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THE LESS DEVELOPED COUNTRIES AND TRANSNATIONAL ENTERPRISES

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This essay ranges over many issues, but it does not survey exhaustibly the topic of interactions between the less developed countries (LDCs) and transnational enterprises (TNEs). The vastness of such a topic imposes certain selectivity. Both TNEs and LDCs are heterogeneous, and even the area of their interaction contains great variety.

TNEs from industrialized countries are interested mainly in the markets of, and supplies from, industrialized countries. Substantial TNE interest in the third world is limited to a handful of LDCs (which nevertheless contain a non-trivial share of LDC population); more than one fifth of the foreign direct investment stock in LDCs in 1975 was held by oil-producing countries and a further two-fifths by ten other countries.[1/] Only LDCs with large internal markets or significant natural resources receive sustained attention from TNEs. Fundamental issues raised by TNE activities in the world economy should therefore concern industrial countries as well as LDCs, and the fate of TNEs will depend more on what happens in industrialized countries than on LDC policies. However, LDC-TNE relations are often asymmetrical; a small and very poor LDC is likely to be of marginal interest to TNEs, but that LDC policy-makers may attach great importance to TNE decisions regarding their country.

Both the special assets sustaining the market power of TNEs, and their motivations for going into LDCs are diverse. The special asset may be knowledge of advanced technology or a popular trademark built up by many years of advertising. Indeed, under contemporary conditions it seems that even the simplest products (or processes) upon close inspection turn out to have specialized wrinkles, often of doubtful social benefit, giving firms special assets. The variety is such that the concept of special assets of firms may become empty without a careful typology. Motivations for producing within LDCs, rather than exporting to them either goods or services embodying the special asset, are also variegated, ranging from jumping import restrictions to preparing for export cheap LDC resources, such as primary commodities or semiskilled labor. Given the diversity of special assets and of the stimuli triggering foreign investment, one may doubt *a priori* claims regarding unambiguous welfare implication of TNE activities.

The ambiguity of the welfare implications of TNE activities is reinforced by noting the heterogeneity of LDCs, not just in domestic market size and natural resource endowment, but also in the responsiveness of their government officials to different domestic social groups and in the bargaining ability of those officials. LDC government officials may or may not bargain cleverly and firmly with TNEs; may or may not focus their bargaining on substantive issues; and may or may not distribute equitably the fruits of their bargaining efforts among their fellow-countrymen.

The agnostic approach of this essay is in the spirit of that line of economic thought teaching that private profit-seeking behavior may lead to socially desirable results but only if certain conditions are met, conditions which involve both economic and political variables, and whose presence cannot be taken for granted, particularly in LDCs. If there is a simple formula to understand the nature and consequences of TNEs, this essay has not found it.

Before tackling some specific types of LDC-TNE interaction, Part I of this essay reviews some of the theorizing and controversies about international firms. Part II discusses TNE activities involving LDC exports, with examples of the old and of the new. Part III covers TNE participation in LDC import-substituting industrialization. Both Part II and Part III may be viewed as polar cases of LDC-TNE interaction; there are, of course, many other types of TNE involvement in LDCs which are left out, such as those in services and in activities producing simultaneously for domestic and foreign markets. Part IV makes a few additional observations on technological transfer and international rules.

I. The International Firm

Social science has difficulty coming to grips with TNEs. Traditional economic theory, whether neoclassical or marxist, is uneasy in the presence of imperfect competition and the modern corporation. Furthermore the sources and diffusion of technical change are typically incorporated into economic models in a mechanistic fashion. Finally, standard democratic theory has little room for "corporate citizens". Yet much of the practical debate about TNEs, or large corporations in general, revolves around their market power, their contribution to innovation and its diffusion, and their political consequences. Mainstream theory provides little guidance in these debates, either in the North or in the South.

Indeed the positive theory of the capitalist, corporate firm used by many LDC economists, such as Norman Girvan, or by radical economists, such as the late Stephen Hymer, is close to that advanced by heterodox Northern economists such as Raymond Vernon and John Kenneth Galbraith. Such a theory views the modern corporation as an institution which in its search for a satisfactory and secure return to its special asset substitutes reliance on imperfect external markets for internal planning. The more the firm expands and the larger its investments become (with each new investment often having a longer maturation period), the greater will be the perceived need to control its economic environment so as to reduce business and other risks. Whether the firm commits large funds to develop a mine or a new product, it will feel the urge to strengthen a marketing network yielding loyal customers. Only a lunatic will let auction (spot) markets decide the fate of multi-billion dollar investment projects.

The corporate commitment to private planning involves reliance on hierarchical, bureaucratic organizations internalizing informational networks and encouraging "team spirit". The right balance between centralization and decentralization will be a major preoccupation of top management. Investment decisions, including those in Research and Development, with horizons well into the future will tend to be centralized.

TNEs are viewed as simply the contemporary culmination of the tendency for capitalist firms to expand and control their environment. Dramatic advances in transport and communication over the last one hundred years facilitated first the expansion of local firms from regional to national dimensions, and more recently from national to international dimensions.

The regional-national-transnational expansion path applies in principle to any capitalist firm, regardless of historical origins or home country. The analytical focus is on the firm, not on countries, nor on an aggregated, homogeneous capital in contrast with some versions of theories of imperialism and dependency, and with standard nonclassical theory. The characteristics of firms at each point in the expansion path will, of course, differ; TNEs will be fewer and larger than regional corporations.

There is constant movement along the path, both upward and downward, fueled by technological innovations, oligopolistic rivalries and by political events. TNEs sit on top of this swarming pyramid, but uneasily. Oligopoly remains, but oligopolists may die. In a changing world, they must continuously reproduce the barriers to entry protecting their leading position.

