FOREIGN INVESTMENT, TRANSNATIONALS AND DEVELOPING COUNTRIES

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Preface

This book brings together many years of work on foreign investment and transnational corporations (TNCs). We have both been concerned with the impact of TNCs, particularly in the manufacturing sector, on the economies of less-developed countries (LDCs), and we have both come increasingly to realise that the conventional tools of economics, narrowly conceived, are inadequate to deal with issues which are much broader than those of 'private foreign investment'. What is at stake is the transformation of political, social and economic structures, and what is needed is political economy in the broadest sense. Unfortunately, political economy is an underdeveloped art, and this book reflects our difficulties in dealing with the enormous issues in hand without proper tools. Although we stay largely within the realms of economics as conventionally defined, it also reflects our disquiet with the use of the tools of conventional economic theory.

Part I of the book concentrates on the general questions of the growth of TNCs and their implications for the welfare of host LDCs. Part II draws upon research conducted for the New York office of the United Nations Conference on Trade and Development (UNCTAD) on the balance-of-payments and income effects of a sample of foreign investments is six LDCs. Chapters 7 to 10 present the main findings of these studies; Chapter 6 gives the results of some later work on the data collected for these studies on various aspects of the sample firms' performance. Part III discusses policy measures for host governments and outlines the difficulties in formulating and implementing policy. It is hoped that each part will in its own way prove useful to students and practitioners in this field.

The empirical part of the book was the work of Lall; the analytical sections were prepared jointly. Most of the drafting was done by Lall, but we collaborated in so many ways that it is difficult to separate our ideas and our contributions.

We owe gratitude to so many people that it would be impossible to name them all here. The secretariat of UNCTAD, and in particular Sidney Dell and Gerry Arsenis, deserve our greatest thanks for having financed the initial research project and encouraged and commented on our work. Several people worked on the research teams; of these we should especially like to thank Andrew Elek, Daniel Chudnovsky and Kenneth Mayhew.

Those who helped us in the field must, of necessity, remain anonymous, but we are deeply grateful to them all for their co-operation and kindness. Harikleyia Bacon did valuable statistical work in the final stages of preparing the book. Of those who helped to form our ideas (though they may not agree with them) and who commented on the manuscript, we wish to thank Max Corden, Gerry Helleiner, Robert Mabro, Ajit Singh, Frances Stewart and Constantine Vaitsos. We should like to acknowledge the secretarial assistance of Valerie Boulton, Caroline Carr, Judy Chance, Margaret Ko, Karen Exley, Muriel Payne and Karen Popham.

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Part I

Transnational Corporations and Developing Countries

CHAPTER 1

Introduction

THE UNSETTLED BACKGROUND

We have now reached a stage of profound disillusionment with development economics. The days of optimism, when the problems of the poorer countries were thought to be fairly well understood, and when the solutions, though not easy, were thought at least to be amenable to the conventional tools of economic analysis, are almost past. There was a time when certain views on economic development were held with the conviction and clarity of Victorian morals: development meant, or at least was measured by, the growth of national product per head; governments could adopt generally agreed-upon policies to provide such development, by planning (balanced or unbalanced) economic growth and by encouraging international aid, trade and investment; there was often the implicit assumption of a fundamental harmony of interests both between different classes or groups within the poor countries and between different nations; the transfer of the most advanced technology and knowledge from the rich to the poor countries was considered desirable and necessary; and, more generally, there were purely 'economic' answers to problems of underdevelopment. The main conflict was seen to be neither between classes nor between nations but an intertemporal one: between consumption now and more consumption later, as a result of the savings effort. The maximum feasible savings ratio, combined with a largely technically determined capital–output ratio, yielded the target growth rate. The role of international 'co-operation', including foreign investment, was to supply missing components, in the form of extra savings, foreign exchange or skills, so as to accelerate the government-organised march of the people towards 'take-off'.

As with Victorian morality, the façade hid many unpalatable facts and contradictions. With the passage of time, some of these have become more obvious, partly as a result of the patent failure of conventional economic policies in many countries and partly as a result of changing values and a growing awareness of the largeness and complexity of the problems involved. Thus, new development literature reveals a number of 'unconventional' views: per capita growth of gross national product (GNP) hides growing inequalities of income, wealth and opportunity; governments do not or cannot always act to promote the well-being of the majority of their populations, and class or group interests do often conflict (and influence policies); external economic relations may lead to a 'dependent' form of development, and the wholesale transfer of technology may aggravate the employment, distribution and scientific problems of backward areas; non-economic factors are usually inseparable from economic ones, and the arbitrary division imposed by economists is unwarranted and misleading. These are all deep and extremely controversial issues which raise serious methodological problems for development economics. It is, for instance, no longer very clear what is meant by 'welfare' in less developed countries (LDCs) – or, much less, for the world as a whole – or even how the lines of 'economic' analysis are to be drawn. We are forced increasingly to question the values, concepts and definitions that we have been taught to use – a difficult process, but, as Gunnar Myrdal has argued in the Prologue to *Asian Drama* (1968), one which is necessary if as social scientists we are not to fall into the traps of irrelevance, implicit bias, or straightforward ideological pleading.

