related UNITAR Research Reports; also UNCTAD, Guidelines for the Study of the Transfer of Technology to Developing Countries, December 1972, (United Nations publication, Sales No. E.72.II.D.19).

23/ See, International Labour Organisation, Multinational Enterprises and Social Policy, Studies and Reports, New Series, No. 79, (Geneva: ILO, 1973).

24/ Grant Reuber, "Private foreign investment in less developed countries", paper presented at International Meeting of Directors of Development Research and Training Institutes, Belgrade, 28-30 August, 1972.

This appears to be especially the case in respect of foreign affiliates' participation in the extractive industries which, when operated on a large scale, are highly capital intensive. In Venezuela and Chile, for example, despite the importance of oil and copper, labour employed in the combined petroleum and mining sectors accounted for 2.3 per cent and 4.1 per cent, respectively, of the total economically active population in 1960. Moreover, there appears to be very little growth in employment in the foreign-operated large-scale extractive industries. 25/

On the other hand, the effect of foreign affiliates on employment in specific localities is often a major attraction in a given multinational corporation project. This is especially true of depressed areas, where the location of a plant can make a significant contribution to solving the local unemployment problem. There is thus a tendency towards keen competition for the foreign enterprise among the various localities.

Moreover, the contribution through "learning by doing", especially for technical and professional employees, may be significant. 26/ Thus, an OECD study shows that for a sample of 50 foreign investment projects, local clerks and accountants accounted for 97 per cent of the staff concerned, foremen and supervisors 90 per cent, sales and marketing personnel 80 per cent, management and engineering personnel 73 per cent. There is, moreover, a tendency of the local share to increase over time, especially in the professional categories. Furthermore, many managers and technicians move from foreign affiliates to domestic enterprises. Nevertheless, the particular skills learned may be more suitable to the activities of foreign enterprises than for national development. Similarly, they may be associated with technologies that are inappropriate for local conditions. 27/

The relatively high labour standards generally adopted by foreign affiliates of multinational corporations are a mixed blessing. In some host countries, the wage rates paid by multinational corporations are several times higher than those prevailing elsewhere. The creation of an élite labour group raises irritating questions of competition, especially for technical personnel, with local enterprises. It also accentuates distortions in the wage structure, between occupational and skill groups as well as between rural and urban areas. Moreover, the standards imported from highly developed economies gradually tend to be adopted as a national norm, although they may be beyond the means of less-developed host countries, especially from the point of view of international competitiveness and employment.

25/ Constantine V. Vaitsos, Employment and Foreign Direct Investments in Developing Countries: Some Notes and Figures, Junta del Acuerdo de Cartagena, mimeographed document J/AJ/35/Rev. 1 (Lima, 1973).

26/ Council for Latin America, The Effects of United States and Other Foreign Investment in Latin America (New York, 1970), p. 5.

27/ Grant Reuber, op. cit.

Another source of tension is the impact on local labour when local plants are shut down in line with a global strategy. Although there is little evidence that this happens frequently, when it does occur the adverse effects are highly visible and attract public attention and reaction.

Balance of payments[28/]

Evaluating the impact of multinational corporations on the balance of payments of host developing countries is no less complex a task than evaluating the impact on other economic variables. If the evaluation concentrates on the capital flow of direct investment, the effect on the host country is undoubtedly positive. For the developing countries as a whole, direct investment amounted to $4 billion in 1971, almost half the total official bilateral and multilateral flows. At the same time, if the earnings generated by past investment which accrue to the foreign affiliates are deducted from that flow, the net flow is generally negative for host countries. Between 1965 and 1970, net foreign direct investment inflow into 43 developing countries was 30 per cent of the investment income outflow. If the oil-producing countries in the sample are excluded, inflow was 68 per cent of outflow. 29/ The difference reflects the differing time patterns of capital flow and earnings rather than the balance of payments effect of a given investment. Nevertheless, in developing countries, where the supply of foreign exchange is often a problem, the excess of this outflow over inflow has been a familiar source of tension with multinational corporations. Such tension is particularly likely to occur in cases where a multinational corporation has operated in the host country for an extended period of time and where the outflow of investment income increasingly exceeds the inflow of new capital.

In addition to the effect on the capital account and the investment income account, a foreign affiliate also generates imports and exports. If it is assumed that these imports and exports would not otherwise be made, the trade effect on the host countries is generally positive. In Latin America, for example, in 1966, United States affiliates exported about $4.5 billion of their products and imported about $1.3 billion of materials and supplies.

When all the direct effects on the balance of payments accounts are taken into consideration, the net result in developing countries is usually positive, though it is more visible in the case of extractive industries than in the case of manufacturing, because manufacturing affiliates are heavily oriented towards

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28/ See also tables 41 to 43 in annex III.