It is important to emphasize that both oligopoly and innovation are ingredients in this view of capitalist firms and TNEs. One could conceptualize oligopoly with given production functions for an unchanging number of products. Equilibrium solutions to oligopolistic interdependence may then vary according to other specific assumptions, but they will be inferior to either the classic competitive solution or to state ownership with marginal cost pricing. Yet it appears unrealistic to contemplate oligopoly lasting very long without innovation, generated by private firms searching for quasi-rents. The oligopoly-cum-innovation combination is not easily comparable to the classic competitive solution nor to public ownership, hence the recurring debate over antitrust and patents. It could also be argued that while in the long run it is difficult to imagine oligopoly without innovation, under contemporary conditions it is even harder to imagine innovation without oligopoly for some sectors of the economy. The process of innovation and its diffusion need not be predictable nor orderly nor efficient.

Focussing on the firm and on the regional-national-transnational expansion path does not mean that national boundaries are irrelevant for understanding TNE activities. It does remind us that within countries, particularly large ones like the U.S., there are corporations with plants scattered geographically to take advantage of transport economies, proximity to customers and domestic market imperfections. Market imperfections, of course, are more severe once national boundaries are taken into consideration; actual or threatened import restrictions, factor price inequalities and information gaps are some of the most obvious ones.

The vision of a contemporary TNE sketched above differs from the atomistic, price-taking version of the competitive firm found in introductory (but not industrial organization) textbooks. It is different, but is it better or worse from a normative viewpoint? On this question opinions differ sharply, particularly between Northern and Southern observers.

John Kenneth Galbraith has put forth perhaps the best case for large corporations in general and TNEs in particular.[2/] The thesis is that TNEs naturally arise when international trade consists of modern technical, specialized, or uniquely styled manufactured products. Auction markets may be feasible for wheat or sugar, but electric generators will involve customer markets and TNEs.[3/] When advanced technology is involved, it is argued that multinational operations realize the economies of scale. TNEs are credited with favoring freer trade, with a reduction in economic conflicts among countries where they operate, and even with the creation of the world's first truly effective international civil service (which will be news in the Vatican).

Stephen P. Magee has expressed related notions arguing that TNEs are specialists in the production of information that is less efficient to transmit through markets than within firms.[4/] TNEs are said to produce sophisticated technologies because appropriability is higher for these than for simple technologies. The appropriability of the returns from information and complementarities among different types of information dictate large firm size. Magee concludes that private market generation of new information and new techniques may require concentrated industry structures and large firm size, so that any policy proposal aimed at increasing private market technology transfer through reducing the market power of the TNEs via increased intraindustry competition is close to a contradiction in terms.

Neither Galbraith nor Magee is blind to the dangers posed by the concentration of power in the large corporation. Galbraith notes several danger zones and emphasizes that the large corporation has power both in markets and states, giving it the capacity for anti-social action. Magee notes that: "The rational firm will create artificial and sophisticated masking devices, artificial product differentiation, and expend resources to appropriate the returns on earlier investments...A rational monopolist or collusive oligopoly will prevent or delay the introduction of a randomly discovered new unskilled-labor-intensive technology with <u>low</u> appropriability, if it is highly substitutable for an existing technology that has a higher <u>private</u> present value because of its <u>higher</u> appropriability."[5/] The contradiction between private and social rationality could not be expressed any clearer by a radical economist.

Yet, when all is said, Galbraith and Magee, as well as Kindleberger and Vernon, end up with relatively complacent views of TNEs. Compared with most LDC observers, their evaluation of the evidence will differ in two crucial areas: degree of competition in world markets, and the political power of corporations.

Measures of industrial concentration and market power are notoriously tricky. For a given country, the share in all manufacturing value added (or assets) of the largest 100 firms could point toward greater concentration, while measures of concentration in particular product markets could show no clear trend. Furthermore, Vernon argues that conventional measures of industrial concentration for a national market have become increasingly inadequate, primarily because such measures have not captured the buyers' perception of a larger number of substitutable sources for the products in which the buyers are interested. For the world production of eight standardized products, he shows declining concentration indices between 1950 and 1975, if one takes the TNE output of each product as a single unit irrespective of where its production takes place. This dispersion of industrial leadership could mean that while the aggregate position of TNEs in a given LDC may be growing, the market power of each TNE may have declined.[6/]

Some would argue that rivalry between, say, Japanese and U.S. TNEs is only a temporary stage, which will eventually lead to a *modus vivendi* involving market sharing or even the formation of even larger (and more truly multinational) units of capital. Experience so far indicates that the variety of nationalities of TNEs is one of the most robust structural bases for the maintenance of competitive pressures in world markets. One can also foresee that the most advanced semi-industrialized LDCs will enter their own TNEs into these oligopolistic rivalries. It has also been noted that besides the rivalry among TNEs of different nationality the alternatives faced by LDCs in recent years have been expanded by the entry into the international arena of many new and relatively small firms from industrialized countries.[7/]

The precise nature of the interaction between private TNE planning and the performance of markets remains murky and paradoxical. In some cases, TNE private planning results in thin and residual open markets for transactions falling outside the TNE closed planning network. Such remaining open markets tend to behave erratically; LDCs unwilling to hook into TNE networks may have no choice but to go there. LDC goods exported via residual markets are particularly vulnerable to the protectionism of industrialized countries, as they have no TNE friend in court. For all international trade, intra-firm trade is already more important than that carried out among different firms at arms' length. While there are difficult problems in defining and measuring intra-firm trade, not to mention in establishing departures of intra-firm pricing from ideal competitive pricing, in a pioneering paper Gerald K. Helleiner concludes that a very high proportion of U.S. imports from developing countries originates with "related parties".[8/] On the other hand, the scanning TNE central planning boards may pick up opportunities and economic signals more quickly than atomistic agents in auction markets could. Indeed, large corporations are resented by the abrupt fashion in which they transfer their activities from, say, high-wage to low-wage areas, presumably a stimulus which would also have triggered resource reallocation under purely competitive conditions, but perhaps more gradually. Put another way, up to a point TNE private planning may make for fiercer oligopolistic competition in customers' markets.