The topic of foreign private investment in LDCs raises all such problems with a vengeance. There are few subjects which arouse so much controversy and such a variety of interpretation and valuation (see Lall, 1974a), and certainly it is a field in which both the reality and the perception of it are changing rapidly. The heresies of yesterday are today's conventional wisdom; what was seen not very long ago as a competitive world of foreign investors acting as neutral agents of capital and technological transfer is seen now as a highly oligopolistic world of transnational corporations (TNCs) possessing great commercial and economic power, and posing a challenge to national policy and economic independence (see Streeten, 1973, and Vernon, 1971). Our own researches into the balance-of-payments and income effects of foreign manufacturing investment, which began in 1969 and ended in 1973, reflect this sort of change.[1] We started with what we considered adequate tools to analyse certain effects of a sample of foreign investments in selected LDCs, and we finished with results which, though of great interest, did not in our view convey the larger implications of the significance of TNCs for development. The value of

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our work thus lies not only in what we did discover but also in what we *did not*, and *could not*, discover with the tools at hand and within the framework set by the questions to which we initially addressed ourselves.

In this book we first try to analyse in general qualitative terms the nature of transnational manufacturing firms and their economic effects on host developing countries; we then describe the main findings of the UNCTAD project and show its merits and weaknesses; and we finish with a discussion of the implications for government policy. We have thought it best to keep the analytical sections separate from those on the project results, because in many ways they have different purposes. We shall touch upon problems of defining welfare and of evaluating various 'non-economic' factors; no doubt our arguments will mirror some of the confusions of the present state of the 'science'.

FOREIGN INVESTMENT AND TRANSNATIONAL CORPORATIONS: SCOPE AND DEFINITION

In spite of the recent flood of literature on TNCs and the various investigations undertaken by national governments and international organisations, data on the extent and nature of foreign private investment are still sadly inadequate. There are inherent problems in measuring foreign investment, particularly when the investment takes the form of machinery or capitalised technological contributions and when inflation renders book values of investments (which are generally the only figures available) largely meaningless. If, moreover, a distinction has to be drawn between investments where the effective control lies with the foreign firm, and so constitutes foreign investment *proper*, and those where it lies with a local entity, and so constitutes simply a form of payment for technology or some asset transferred, there arise difficulties in determining how, and to what extent, control is exercised. A majority shareholding by the foreign firm is not necessary for it to exercise control; in appropriate circumstances, and even without an explicit management contract, a particular investor can exercise control with an equity share as low as 10 per cent.

Quite apart from these conceptual difficulties, there are great gaps in the statistics available, from both investor and recipient countries, on foreign investment. Partly as a result of business secrecy and partly owing to a lack of official scrutiny, most developed countries do not publish comprehensive information on the foreign operations of their firms. Even the United States, which has by far the best coverage of all aspects of business activity, is found wanting: thus, the massive study recently prepared for the US Senate's Committee on Finance (US Tariff Commission, 1973), with almost 300 tables of detailed statistics on US transnationals for 1966 and 1970, had to rely for its 1970 data on a sample of 298 parent companies, which were then used to extrapolate figures for the entire group of some 3400 companies with foreign investments for which data had been obtained for 1966. Furthermore, data on foreign operations were available only for majority-owned affiliates, leaving out a substantial proportion of operations abroad which were in fact controlled by US TNCs. A study of the effects of UK investment overseas (Reddaway et al., 1967–8) had to depend almost entirely on sample data, while most LDCs have (with the possible exception of India in our sample countries) the scantiest idea of the real value of foreign investment in them.

Bearing these problems in mind, let us look at the available figures. The most comprehensive collection of data on foreign investment in LDCs is contained in the recent study by the UN Department of Economic and Social Affairs (UN, 1973), which has managed to glean an illuminating – but admittedly imperfect – set of tables from an amazing variety of sources. The *total book value* of foreign private investment held by the market economies came to $165 thousand million in 1971, with the US accounting for 52 per cent of the total, the UK 15 per cent, France 5 per cent, and West Germany, Switzerland, Canada and Japan about 3 to 4 per cent each. This had risen by 53 per cent from $108 thousand million in 1967, when the respective shares of the leading three investors were 55 per cent, 16 per cent and 6 per cent, and of West Germany 3 per cent, Switzerland 4 per cent, Canada 3 per cent and Japan only 1 per cent.[2]

The *developing countries* as a whole accounted for $33 thousand million of the estimated stock of investment (32 per cent of the total) at the end of 1967, the last year for which the UN study provides estimates.[3] Of this stock, the US accounted for 50 per cent, with the bulk of its investments concentrated in Central and South America; the UK for 20 per cent, with Africa and Asia taking large and almost equal shares; France for 8 per cent, mostly in Africa; the Netherlands for 5 per cent, mostly in South America; and the others for 4 per cent or less. A separate estimate by M. Emerson of the OECD Secretariat puts the value of the stock of direct investment in LDCs at the end of 1970 at $39 thousand million,[4] a rise of 15 per cent from his estimate of $34 thousand million for the end of 1967; however, the share of LDCs in the total stock of direct investment ($153 thousand million) is seen to decline to 25 per cent of the total.