29/ Another calculation of the flows, adjusted for petroleum, shows that between 1964 and 1968 the United States and the United Kingdom (representing 80 per cent of total foreign direct investment) received approximately $5.8 billion from developing countries (in investment income) and paid $3.2 billion (in capital flow). See, W.A.P. Manser, The Financial Role of Multinational Enterprise, (Paris, International Chamber of Commerce, 1973), pp. 17-30.

production for import substitution rather than for export, a fact which usually reflects the host government's industrialization policy. 30/ At the same time, the payments effect may be partly limited by export-restricting practices followed by the multinational corporation, and moreover, the import bill may be inflated by tied-purchases and over-pricing. 31/

The direct balance of payments effects of foreign affiliates do not, of course, answer the question of what the total effect may be. Thus, to the direct effects must be added the indirect effects resulting from the fact that the incomes and sales promotion generated by affiliates raise the level of income and thus induce higher consumption of imports and possibly even lower the export supply of some domestically produced goods. 32/ At the same time, insofar as the affiliate may serve as a "growth pole" stimulating the establishment of complementary domestic industries, it may also generate additional exports from the local production of other firms. Basic to the entire calculation of total trade effects is the question, at present unanswerable, whether the foreign affiliates' output is entirely additional to what would otherwise be produced or whether local replacement of output can be assumed.

When all the indirect effects are taken into account, the estimated net result varies with the assumptions made. For instance, a study of the impact of import-substituting United States manufacturing investment in developing countries reached different conclusions depending on the model used. 33/ The one based on the assumption that no local replacement was possible indicated a positive impact on the balance of payments of developing countries; the other, assuming local replacement, indicated negative impact in the case of Latin America, and neutral in other developing areas.

Other case studies made under the auspices of UNCTAD examined the over-all effect of several foreign manufacturing affiliates in Colombia, India, Iran, Jamaica, Kenya and Malaysia. 34/ It was found that in 55 per cent of a sample of 159 foreign firms, the impact was positive. In the case of the other firms, it was concluded that it would be cheaper for the host country to substitute its own capital for the existing foreign capital. However, 60 per cent of the firms

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30/ Among 159 foreign firms in Colombia, India, Iran, Jamaica, Kenya and Malaysia, 53 per cent had negligible exports or no exports at all. See, P.P. Streeten and S. Lall, UNCTAD, Main Findings of a Study of Private Foreign Investment in Selected Developing Countries, (TD/B/C.3/111), 1973.

31/ See UNCTAD, Private foreign investment in its relationship to development (TD/134), 1972.

32/ See detailed discussion in David Robertson, "The multinational enterprise: trade flows and trade policy" in John H. Dunning, ed., The Multinational Enterprise, (London, 1971).

33/ See G.C. Hufbauer and F.M. Adler, Overseas Manufacturing Investment and the Balance of Payments, (Washington, D.C., United States Department of Commerce, 1968).

34/ See, UNCTAD, TD/B/C.3/111, op. cit.

fall around the demarcation line between positive and negative impact, and only 21 per cent show a clearly positive, and 11 per cent a clearly negative, impact. On the whole, the study indicates that no conclusive results can be obtained. Uncertainty is high, as conditions change and effects differ greatly from case to case.

In host developed market economies, the impact of foreign direct investment on the balance of payments appears on the whole to be positive. In so far as evidence is available, the export performance of foreign affiliates seems to be as good as that of domestic firms and often better. It is better in the United Kingdom, for instance, where United States affiliates in manufacturing export on the average a quarter of their output - a much higher proportion than that of the average United Kingdom firm. 35/ It is equal to that of domestic firms in Canada and is increasing steadily. 36/ But it was also found, in Canada, that in a large number of cases foreign affiliates followed export-restrictive policies. This is apparently a reflection of the marketing strategy of parent companies, which try to protect export markets for themselves or for their other affiliates. They may also be obliged to resort to this practice either as a result of international market sharing with other multinational corporations, or in response to the governmental policies of the home country.

A large share of exports is, moreover, represented by intra-company sales. In the United Kingdom, half the exports of United States affiliates were made to affiliated firms. In Canada, as much as three-fourths of all exports of foreign affiliates were accounted for by intra-company sales in 1969. 37/ Such sales suggest a large scope for transfer pricing and the vulnerability of the host country's economy to foreign governmental or corporate policies.

As far as the import content of purchases by the affiliates is concerned, it appears to be relatively small in the case of United States affiliates in the United Kingdom and more important in Canada. Thus, three-quarters of the imports of foreign affiliates in Canada (which amount to one-third of their total purchases) originate with other affiliates and almost all the imports of United States affiliates originate in the home country. 38/

35/ J.H. Dunning, United States Investment in Britain (London, 1972).

36/ A.E. Safarian, Foreign ownership of Canadian Industry (Toronto, 1966). The share of exports of foreign affiliates to their total sales increased from 18 per cent in 1964 to 28 per cent in 1969. See Foreign Direct Investment in Canada (Grey Report), op. cit.

37/ The increase in this share from 52 per cent in 1964 largely reflects the very rapid increase in exports of motor vehicles under the Canada-United States Automotive Agreement. In 1969, more than four-fifths of the exports of foreign affiliates were made to the United States, while only half of total Canadian exports were sold to the United States.