Charges that international markets are characterized by oligopoly are sometimes dismissed by Northern observers with the remark that imperfect markets bear no necessary link to profits, and that profit rates registered by TNEs do not seem abnormal over the long run, especially when all research and development expenses are taken into account. Even if published reports were reasonably accurate, the remark overlooks the debate over the "perks" enjoyed by the corporate technostructure, which are of course registered as expenses, as well as other expenses of doubtful social justification, such as advertising for building up the image of the corporation. Within broad limits, the corporate technostructure seems to have considerable leeway to reward in-group employees; threats from stockholders or takeovers by outsiders represent weak checks on executive discretion. While some argue that debatable "perks" add up to small sums, or represent normal returns to investment in human capital, others regard them as key motivations for setting up barriers to entry. It may be conjectured that the demonstration effect of such "perks" motivates some LDC public and private technocrats in their struggle for a New International Economic Order and their own bureaucratic hierarchies; the joys of travelling in a Concorde, and of the three-martini lunch have universal appeal.

Be that as it may, it remains true that while industrialized countries have legislation curbing abuses of economic power and restraint of trade, at the international level such regulations are weaker. National legislation may exempt international operations from anti-trust action, or lead to conflicts with other nations leading to sporadic, ineffectual or inefficient control of monopolistic practices. The balance between collusion and competition in international operations is tilted in the direction of collusion and/or inefficiency by the lack of clear international anti-trust agreements.

Although it has been noted that the large private corporation does not fit easily into democratic theory,[9/] and there is general recognition of significant corporate political power in capitalist societies, Northern observers derive comfort from the countervailing forces at work in pluralistic industrial nations. Historical abuses of corporate power are viewed as aberrations rather than as examples of the norm. Northern academic observers frequently rub shoulders with corporate executives in pleasant surroundings, induced feelings of good fellowship and, in the part of the academic, a conviction that the limited vision and intellectual range of executives must check their potential for really serious mischief.

While Northern observers prefer looking at the future belittling the past, history lies heavily on Southern perceptions of the present. The political and economic abuses of colonialism and hegemonism, the close and open cooperation between foreign governments and foreign companies, are viewed not as phenomena which suddenly ended in 1945 or 1955, but which evolved into subtler manipulations and interactions which are with us today. ITT-type scandals, which in the North are typically viewed as aberrations,are regarded in the South as merely the tip of the iceberg.

Southern observers can argue that the TNE-home government link is crucial for sustaining a pillar of TNE power, i.e., their technological advantage. The major industrialized countries have heavily subsidized research and development, often under the rubric of defense expenditures, which later on has provided the basis for corporate prosperity. A recent example of such government-corporate alliance is provided by deep-sea mining, an area in which U.S. private corporations are now benefitting from defense research carried out earlier by the U.S. government. Kennecott Copper Corp., International Nickel Co., Deepsea Ventures Inc., and Lockheed Aircraft Corp., the four leaders of the seabed mining consortiums, now loudly complain how bureaucratic red tape, in the form of a proposed international Law of the Sea, hampers their private enterprise, yet it is unlikely that they will proceed very far without double-checking their plans with Washington civilian and military bureaucrats.

TNE corporate power, which in the North is countervailed by trade unions, consumer organizations and other private and public actors, meets weaker institutions in LDCs. Typically it will be the public sector which will have the role of <u>interlocutor</u>, not always <u>valable</u>. The energy generated by defensive nationalism may be the most robust countervailing force offsetting TNE political and social influence in LDCs.

The political and social consequences of TNE presence in LDCs may be regarded, from the viewpoint of the corporation, as secondary repercussions of the drive for satisfactory and secure profits. Furthermore, the repercussions are likely to be contradictory, difficult to foresee and certainly variable among different types of LDCs. But on balance, a case can be made that corporate business needs will produce an attitude favoring authoritarian LDC regimes which repress trade union activity and consumers organizations. While right-wing authoritarian regimes will be most congenial, it should not be surprising if left-wing authoritarian regimes also become favored, once messy revolutionary transitions are out of the way and such regimes become interested in dealing with TNEs. Business publications show little enthusiasm for democratic struggles in the Third World, nor for President Carter's campaign for human rights. Business reasons can induce IBM to pull out of India while maintaining operations in South Africa. Business reasons operating within a peculiar European political framework led I.G. Farben to set up a branch plant at Auschwitz.

Historical background will make Northern and Southern observers react differently to corporate organization charts. To the Northerner such charts simply embody commonsensical principles of organization, subject to tinkering in detail, but whose basic pyramidal structure is rooted in the wisdom or at least the practice of the ages.[10/] Southerners view the pyramid from the base noting that the apex is typically located in New York or London. An author like Norman Girvan will reproduce in his book corporate organization charts which were blandly presented in standard industrial organization books, but surrounding them with sadomasochistic overtones, relating hierarchies to dominance/dependency relationships and to subjugation.[11/] Independent traders meeting in an open, competitive market can exchange goods and services in an impersonal and standoffish fashion, but doing business with a TNE will involve becoming enmeshed into a system of hierarchies and personalized alliances. Such alliances will have effects spilling beyond the economic life of LDC agents, influencing their social, cultural and political life. The "team-spirit" of the TNE may come to dominate other allegiances of those enmeshed in the organization, regardless of their national origins.[12/]

This section started noting that social science theory has difficulties handling TNEs. Robust empirical work on international firms, not surprisingly, has been sketchy and inconclusive, particularly regarding their operations in LDCs. Among other difficulties, a clear comparison between international and LDC firms, controlling for such variables as economic activity and size, is seldom possible. Thus, whether in general TNEs cause higher levels of economic concentration in LDCs or whether they earn higher profit rates than local firms remain debated issues. Such generalizations may never be possible outside some kind of typology, to which the rest of the paper turns. Even with typology, however, extant empirical work warrants few strong generalizations on the economic (not to mention political) consequences of TNEs in LDCs.[13/]

II. TNEs and LDC Exports

This section will touch on some issues arising from two types of LDC activities primarily oriented toward foreign markets and involving TNEs. For minerals the involvement is old and has been declining, at least in relative terms; for non-traditional LDC exports the involvement is fairly recent and shows great dynamism.