38/ For the effect of short-term capital flows, see section on implications for the international monetary system below.

Socio-cultural considerations

The passage above has concentrated on the more tangible considerations. Even here, however, it is important to interpret these considerations in a broad sense. Thus, the issue of sovereignty is not simply jurisdictional but is intimately related to the rise of nationalistic feelings which may acquire special meaning as a rallying political force for cementing diverse interests and groups, especially in developing countries. The issue of development is not merely a matter of maximizing the growth rate of output but is inseparable from social needs and style of living. Even with questions of employment and balance of payments, it is sometimes the less tangible aspects that are more important.

The strong reaction against the multinational corporation in some host countries must therefore be understood in the broad socio-cultural context. The mere presence of powerful foreign enterprises may serve as a reminder of past foreign domination. The popular sentiment expressed in the form of consumer boycotts against the home country of certain multinational corporations testifies to the broad base of such sentiment and the readiness to make economic sacrifices.

In many host countries, there is growing dissatisfaction over playing a peripheral role, quite apart from the economic consequences. 39/ 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.

The ostentatious living styles of foreign personnel as compared with those of domestic employees are a source both of envy and resentment. Styles of

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39/ See Raul Prebisch, Towards a New Trade Policy for Development, (United Nations, 1964); also, according to M. Wionczek in R. Vernon, ed., Latin America Views the Foreign Investor (New York, 1965): "The efforts of foreign capital to perpetuate the political and economic dependence of Latin America on the industrial countries, particularly dependence on the United States, represent probably the single most important element in the growing conflict between foreign private capital and Latin American society", p. 13. See also Edith Penrose, "The State and Multinational Enterprise in Less-Developed Countries" in J. Dunning, ed., The Multinational Enterprise, op. cit., and Andreas G. Papandreou, Paternalistic Capitalism, (Minneapolis, 1972). Even in host developed countries, similar views have been voiced; see, for instance, the 1969-1970 Report and Accounts of the Industrial Reorganization Corporation, (London, 1970). "Britain has also to protect her vital industrial interests as a state...if this was neglected Britain could find itself becoming a branch office economy where industries vital for growth, technology or defence were either absent or entirely directed from other parts of the world." p. 17.

management directed towards efficiency but insensitive to local cultural values may appear to people in the host country as arrogant and dehumanizing. Even the local people who receive a good technical training through working with the multinational corporations may be regarded as unduly influenced by alien values. Although these reactions may change with the change in attitudes on both sides, the intensity of the feelings that have been aroused should not be under-estimated.

The multinational corporation and the home country

Tensions between multinational corporations and their home countries have generally been kept down. Many home countries which are also hosts tend to view their own multinational corporations as a countervailing force to those of other industrial countries. European countries, for instance, often view theirs as an answer to the "American challenge", while Japan has endeavoured to make the activities of its multinational corporations consistent with its national objectives.

The chief home country to raise serious questions about the impact of its multinational corporations is the United States, whose experience as a host country is as yet very limited.

These questions range from domestic economic effects to balance of payments and foreign policies. Multinational corporations have been blamed for "exporting jobs" through "run-away plants" and for making high technology available to foreign lands or taking advantage of low-wage foreign labour. Moreover, the option open to the multinational corporation to locate plants in foreign countries tends to weaken the bargaining power of domestic labour.

As in the case of the consideration of the effect of multinational corporations on employment, trade and the balance of payments in host countries, there is considerable uncertainty about the effects on home countries, the conclusions depending upon the assumptions made regarding what the alternative to the multinational corporation's activities would be likely to be. 40/ A recent study on the effect of investment abroad on domestic employment in the United States between 1966 and 1970 shows that, under certain assumptions, the presence of United States plants abroad may have resulted in a net loss of 400,000 to 1.3 million jobs. Under an alternative assumption, the net effect may instead

40/ United States Senate, Committee on Finance, Implications of Multinational Firms for World Trade and Investment and for United States Trade and Labor (Washington, D.C., 1973).

have been a gain of about 500,000 United States jobs. 41/ Moreover, there were important industry differences. While most of the assumptions made are hypothetical, the result nevertheless demonstrates the importance of the underlying assumptions in any assessment.

Multinational corporations have also been blamed for deficits in the United States balance of payments resulting from capital outflows and an alleged reduction in the rate of increase of exports. Here also studies have indicated that different assumptions, regarding such questions as whether United States enterprises would have lost their export markets abroad if they had not made the investment, yield different results. 42/

Taking into account all the considerations, the governments and social groups of the home countries, especially the United States, are increasingly concerned with the implications of the activities of multinational corporations. The key issue is not whether the home country should hamstring or do away with the multinational corporations, but how their behaviour may be influenced so as to correspond more closely to a set of enlightened national and international objectives. In this connexion the entire range of policies and institutions, including tax, money, and trade and anti-monopoly machinery, will have to be reviewed.

41/ It should be mentioned in this connexion that the findings in five out of six earlier studies dealing with the domestic employment effects of foreign investments by United States multinational companies were that such investments had caused United States employment to increase. See, for example, Business International, First Report on the Business International Investment and Trade Study (New York, 1972); Emergency Committee for American Trade, The Role of Multinational Corporations in the United States and World Economies, vols I and II (Washington, D.C., 1972). National Association of Manufacturers, U.S. Stake in World Trade and Investment (New York, N.Y.); National Foreign Trade Council, The Impact of U.S. Direct Investment on U.S. Employment and Trade (New York, 1971); Stanley Ruttenberg, "Needed: A Constructive Foreign Trade Policy" (AFL-CIO, 1971); Robert Stobaugh and associates, U.S. Multinational Enterprises and the U.S. Economy (Cambridge University, 1972); U.S. Chamber of Commerce, Multinational Enterprise Survey (Washington, D.C., 1972).

42/ See, G.C. Hufbauer and F.M. Adler, op. cit.; Raymond Vernon, The Economic and Political Consequences of Multinational Enterprise: An Anthology (Boston, 1972); Robert B. Stobaugh, U.S. Multinational Enterprises and the U.S. Economy (Washington, D.C., United States Department of Commerce, 1972); Susan Foster, "Impact of direct investment abroad by United States multinational companies on the balance of payments", Monthly Review, Federal Reserve Bank of New York, July 1972.

Implications for the international monetary and trade régimes

The responses of host and home countries to the activities of multinational corporations may in turn be a source of tension between these countries. Action and reaction tend to be escalated, unless great restraint is exercised. Many countries have probably underestimated the international repercussions of their own actions. Thus, nationalization of property by some host countries, and "extraterritoriality" as practiced by some home countries (e.g. in the area of anti-trust law, security and exchange disclosure requirements, export controls and balance of payments regulations) raise many difficult jurisdictional issues. The extension of anti-trust policies abroad, for instance, although it may at times benefit the host countries by preventing monopolistic practices, can collide with the policies of host countries that encourage mergers as a way to rationalize their industries. Export controls motivated by political considerations can arouse political tensions in addition to conflicts of economic interests. At the same time, the double allegiance of the subsidiaries is put to critical test.

These problems underline the far-reaching implications of multinational corporations, not only for host and home countries but also for international relations. The implications for the international monetary and trade regimes, as well as some jurisdictional issues concerning taxation of multinational corporations which are in the forefront of world attention, should be especially noted.

Implications for the international monetary system

It has often been suggested that multinational corporations are capable of undermining the monetary policies of host as well as home countries. Credit restraint does not, for example, have the same effect on multinational corporations as on domestic firms in the host country because the former have greater access to the resources of the parent. Similarly, tight monetary conditions in the home country can be circumvented by shifting funds from subsidiaries.

Most recently, multinational corporations have been linked to the viability of the entire international monetary system. In particular, the massive movements by multinational corporations against the dollar have jolted the exchange parities and thrown doubts on the workability of the existing rules. There is no doubt that multinational corporations could precipitate a currency crisis if they were to move only a small proportion of their assets from one currency to another. At the same time, "hot money" movements would have resulted regardless of the degree of participation by multinational corporations, given fundamental conditions of disequilibrium that the monetary system is not equipped to correct.

The vast amount of liquid assets owned by multinational corporations, to the tune of several hundred billion dollars, is often cited as a source of potential danger. 43/ During the recent currency crises, massive international movements of funds were a well-known fact. At times, central banks had to absorb several billions of dollars in a single day. The "current assets" of foreign affiliates are frequently cited as a measure of the magnitude of the funds which multinational corporations can move at will at times of exchange disturbance. Foreign assets of local banks are used as a similar measure. It should be observed in this connexion, however, that current assets include inventories and receivables as well as cash balances. Not all of them are immediately convertible into other currencies, nor are they strictly comparable to international reserves. Moreover, a substantial component of the assets reported for United States banks consists of "collections outstanding for account of reporting banks and domestic customers" and "acceptances made for account of foreigners". These are not altogether available to the United States banks to be shifted at will to other currencies in moments of crisis. Even after such allowances are made, however, the orders of magnitude involved are substantial.

A number of multinational corporations have correctly stated that currency speculation is not their business and that predatory and destructive motivations should not be attributed to them. Yet the decision-makers of multinational corporations, which have assets and liabilities in different parts of the world and a variety of currencies, must take into account risks resulting from shifts in the exchange rates.

Quite apart from purely speculative activities, exchange rate questions enter into management decisions almost every day. Assets denominated in a currency which may be depreciated can be protected by a forward sales contract. Similarly, liabilities in a currency that is expected to be revalued can be covered in a forward purchase. In this connexion, it is not the current assets or cash balances alone that are subject to exchange rate risks. A broad range of assets and liabilities is involved which may in turn be responsible for a stream of future flows. Thus, at the end of 1970, foreign affiliates of United States firms had outstanding borrowings equal to about $11 billion, half of which had maturity dates in 1976 and beyond. It is clear that adverse movements in the exchange rate can significantly increase the burden of servicing the debt.