The interaction between TNEs and LDCs in minerals presents in their purest form some of the themes developed earlier: the sources of potential conflicts are many and substantial, and so is the potential surplus to be generated and shared. The rents generated by mineral production can be divided into three categories: those arising from the exhaustible nature of the resource (Hotelling-Solow rents); those arising from differential qualities of mines, either because of location or of mineral content of the ores (Ricardian rents); and those arising from oligopolistic control of production, processing, and marketing.[14/]

Throughout history international trade in minerals has been associated with violence and conflict, and few open and competitive auction markets. TNEs, mainly based in countries of substantial power, arose to replace "market anarchy" for minerals. For commodities with high fixed and low variable costs, and where information is imperfect, badly diffused or asymmetrically located, it is reasonable to expect a nonmarket institution to replace open markets. Incentives for vertical integration become large when uncertainty regarding the supply price of the upstream good pressures the informational needs of downstream firms. Once they came into existence, TNEs routinely erected barriers to entry, including hoarding mineral deposits, limiting technological diffusion and establishing exclusive processing and marketing networks.[15/] TNEs participating in the international trade and investment in minerals engaged not only in oligopolistic rivalry of a purely commercial nature, but were also part of international political rivalry. The symbiotic relationship between many TNEs and home governments has been clearest perhaps in the case of oil especially in the years around the First World War and the decade and a half following the outbreak of the Second World War.

Since the second world war, there has been a trend of growing LDC participation in mineral rents. This seems best explained, in spite of the vagueness of the phrase, by an increase in LDC bargaining power. Decolonization, super-power political rivalry, economic rivalry among TNEs of different nationalities, and the expansion of LDC expertise, knowledge and political awareness have contributed to this trend. In retrospect, it could be argued that the characteristics of mineral industries made the rise of LDC bargaining power almost inevitable. The concentration of mines, in contrast with the diffusion in the production of most tropical crops, made taxable surplus highly visible even to a "soft state" and, eventually, also vulnerable to the exchequer.

LDCs, and countries such as Australia and Canada, have not only increased their shares in mineral rents, but by creating their own state enterprises have also threatened what may be called the commodity stabilization regimes of the TNEs. The greater number of actors in world markets for exhaustible resources promises greater competition and more choices for consumers. An expanded role for auction markets, especially the London Metal Exchange, has been reported in recent years for copper, aluminum, and nickel. Those changes to a large extent can be attributed to LDC assertiveness in the production and marketing of those minerals. In spite of rhetorical commitment to free markets, nickel and aluminum TNE executives appear unhappy over the expanding role of the London Metal Exchange.[16/] The presence of LDC firms, whether private or public, in the marketing of exports, and in services ancillary to LDC foreign trade (banking, shipping, insurance) represents an important break with the pattern of foreign domination of such activities, which historically have been important sources of quasi-rents.[17/]

So one possibility for the near future is that with the TNE commodity stabilization regime in decadence, and no alternative regime firmly in place, world markets for exhaustible resources would become more competitive but also more unstable and unpredictable. Under these circumstances, prices observed in markets will be poor guides for fresh investments. During a transition period which could be long, the LDC share in world investment and exploration expenditures in mining would decline, as indeed has happened recently.[18/] Eventually the world market would once again become fragmented, as users of raw materials seeking predictability in prices and in the flow of supplies would seek special "consumer relationships" with producers. This could occur in geographical patterns of the "spheres of influence" type. For minerals with substantial production within industrialized countries, such as copper in the U.S., charges of "dumping" against LDC state enterprises will encourage protectionism, even as the same countries express anxiety about access to LDC supplies for other minerals and fuels.

An alternative scenario would feature the emergence of a *modus vivendi* between LDC national enterprises, including paper organizations, and the TNEs. This collusion between LDCs and TNEs to share in oligopoly profits is what some observers see as a key feature of OPEC, and what some see as desirable in the copper case. The stability of this new partnership will depend on other changes in world markets, particularly those where management, technology and capital can be hired separately, as well as the will of LDCs to expand their ability to combine all of these inputs. Note that the discovery and exploitation of new deposits appears to be increasingly complicated and expensive, and the technological and organizational skills of TNEs may be helpful for such tasks. Even Vietnam, which has amply demonstrated its vocation for national autonomy, will deal with

TNEs in its search for oil deposits, for example.

There are many other possible futures for international trade and investment in minerals and fuels. In an unlikely fit of rationality and far-sightedness the various actors could agree to Keynes-ITO stabilization agreements. Mongrel proposals, such as the peculiar International Resources Bank launched in the 1976 UNCTAD Nairobi meeting by Henry Kissinger, could be revised and adopted, perhaps under the supervision of the World Bank and regional development banks.

The search for a new order in minerals and fuels is likely to be a messy and complicated process. LDC-TNE relations in the area of minerals and fuels will remain tense and conflictive, even if history were to be totally forgotten. As noted by Raymond Vernon, for each particular deal in minerals or fuels there is an inexorable cycle in the bargaining strength of TNEs and LDCs. Lamentations and exhortations are unlikely to change the dynamics of this cycle, which is based on a sharp break from a situation of great uncertainty, asymmetries and little TNE commitment, to a situation of much more information, symmetry as well as large TNE investments <u>in situ</u>. The 1974-75 recession and the slow recovery since then have postponed pressures for that search, but not for long. Some Northern voices warn that the search could involve military action; they may sound archaic but they are not without influence.[19/]

We now turn to LDC-TNE interaction in the area of non-traditional exports. Since around the mid-1960s a growing number of LDCs have given greater incentives to their new exports. The results have been impressive, even after the world economy turned sluggish during the mid-1970s, particularly for about ten semi-industrialized LDCs. Non-traditional exports are made up of a broad range of goods, including traditional primary products now exported with more domestic value added, but its most dynamic component are manufacturers. Most of these goods are produced by locally owned firms, but an important part originate in TNE subsidiaries and a good share of the marketing of all non-traditional exports is carried out by foreign firms. For all LDCs, exports of manufactured products produced by TNEs may not exceed 20 percent, with a higher percentage for Latin America and lower one for East Asia. Contrary to general impressions, this share apparently has not registered any significant increase since 1966.[20]

It is likely that either as producers or merchandisers TNEs will remain important actors in LDC export drives, thanks *inter alia* to their special information and marketing networks, as well as their greater ability to resist protectionist pressures within their home countries. Commodities using labor-intensive techniques of production are natural candidates for exporting, but the drive could include an increasing share of other goods as well. A clear and dynamic example of TNE association with LDC manufactured exports involves subcontracting and assembly activities, often located in free trade or special border zones.