Protective measures against exchange risks do not necessarily have to be taken for each transaction or each subsidiary. If the decision-making with respect to currency operations is centralized, as long as the expected exchange-rate shift does not result in a net exchange loss, no action may be

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43/ See, United States Senate, Committee on Finance, Implications of Multinational Firms for World Trade and Investment and for United States Trade and Labor, (Washington, D.C., 1973).

considered necessary. Where action is required, the amount that may be shifted is not limited to the current assets or cash balance alone, since the ability to operate on the foreign exchange market depends on the over-all availability of credit to the firm.

Nor does a shift of funds necessarily involve the foreign exchange market. Various techniques of "leads and lags" can be employed. For example, affiliates in undervalued currency areas may be instructed to speed up collections and reduce their liabilities. 44/ In addition, if a devaluation is expected in a given country, the parent may instruct the affiliate to increase borrowing locally and make pre-payments to the parent or other affiliates in the hard currency area. Conversely, payments to the affiliate may be deferred.

In view of the variety of ways in which multinational corporations may affect the stability of currencies, however, the recorded transactions do not usually reveal the whole story. Currency transactions through banks, for example, do not reveal the identity of particular clients. Nevertheless, the large increase of claims by United States banks to $2.94 billion in 1971 from an average of $300 million in the previous five years, reflected shifts in currency holdings financed by short-term loans. A further substantial increase was recorded in 1972.

There is also some evidence in the large increase in intra-corporation claims of United States affiliates from $1.4 billion in the first three quarters of 1970 to $2.7 billion in the same period in 1971. This was apparently in anticipation of the exchange realignment prior to the Smithsonian agreement. A reversal of this flow of $0.9 billion was recorded in the fourth quarter of 1972. Similar behaviour is observed with respect to Japanese firms in changing claims on United States affiliates.

In addition to recorded transactions, the "leads and lags" and speculative movements are partly reflected in errors and omissions in the balance of payments accounts. In 1971, outflows from the United States recorded in errors and omissions amounted to $11 billion, almost half of which occurred in the third quarter. This compared with the average of $1 billion per year in the 1960s. After reversing the flow in the first quarter of 1972, errors

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44/ Multinational corporations often use a single invoicing centre to serve a large market area. The centre can use different time-periods for issuing invoices and enforcing collections located in different currency areas.

and omissions once more indicated increased outflows and reached as much as $4.2 billion in the first quarter of 1973. 45/

45/ The net short-term outflow during that quarter was estimated at $7.0 billion. This sum consisted of interest rate-sensitive funds, including a large increase in bank loans to foreigners who drew on their lines of credit, and funds moved via "leads and lags" in commercial payment. Further, despite a reduced trade deficit, deterioration in net invisible transactions might have caused the current account deficit to approach $2.0 billion (on a seasonally adjusted basis), from $1.6 billion in the fourth quarter of 1972. There was most probably a reduction in repatriated earnings of foreign subsidiaries of United States companies and shifts of funds out of United States dollars and into foreign currencies because of the considerable uncertainties in the foreign exchange markets culminating in the devaluation of the United States dollar by 10 per cent on February 12, 1973.

Following a decline in confidence in sterling in June 1972, errors and omissions in the "overseas sector" of the United Kingdom during the second quarter of 1972 registered an outflow of £883 million, compared to an inflow of £229 million in the same period of 1971. A part of the outflow was due to an acceleration of payments for United Kingdom imports and a delay in payments for exports. Additionally, United Kingdom banks shifted funds to the rest of the world by £215 million in the second quarter of 1972, as compared to an inflow of £263 million during the same period of 1971, and an over-all inflow of £532 million in the fourth quarter of the same year.

In the case of the Federal Republic of Germany in February 1973, when the realignment of the value of the United States dollar occurred, the inflow of funds was DM 5,938 million on short term capital and DM 6,961 million on unrecorded transactions, both of which were negative during the previous month.

In the case of Japan, on the other hand, short-term capital inflows rose to $2,435 million for 1971, and $2,035 million for 1972 (compared with an annual average during the preceding five years of a little more than $300 million. Japanese foreign exchange banks reduced their net position in foreign currencies by $2,808 million between August and December 1970 (in anticipation of the revaluation of the yen) and again by $178 million in January 1973.

Similar currency shifts, reflecting the disturbances in the international currency markets occurred in all the developed market economies. The above examples demonstrate the magnitude of currency movements in anticipation of exchange rate realignments in which both financial institutions, non-financial institutions, and multinational corporations appear to be involved.

These volatile short-term capital movements reflected the international financial mobility that followed external convertibility of major world currencies toward the end of the 1950s. They also reflected significant interest differentials among the major money markets, as monetary policies have assumed greater importance in influencing the pace of business activities which have not always kept step in different countries. In addition, recent developments have demonstrated that exchange rate fluctuations, even among the major currencies, can be significant. 46/

Although the future international monetary system is still to be determined, some of the underlying reasons for short-term capital movements will continue to exist. The money markets of the financial centres of the world have been closely knit together and thoroughly entrenched in institutions, such as the Euro-currency markets and branch banking across the frontiers. The stability of the future system will thus depend on the degree of success in avoiding massive speculative movements.

In considering the various alternatives, it should be noted that in practice it is extremely difficult to distinguish speculative from ordinary transactions. Moreover, recent experience with various systems of exchange controls indicates that unless they are extremely rigid there are bound to be many loop-holes. At the same time, rigid exchange controls are fraught with familiar dangers. There is therefore no easy solution, other than a reform of the international monetary system and a reorientation of national policies which would provide for fundamental adjustments in the face of changing circumstances. At the same time, no matter how responsive to fundamental adjustments the system may be, the question will remain as to the need for compensatory capital arrangements as well as for some measure regulating, or at least monitoring, short-term capital movements under an international scheme in a future monetary régime.

Any such scheme should take into account the long-term implications of the operations of multinational corporations for the international monetary system, as well as the impact that a new system would have on these operations. In the past, foreign investments by multinational corporations have been stimulated by overvalued currencies in home countries. Income remitted by affiliates to parent corporations tends to increase the demand for the currency of home countries and the supply of the currency of the host country. Such demand on home country currency did not occur in the case of the United States dollar in spite of the expansion of United States foreign direct investment because of the existence of the Euro-dollar market. To some extent existence of this market is due to United States foreign investment but it has also served as a source of funds for further investment by multinational corporations.

46/ Pierre-Paul Schweitzer, "International Investment and the World Monetary System", an address to the Financial Analysts' Federation, Washington, D.C., 8 May 1973.

It is possible that in the long run the natural tendency of the multinational corporations to concentrate their vast funds in hard currencies, coupled with their enormous ability to shift these funds internationally even in the presence of strict capital controls, will tend to increase the frequency of parity changes or amplify exchange rate fluctuations.

Implications for the international trade régime

Trade is still a basic ingredient in monetary and payments equilibrium. Yet, for the multinational corporation, trade and capital movements are partially interchangeable options. Thus, in the general framework of decisions on the location of activities, exports from domestic plants may be replaced by investment and production abroad. A trade barrier may, for example, induce capital flow in lieu of trade flows.

At the same time, the multinational corporations are in themselves a major force in world trade. In many countries, a few multinational corporations are responsible for a significant portion of exports of manufactures. Moreover, intra-corporation trade has also grown in importance. Trade between parent firms and their affiliates, as well as among the latter, represents a major component of the total operations of multinational corporations. Since the goods and services entering intra-corporation trade do not involve "arm's length" transactions (i.e., transactions with non-affiliated firms at market prices) their prices are not determined by the market mechanism but by the corporations themselves. A firm's transfer prices are designed to satisfy a variety of requirements, and a number of factors are taken into account in determining their level, including the tariffs of the importing country, absolute and differential tax rates, actual or expected exchange rate differentials, government policies on royalty payments and profit transfers, the need to satisfy equity holders both in the home and host countries and numerous others. Transfer prices can also include payment for part of the corporation's global overhead cost much of which is incurred by the parent firm.

These characteristics have significant implications for the international trade regime. In the first place, the link between trade and investment has not as yet been adequately reflected in current trade negotiations. While trade negotiations might conveniently come under the auspices of GATT, a negotiating machinery and set of rules concerning investment and other activities of multinational corporations are as yet lacking. 47/

Another implication is that the predominance of intra-corporation trade may render the traditional adjustment mechanisms less sensitive. Thus, exports of machinery to affiliates or imports of components from them are unlikely to be influenced by minor cost changes, once the location of activities has been decided. This may render trade insensitive not only to domestic price changes but also to exchange rate adjustments. The lag in the improvement of the United States trade balance following exchange rate adjustments may have been partly influenced by this consideration.

47/ See below for suggestions for a programme of action.

A further implication for the trade regime is that trade conducted largely by multinational corporations tends to be influenced by oligopolistic considerations. Host countries tend in turn to react to the large size of multinational corporations by strengthening their bargaining positions. Some of these measures are undoubtedly protectionist in character, but most of them tend to reinforce the oligopolistic tendencies on both sides of international trade. In such circumstances there are real possibilities of mounting disputes or even trade wars. Whatever the trade regime may be, it is increasingly difficult to assume that the automatic rules of the "invisible hand" will operate smoothly.