There are a number of intriguing similarities as well as contrasts between TNE-LDC old-fashioned interactions in minerals and plantations, and those recent ones involving labor-intensive exports generated in free-trade or border zones. In both cases the operations have "enclave" characteristics, with heavy import dependence and limited linkages into the domestic economy. In both cases TNEs control information and marketing networks to such an extent that host governments have little idea of prices, costs, and other accounting details. Under the Cuban *ancien regime*, U.S. sugar corporations producing within the island provided some insurance against protectionist excesses emanating from the U.S. Congress; a similar role as friend-in-court is now played by Northern TNEs producing or selling LDC labor-intensive goods. LDC vulnerability may be even greater in the case of new exports; for minerals and plantations the presumption is that the LDC has some natural asset not easily found elsewhere, while cheap unskilled labor is in plentiful supply. Yet, plantations, mines, and labor-intensive activities all vent abroad an LDC surplus which under autarchy would have a low opportunity cost at home. So these activities generate rents or quasi-rents which could be captured partly or totally by private or public host country actors. Under the right political and geographical circumstances, a host-country government can also control undesirable social and cultural spillovers of such enclave activities. Enclaves, in fact, may be very suitable for such vigilance.

While there is a presumption that export-oriented TNE activities in LDCs will yield net economic benefits to host countries, the magnitude of benefits could be eroded by overly generous subsidization of social overhead capital and other inputs, such as credit. It is not inconceivable that there may be projects for which the host country gains less from taxing mineral rents or from returns to labor above opportunity cost, than what it gives away in subsidized capital.

III. TNEs and LDC Import Substitution

As early as the 1920s some Latin American observers began to differentiate between two types of inflowing direct foreign investment: that associated with exports of minerals and other primary products, and that going into the nascent import-substituting manufacturing sector. The latter was more popular than the former. Since then, particularly since the Second World War, much LDC industrialization has been associated with direct foreign investment and TNEs, and an increasing share of all direct foreign investment flowing into LDCs has been for manufacturing activities selling primarily in the protected domestic market. But early enthusiasm for foreign investment in manufacturing has waned.

International corporations deciding to set up plants in LDCs typically took that step after their exports to those countries were threatened by LDC import barriers of one type or another, i.e., in contrast with the case of minerals, most direct investment in manufacturing became a substitute for trade. Once an international corporation took the investment decision, it was not unusual to observe similar moves, rational from their private viewpoints, by its oligopolistic rivals. As the nineteenth century witnessed railroad manias in country after country, semi-industrialized LDCs have gone through waves of automobile manias, petrochemical manias, etc. LDCs have learned little from each other in this area. Kenya, for example, seems to have repeated Argentine excesses regarding TNE-related import substitution.

While during the 1930s and 1940s the combination of import restrictions and inflows of direct investment into manufacturing had a number of redeeming features, the more prosperous world conditions of later years highlighted its negative aspects. Foreign-owned plants benefitted from exhorbitant effective rates of protection in many cases, shielding both excess costs and profits. Even without excess profits, it is not difficult to show in a simple neoclassical model that a small tariff-imposing country importing a capital-intensive good will see its welfare reduced by an inflow of foreign capital. While the presence of foreign capital increases claims on exportable goods, required for the real transfer of (normal) profits abroad, the combination of tariffs and capital inflow will distort the productive structure in the direction of importable goods.[21/]

In a more realistic model which recognizes that the small country deals with a foreign firm with monopolistic power, perhaps due to the firm's special asset, it can be shown that an import tariff which does not induce a decision by the foreign firm to produce locally could lead to the small country being better off than either having a zero tariff, or one so high that it triggers a capital inflow for import substitution. If the "switchover" tariff is less than the optimal tariff when only imports are contemplated, the small country could maximize its welfare by prohibiting subsidiary production ("switchover") and imposing the optimal tariff on imports.[22/]

The venerable infant industry argument was sometimes used to defend protection and other subsidization of the local activities of TNEs. Common sense soon began to question whether the learning-by-doing of infants bearing names such as General Motors and Ford be subsidized by local consumers. A related debate involved the desirability of regulating the sale to TNEs of matured locally-owned enterprises, which had been nurtured through infancy and adolescence by direct and indirect public subsidies.

While many investments by TNEs in the import-substituting sector of LDCs could pass an ex-post social cost-benefit test, a large number could not. Major blame for this situation, of course, rests with host country policies, but TNEs and their home-governments were not passive spectators to LDC policy making on import restrictions and the number of TNEs permitted in a given industry. TNEs lobbied for greater protection, as firms would, but perhaps with greater than average persuasive powers. When in their attempt to limit entrants in a new field LDCs left out TNEs of some nations, home-country embassies often would express their unhappiness, sometimes making references to limitations being placed on competition. Once the TNEs settle behind protective walls, they will resist changes in the status quo.

I would conjecture that the inefficiency of much TNE investment in the import competing sector of LDCs lies behind many complaints and criticisms of TNE practices in the third world. Much of the discussion on transfer pricing, for example, arises in the context of industries which receive significant and reliable protection thanks to tariffs and import controls, yet feel hampered by exchange controls from freely remitting their profits abroad. The latter restrictions are justified by the former privileges, yet inevitably the combination induces cat-and-mouse games besides providing rich possibilities for imaginative though socially unproductive practices. The real surplus generated by TNEs in the import substituting activity is insufficient to satisfy both the company's profit aspirations, expressed in convertible foreign exchange, as well as host country expectations in areas such as taxation, employment and externalities. Similar remarks can be made about the inconclusive debate on whether or not TNEs use appropriate technology in their plants, or about the balance of payments effects of TNEs. Surely debates over appropriate technology or balance of payments effects are more muted, say in TNE activities in oil than in manufacturing.