The gravitation toward large bargaining units is reinforced by the evolution of regional trading groups. Basically, these groups apply two sets of trade regimes, one for insiders and the other for outsiders. They tend to encourage multinational corporation activities within a group. At the same time, they also encourage, intentionally or unintentionally, the location of activities by multinational corporations based in other groups. This tendency may, however, be increasingly neutralized by discriminatory measures against foreign affiliates. These measures range from scrutiny of investment, as well as finance, to anti-monopoly regulation or even price policies. It is evident, then, that in a world in which the activities of multinational corporations predominate, the international trade regime cannot be isolated from the international investment and monetary regimes or from domestic and regional policies.

Taxation and related jurisdictional issues

Governments and multinational corporations pose certain unique problems for each other in the field of taxation which are not found in the relationship between governments and purely national corporations. These problems arise primarily in the area of the corporation income tax. 48/ While this is the most widely used instrument of taxation, its ubiquity is not matched by uniformity: the taxation of corporate income varies significantly from one country to another. Differences among countries are found not only in the tax rates - which usually range between 35 and 50 per cent of profits - but also in the definitions of taxable income, in the principles that govern taxing jurisdiction and in practices in making allowances for foreign taxation.

In the face of these differences, the problem of the allocation of a multinational corporation's world-wide income among the taxing jurisdictions of the countries in which it operates assumes particular importance. The allocation affects, on the one hand, the tax revenue of the corporation's home country and the various countries in which the subsidiaries are located, and on the other the corporation's over-all tax bill.

48/ The individual income tax is often related to corporate tax since countries seek to avoid over or under taxation of corporate profits by the combined thrust of corporate and individual income tax. A part of the large problem of how to tax corporate profits is the question of how to treat dividends, undistributed profits and capital gains on the sale of corporate shares.

One of the most troublesome aspects of the allocation problem in the case of multinational corporations is that of "transfer pricing". The sale by a parent company to its foreign subsidiary, or by one subsidiary to another, of intermediate goods used as inputs by the purchaser is affected at an internal so-called "transfer price". Since there is often no market price for the goods in question and their pricing on the basis of cost plus a normal profit raises problems of costing - notably with respect to the allocation of overhead cost - the setting of the transfer price can be quite arbitrary.

Since the price at which goods are transferred determines the profits of the parent company or subsidiary which sells the goods, and the subsidiary which uses them in its production process, the distribution of a multinational corporation's world-wide profits among its various units depends on the level at which the transfer price is set. The corporation, operating within several tax jurisdictions, can minimize its over-all tax bill by establishing an artificial transfer price which will inflate the profits of subsidiaries located in countries where the tax burden is lowest and limit the profits earned in countries where taxes are higher. The tax authorities in the various countries, not having access to all the relevant data in the books of the parent firm and the affiliates, cannot determine their consolidated profits or evaluate the reasonableness of the transfer prices. They must therefore base their tax assessment on the book profits of the enterprise within their jurisdiction.

The setting of transfer prices at unreasonable levels can not only serve to minimize a corporation's over-all tax bill, but can also be used to circumvent exchange restrictions, minimize customs duties, satisfy local partners of foreign subsidiaries and for a variety of other purposes. In order to avoid disputes and uncertainty arising from the problem of transfer pricing, a few countries, including the United States 49/ and the Federal Republic of Germany, have made or are making an effort to formalize certain rules to be followed for transactions "not at arm's length". Further action in this field will need to be taken if existing anomalies are to be eliminated.

The problems that surround the taxation of multinational corporation activities are further exacerbated by differences in the taxation principles followed by various countries. While every country claims the right to tax income arising within its borders ("territorial" principle), some also claim the right to tax income arising outside their borders when that income is received by a corporation incorporated, domiciled or with its centre of control within the country ("world-wide" taxing principle). In these circumstances, a claim to tax income arising abroad implies double taxation. It also implies that competition among firms within a given host country will take place under different tax rates if the home countries of these firms follow different taxation principles.

49/ The concern over the regulation of transfer prices and the transfer of technology readily fall under the jurisdiction of existing national tax laws. The United States Treasury, for example, has elaborated some acceptable methods for determining the allocation of research costs. Such elaborations were designed to define more precisely the taxable income arising from these transactions. See Detlev F. Vagts, "Multinational enterprise", Harvard Law Review, vol. 83 No. 4, pp. 767 and 770.

In fact, however, those countries which tax income arising beyond their borders grant tax credit on account of foreign taxes paid on income from foreign sources, usually up to the level of the domestic tax rate. 50/

In the United States the credit provision is very broad, encompassing both withholding taxes and corporate income taxes and extending down through three tiers of foreign subsidiaries. 51/ This unilateral credit reflects the willingness of the United States Government to give priority to the host country in taxing corporate profits while it retains the power to set the lower limits of the combined taxation. On the other hand, if a foreign government grants a tax holiday and if the subsidiaries repatriate their profits to the United States as dividends during that holiday, the absence of tax in the host country confers no benefit on the United States corporation. The tax holiday only remains effective if earnings are not repatriated during the holiday period.

Although the "world-wide" taxing countries have unilaterally granted credit for income tax paid abroad, double taxation or undertaxation has not been altogether avoided. Partly for this reason, several developed market economies have concluded bilateral tax treaties, which are designed to ensure that foreign taxes paid by multinational corporations incorporated in or managed from a world-wide taxing country will not encounter the problem of "excess taxation". Such excess taxation is especially apt to arise if, in addition to a substantial corporate income tax, the government of the host country imposes heavy withholding taxes on dividends, interest and royalties paid by the foreign subsidiary to its parent firm. Under the tax treaties, contracting countries agree to limit their withholding taxes to relatively low levels. Developed countries have been able to reach agreement on such treaties chiefly because of the similarity of their economies and the existence of a two-way flow of income between them. Since the flow of investment income between developed and developing countries is predominantly in one direction - from the subsidiary in the developing to the parent in the developed country - the latter cannot offer a meaningful concession to its partner in exchange for an agreement by the developing country to keep its withholding tax rates low and tax treaties between them are therefore rare. 52/

50/ If the host country's tax rate is higher, the difference is not refunded by the home country. In effect, it is the higher of the two rates that applies.

51/ For a brief history of the United States foreign-tax credit, see, United States Senate, Committee on Finance, Implications of Multinational Firms for World Trade and Investment and for U.S. Trade and Labor (Washington, D.C., 1973), pp. 874-75.

52/ A group of tax experts established under the auspices of the United Nations, under Economic and Social Council resolution 1273 (XLIII), has been formulating guidelines which reflect a compromise between the interests of developed and developing countries. A broad consensus has already been achieved on a majority of issues.

Instead of inter-country agreements on tax matters, developing countries have tended to conclude agreements with multinational corporations concerning a specific project or group of related projects. They refer chiefly to the granting of tax relief as an investment-inducing measure, and usually also include such non-tax matters as convertibility of earnings at a fixed rate and other benefits. Tax relief ranging from generous depreciation allowances to tax holidays has also been granted independently of agreements between government and corporations by both developed and developing countries. Some small countries observing the territorial principle and also taxing profits at zero or very low rates have attracted multinational corporation subsidiaries and holding companies. While these countries benefit from the financial and commercial activity that grows up around the subsidiaries, the multinational corporations, by making their profits appear to be within the jurisdiction of the "tax haven", minimize their over-all tax burden. The effectiveness of the incentives granted depends in part on the attitude of the home country. Whereas some encouragement has been given to multinational corporations to invest in developing countries, 53/ agreements between host countries and multinational corporations are not allowed to contravene the tax laws of world-wide taxing home countries. Furthermore, there is a discernible tendency among home countries which follow the territorial principle to move towards the world-wide taxing principle and to tax profits when they are repatriated and in some cases even when they are not.

The question of the discontinuation of tax deferrals for non-repatriated profits is probably most urgent in countries belonging to common markets. In the European Community, efforts have been made towards the gradual harmonization of direct taxation. 54/

Another force that is gradually making for more uniform taxation of multinational corporations arises out of dissatisfaction over the variety of methods at present employed to integrate the corporate and individual income tax. 55/ Many countries fear that other countries' methods of integration may become more attractive to direct investment. 56/ Decisions on

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53/ For a list of United States measures that encourage investment in developing countries, at least relative to investment in foreign developed countries, see Implications of Multinational Firms ... op. cit., pp. 71, 124-25, 882-84. This list is important, since "the great majority of multinational corporations are based in the United States ..." ibid., p. 868.

54/ See "Tax harmonization measures planned for first stage of the proposed economic and monetary union" in European Taxation, vol. 11, No. 3, March 1971. Work in the field of taxation is also done by the Organisation for Economic Co-operation and Development, through a new Committee on Fiscal Affairs established in 1971.

55/ See Carl S. Shoup, Public Finance (Chicago, 1969).

56/ For a lengthy description and analysis, with many numerical examples, see "A comparative analysis of the classical, dual rate, and imputation taxation systems and an examination of the corporate tax systems in Belgium, France, Germany, Italy, the Netherlands and the United Kingdom", European Taxation, vol. 12, Nos. 5 and 6, May-June 1972, pp. I/112-174.

investment and the distribution of profits are affected by countries' policies regarding the taxation of distributed and undistributed profits in connexion with taxation of dividends. In some countries, shareholders are given tax relief for profits taxed at the corporate level, in others, a "split rate" tax is used under which distributed profits are taxed at reduced rates. Among the European Community countries, there is now a tendency to move towards the relief of the shareholder method, as witnessed by the recent adoption of this system by the United Kingdom. 57/ There is finally a large number of countries, including the United States and most developing countries, which do not accord relief for distributed profits. Withholding taxes on dividends, interest and royalties paid to recipients abroad, on the other hand, are often regulated by tax treaties.

Although it does not appear that an immediate crisis in the taxation of multinational corporations is pending, there is a tendency to long-term deterioration that could eventually result in drastic unilateral actions by governments, or even by the corporations themselves in respect of their investment decisions.

57/ United Kingdom, "Tax Reform", European Taxation, vol. 12, No. 3, March 1972.