TNE involvement in the local production of some of the most sophisticated or novel lines of LDC consumption has also raised the appropriate product issue. Since at least last century, some economists have viewed the introduction in LDCs of new consumer goods, either via imports or local production, as a spur to development. This view stresses the incentive effects as well as the linkages of the new consumption habits.

In recent years a critical interpretation portraying TNEs as purveyors of consumerism has gained prominence. The new gadgets are said to be limited to consuming elites, as in the case of automobiles, but in other cases are charged with distorting mass consumption toward products of dubious nutritional or aesthetic worth, such as soda pop, corn flakes, filtered cigarettes, and plastic bags, to the detriment of goods rooted in local tradition and sound habits, such as mother's milk, cigars and handicrafts. TNEs and their retinue of public relations firms blitz local culture until the old ways are seen to be backward and shameful, while consumption of TNE goods becomes a sign of modernity and sophistication. Local production of the new goods promotes their use by swelling local pride at being at the frontier of progress, and by the knowledge that employment is being generated. Attempts by some TNEs to adapt their products to LDC circumstances and needs, as in the case of nutritious soft drinks or smaller and simpler autos and hotels, are regarded as exceptions proving the rule. The commercial success of such exceptions has been mixed.

The economic and political complexities found in TNE involvement in LDC import-substituting industrialization become even more acute when LDCs attempt to expand the size of the protected market by the creation of customs unions.[23/] It is recognized that TNEs could be powerful instruments of integration; indeed so powerful that they may lead the process to their great gain, and with repercussions the host countries regard as undesirable. When a group of these countries had been following, each on their own, policies of import substitution, a common market could bring about significant gains by rationalizing existing activities (i.e., trade creation). If existing plants are owned by TNEs, they may oppose the process, but some may go along with it expecting to cut costs and increase profits. Such long run real productivity gains may be shared between TNEs and host countries, and among host countries, in various and not easily predictable ways. When the customs union aims at creating new activities (i.e., trade diversion), the host countries will naturally hope to retain as much of the perceived benefits from the enlarged market as possible, squeezing the maximum concessions from new TNE entrants. Hence the establishment of such regulations as the Andean investment code. But the less efficient the new investment plans the more likely it is that the bargaining between LDCs and TNEs, and among the partner countries, will be time consuming and mystifying.

IV. Technology and Rules

This last section will say a few more words on the subject of TNEs and technological transfer to LDCs, and will raise the question whether the bargaining between TNEs and LDCs can be aided by international rules.

Reliable empirical evidence on the different channels of technological diffusion and on the varying costs of each channel to receiving countries is not plentiful. What seems clear is that TNEs are neither the only nor necessarily the cheapest (for LDCs) mechanism for technological diffusion. Producers of machinery, consultants, students, and specialized publications are some of the other conduits of technological diffusion, which under some circumstances become attractive alternatives to parts of the TNE package.

One should note that a TNE presence in LDC manufacturing, by itself, is no evidence of technological diffusion to LDC residents; it is only a geographical fact. At one extreme the TNE may keep to itself all relevant knowledge, leaving local residents as ignorant of the technology as if they were importing the product. At the other extreme, the TNE presence could lead to a costless copying of its technological advantage by competing local entrepreneurs, although it is difficult to see why the TNE would actively promote such a process. TNEs could, however, promote technical improvement among local producers supplying inputs to the TNE. A low-cost and rapid diffusion, involuntary and undesirable from the viewpoint of most TNEs, is most likely to occur in large semi-industrialized LDCs than in small and very poor LDCs.

The peculiarities of technological knowledge as a commodity make both LDCs and industrialized countries perceive that they are cheated by the somewhat metaphysical international technology market. Anxious OECD countries have been flirting with technological protectionism, discovering suddenly all sorts of imperfections and externalities. Fortunately, the various channels of technological diffusion provide some defense against this type of protectionism, which at least since the Industrial Revolution has not been successful for long.

Granting these caveats, TNEs remain one of the important participants in the international technological market, reluctant to share their special technological assets with outsiders, but less secretive regarding technologies not fundamental to their quasi-rents. They are also important forces in the generation of fresh innovations. Their dual role will keep them in a delicate position in the struggle between Southern forces promoting low-cost technological diffusion, and Northern efforts to maintain and extend technological leadership, whose quasi-rents make up part of the higher Northern *per capita* income.[24/] This struggle is unlikely to yield orderly patterns. Already in 1960 Albert O. Hirschman was noting a secular trend toward a continuous shortening of the time needed for a new industry to become footloose, comparing the historical spread of textiles, chemicals, automobiles, antibiotics and transistors.[25/] He challenged the view that the "imitators" would follow the "talented innovators" only at a respectful distance and with well-adjusted speed, and only to occupy positions of comparative advantage which the innovators were more or less ready to yield. It is interesting that the notion of a neat and orderly separation of the world between talented innovators and timid followers, which some regard as the implicit ideology of U.S. foreign economic policy during the post-Second-World-War period, reappears in some of the dependency literature which takes for granted LDC technological serfdom, barring profound socio-economic structural changes.

One can note in passing the emergence and rapid growth of a new source of technology for LDCs: <u>other</u> LDCs.[26/] Significant adaptive technological efforts have been carried out in several semi-industrialized LDCs, leading to new wrinkles in manufacturing production processes making them more suitable to smaller markets, or taking advantage of second-hand machinery, or adapting to lower quality raw materials and intermediate products. There are also examples of product changes. Such technological niches were often carved out by LDC firms engaged in import-substitution which are now in the position to exploit their special asset either by exporting, licensing or investing in other LDCs.

Bargaining between LDCs and TNEs, whether over Hotelling-Solow and Ricardian rents, or over technological marketing quasi-rents or over rents generated by protection, is likely to remain rough and bitter. The normal rate of return to capital found in theoretical constructs is not easily definable in concrete, ever-changing circumstances. Policies of individual LDC governments toward TNEs will no doubt continue to fluctuate, sometimes erratically, depending on whether a given LDC has been most recently impressed by TNE excesses, or by the difficulties and frustrations of effectively running the apparatus of control over foreign investors. But the secular trend is unlikely to be away from growing LDC assertiveness, with public sectors continuing to be the host country major counterparts to TNEs in the bargaining game. Under these circumstances, rhetoric and debate will also remain apocalyptic. LDCs will continue to be lectured on the dangers of killing the celebrated goose. Yet despite occasional confiscations (in most cases amply covered by *ex-ante* risk premia) and despite threats to let LDCs stew in their own juice, a substantial number of TNEs will keep knocking at some LDC doors.

Unless one wishes to see the contradictions between LDCs and TNEs (or, more generally, between TNEs and governments) ending up in a drastic systemic change in the world economy, it is natural to imagine reforms in the international economic order which would reduce the dead-weight losses, irrationalities, and abuses existing in this area. The modest proposals put forth by OECD and UNCTAD attempt to bring into the international jungle some of the rules and regulations on corporations which have been common in advanced industrialized countries for many years. These include standards of disclosure and accounting, regulation of restrictive business practices, codes on corrupt practices, and cooperation among tax authorities of different countries. More ambitious proposals would culminate in a GATT-type of organization to regulate and oversee TNE activity. It is remarkable that weak proposals on disclosure of information, even when coming from OECD, have met with hostility from TNEs and some of their home countries.[27/] In the context of the North-South dialogue it could also be useful to review Northern legislation regarding access to national capital markets and patents to see whether it unnecessarily tends to limit open-market alternatives to TNEs.

In this as in other arenas of international economic interaction we are still witnessing the consequences of the paradox Lionel Robbins identified in classical liberal thought. He noted that the famous liberal harmony of individual actions was only a harmony because legal restraints and institutions created at the national level an arena in which it might emerge. The laissez faire of English classical thought demanded a strong national state. But when dealing with international problems, liberalism adopted a different attitude; when relations between different states were concerned, its attitude became that of philosophical anarchism, or tacit reliance on an imperial or hegemonic power for policing the international economy.[28/]

The outlook for the emergence of generally accepted rules and regulations for international firms is not promising. Even among highly industrialized nations there are growing mutual recriminations regarding unfair behavior; witness especially criticisms of Japanese firms and their trade practices. As "two, three, more Japans" emerge, each with its own cultural style, these problems are likely to multiply. Established old oligopolists are unlikely to accommodate smoothly to the rise of lean and "ill-mannered" new oligopolists. Rather than universal rules of the game, new political and economic subsystems of bewildering variety could emerge.

To most LDC policy makers these systemic preoccupations are likely to appear premature. Their key preoccupation must remain the exact role, if any, TNEs can play in accelerating development in their countries. Governments of LDCs with both political will and local expertise will naturally be in a better position to guide and control

TNE specific contributions to their country's development than those of LDCs lacking both or either. The latter will be unable to look too carefully into the package TNEs bring in. The depackaging of the TNE bundle is not an easy task, and the governments of the poorest LDCs may for many years be satisfied in obtaining just tax revenues and employment from TNE operations. Even the more advanced LDCs which are quite able to, say, run on their own existing new mines, may choose to call on TNEs to help them in opening up new mines. For some projects depending on continuous access to new technology LDC negotiators may prefer some TNE equity participation over a simple licensing agreement, so as to obtain a longer range TNE commitment to the venture.

On the whole, the arguments presented in this paper imply that, suitably directed by responsible host country planning and channeled selectively, TNEs can contribute to achieving <u>specific</u> developmental targets by supplying clearly defined services and expertise. The international economy of the 1970s, with all its problems, has allowed greater flexibility to many LDCs in choosing between TNE packages and alternative ways of reaching economic goals, in contrast with the international economy of the 1950s or those of earlier decades. LDC selectivity regarding TNEs should become as expected and acceptable in the international community as the selectivity industrialized countries apply to immigrant labor.

Footnotes

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1/ United Nations Economic and Social Council, Transnational Corporations in World Development: A Re-examination, (New York: E/C.10/38, March 20, 1978), p.8

2/ John Kenneth Galbraith, "The Defense of the Multinational Company; How Management Puts Its Worse Foot Forward and in its Mouth", Harvard Business Review, March-April 1978, pp. 83-93. See also his "A Hard Case", in The New York Review of Books, April 20, 1978, pp. 6-9

3/ On auction and customer markets see Arthur M. Okun, "Inflation: Its Mechanisms and Welfare Costs", Brookings Papers on Economic Activity, vol. 2, Washington D.C., 1975

4/ Stephen P. Magee, "Information and the Multinational Corporation: An Appropriability Theory of Direct Foreign Investment", Chapter 13 in Jagdish N. Bhagwati, editor, The New International Economic Order: The North-South Debate, (Cambridge: The MIT Press, 1977), pp.317-340.

5/ Stephen Magee, op cit, pp. 327-328. The italics are Magee's.

6/ Raymond Vernon, Storm Over the Multinationals: The Real Issues (Cambridge: Harvard University Press, 1977) pp. 77-82

7/ United Nations Economic and Social Council, Transnational Corporations in World Development: A Re-examination, (New York; E.C.10.38, March 20, 1978), p.7

8/ Gerald K. Helleiner, "Intrafirm Trade and the Developing Countries: Patterns, Trends, and Data Problems", (processed, U. of Toronto), September 1977

9/ Charles E. Lindblom, Politics and Markets; The World's Political-Economic Systems, (New York: Basic Books, Inc. Publishers, 1977) p.5 and p. 356.

10/ As noted by Fernand Braudel: "Capitalism does not invent hierarchies, any more than it invented the market...; it merely uses them". See his Afterthoughts on Material Civilization and Capitalism (Baltimore: The Johns Hopkins University Press, 1977), p.75. He adds in the same page: "For this is indubitably the key problem, the problem of problems. Must the hierarchy, the dependence of one man upon another, be destroyed?"

11/ Norman Girvan, Corporate Imperialism: Conflict and Expropriation. Transnational Corporations and Economic Nationalism in the Third World. (White Plains, N.Y.: M.E. Sharpe, Inc. 1978) See especially his figure 1, p.21, adapted from a book by Alfred D. Chandler, Jr.

12/ In earlier and more candid years orthodox Northern authors openly noted the conflicting loyalties generated by TNEs operating in LDCs. Discussing during the 1930s whether U.S. subsidiaries in Latin America should hire Latin Americans as executives, Dudley Maynard Phelps wrote: "For such major positions very few nationals with the requisite training and experience are available, and, even if they are available, it might not be good policy to place them in a position to know all the affairs of the concern or to instruct them with intimate details of the company's policies. Moreover, it is necessary, at times, for a concern operating in a foreign country to have relationships with the government representatives of its own country...Obviously, in cases of this type, members of the legation could not talk freely before the executives if the latter were nationals. In general, it seems questionable whether a concern should risk the chance of divided loyalty and consequent biased decisions by hiring nationals for major executive positions." Dudley Maynard Phelps, Migration of Industry to South America, (New York: McGraw-Hill Book Company, Inc., 1936) p.262

13/ This echoes the conclusion of Sanjaya Lall in his review of empirical work: "Transnationals, Domestic Enterprises, and Industrial Structure in Host LDCs: A Survey," Oxford Economic Papers, Volume 2, Number 2, July 1978, pp. 217-248.

14/ For a more detailed discussion of these concepts and other issues relating to mineral TNEs see my "International Markets for Exhaustible Resources, Less Developed Countries, and Transnational Corporations," Yale Economic Growth Center Paper No. 256, December 1976.

15/ Examples of "virtual monopoly positions" for several minerals are given in Rex Bosson and Bension Varon, The Mining Industry and the Developing Countries (Oxford University Press; published for the World Bank, 1977) pp. 40-42. Links between mining TNEs and large financial groups are also noted.

16/ See "Big Aluminum Firms Don't Like Plans for Trading on London Metal Exchange," The Wall Street Journal, December 19, 1977, p.20. In its issue of May 15, 1978, p.38 Business Week reports that despite strong opposition from Britain's Aluminum Federation, the LME seems likely to go ahead as early as next fall with aluminum trading. The item adds: "Producers fear a more open market would open the door to producers from developing countries with lower energy costs".

17/ See W. Arthur Lewis, The Evolution of the International Economic Order (Princeton: Princeton University Press, 1977), pp. 22-23.

18/ United Nations, Transnational Corporations in World Development: A Re-examination, op cit, p.67. The percentage of mining exploration expenditures carried out in LDCs has declined from 30 percent during 1966-70 to 14 percent during 1971-75.

19/ Tensions in Africa have been related by some to that region's mineral wealth. See "The Mineral Connection", The Economist, July 9, 1977,p.82. That article quotes Sir Neil Cameron, the chief of the British Defense Staff, saying that in the future NATO might be obliged to wage peripheral wars to keep its share of the world's resources.

20/ See the useful article by Deepak Nayyar, "Transnational Corporations and Manufactured Exports from Poor Countries", The Economic Journal,Vol.88, No. 349, March 1978,pp.59-84. Further empirical work is needed to establish more precisely the role of TNEs in new LDC exports, separating TNE presence in production and merchandising, and according to importers (TNE home country, other OECD countries, other LDCs, etc.)

21/ The proposition involving a simple two-good, two-factor neo-classical model is presented in a paper by Richard A. Brecher and myself, "Tariffs, Foreign Capital and Immiserizing Growth",Journal of International Economics 7 (1977)pp. 317-322

22/ The results of a partial-equilibrium model for a small country dealing with a monopolistic firm are presented by Peter Svedberg, "Optimal Tariff Policy on Imports from Multinationals", processed University of Stockholm, 1978, (forthcoming, Economic Record). While the tariff reduces consumer's surplus in the small country, the tariff revenue captures part of the foreign firm's monopolistic profits.

23/ The costs and benefits from economic integration when there are foreign firms affected by the process have been analyzed by Ernesto Tironi, "Economic Integration and Foreign Direct Investment Policies: The Andean Case", unpublished Ph.D. Thesis, Department of Economics, M.I.T., Cambridge, Mass. Aug. 1976. See also Constantine V. Vaitsos, "Regional Integration cum/versus Corporate Integration," mimeo, The Institute of Development Studies, Sussex, England, January 1978

24/ For a model in which developed countries must continually innovate not just to grow but even to maintain their real income in the presence of technological borrowing by LDCs, see Paul R. Krugman, "A Model of Innovation, Technology Transfer, and the World Distribution of Income,", processed, Yale University, March 1978.

25/ Albert O. Hirschman, "Invitation to Theorizing about the Dollar Glut", The Review of Economics and Statistics, Vol. XLII, No. 1, Feb.1960,pp.100-102. This note not only pioneers in product-cycle theorizing, but to a 1978 reader it also has a remarkable prophetic ring about the U.S. balance of payments.

26/ For a discussion of budding LDC TNEs see Louis T. Wells, Jr., "The Internationalization of Firms from Developing Countries," and C.F. Diaz Alejandro "Foreign Direct Investment by Latin Americans",both in T.Agmon and C.P. Kindleberger, eds. Multinationals from Small Countries (Cambridge: The MIT Press, 1977) pp. 133-195

27/ See reports in The Economist, November 5 (p.102) and December 17 (p.108), both of 1977.

28/ Lord Robbins, Money, Trade and International Relations, (London: Macmillan, St. Martin's Press, 1971) pp. 253-254.