The sectoral distribution of the stock of direct investment in LDCs, taken from the UN for the end of 1967 and from Emerson for the end of 1970 (in parenthesis) is as follows: petroleum 33 per cent (33), mining 11 per cent (10), manufacturing 29 per cent (31), and other 27 per cent (26). The corresponding geographical distribution is: Africa 20 per cent (20), Middle East 9 per cent (9), Asia 15 per cent (14), Latin America and other 56 per cent (57). Thus, both these distributions show very little change, with the exception that manufacturing registered a slight increase over the three-year period (manufacturing accounted for 41 per cent of the world total and for 47 per cent of the total for developed countries at the end of 1969).[5]

TABLE 1.1
Industrial Composition of US Foreign Manufacturing Investment, 1970
($ million)

Industry	*Value of investment*	*Percentage of total*
1. Chemicals and allied products	6858	22·2
2. Transport equipment	5131	16·6
3. Non-electrical machinery	3798	12·3
4. Primary and fabricated metals	2619	8·5
5. Electrical machinery	2613	8·5
6. Paper and allied products	2007	6·5
7. Food products	1853	6·0
8. Instruments	1345	4·4
9. Wood products	1296	4·2
10. Stone, clay and glass	1046	3·4
11. Rubber	974	3·1
12. Textiles and apparel	625	2·0
13. Printing and publishing	138	0·4
Other	602	1·9
Total	30915	100·0

Source: US Tariff Commission (1973), p. 407.

Within the manufacturing sector, US foreign investment, and to a lesser extent UK investment (see below), is concentrated in chemicals, machinery, electrical products and transport equipment. These are 'skill-intensive' industries in which the role of research and development

(R & D), product differentiation and marketing is particularly important. West German and Swiss investment also exhibits this pattern, while Japanese investment is directed at relatively light and low-technology industries, such as lumber, pulp, textiles, steel and non-ferrous metals. In view of the predominant positions of US and UK investment, let us look at their industrial composition in slightly greater detail. Table 1.1 shows the value and percentage breakdown of net fixed assets of foreign affiliates (majority-owned only) of US firms for 1970,[6] with the industries ranked (except for 'other') by size of investment.

The importance of 'skill-intensive' industries is apparent from this table, though exactly what this skill consists of is not clear and will be discussed later. The US Tariff Commission also compares the domestic importance of the largest foreign investors, and concludes that 'generally the rankings indicate that these industries which are strongest in terms of domestic investment in the United States also are stronger in terms of their foreign direct investment positions, while the weaker domestic investors also are the weaker foreign investors'.[7] This point is one of great importance in understanding the nature of TNCs as a whole and is borne out by many studies;[8] it is discussed in greater detail in the next chapter.

The composition of UK manufacturing investment at the end of 1971 is shown in Table 1.2, the figures being for the 'book value of net assets attributable to the United Kingdom'. It may be noted that the total value of all such assets came to £6667 million, with 72 per cent going to developed and 28 per cent to less-developed countries, and that manufacturing investment comprised 59·0 per cent of the total for all countries, 65·9 per cent for developed countries, and only 41·2 per cent for LDCs. Some differences between the American and British investment patterns are immediately obvious. Whereas chemicals, transport equipment and electrical and non-electrical machinery account for 60 per cent of US investment, they account for less than 40 per cent of British investment; the greater importance of textiles, food and tobacco, relatively old and non-technological industries, in the latter (about 36 per cent) than in the former (only 8 per cent) is also significant.

So much for the general picture of foreign investment. What is the role of *transnationals* in all this? And, before we proceed any further, what exactly is a 'transnational corporation'? Though it is now common parlance in economics to talk of 'multinational', 'international', 'transnational' or 'global' corporations (or firms, companies or enterprises), the exact meaning of these terms has not been clearly defined.[9] Many authors use them interchangeably for the same thing, while others

TABLE 1.2
Industrial and Geographical Composition of UK Foreign Manufacturing Investment, end 1971
(£ million)

Industry	*Value of investment*			*Percentage breakdown*		
	Total (1)	*In developed countries* (2)	*In LDCs* (3)	*(1)/overall total* (4)	*(2)/(1)* (5)	*(3)/(1)* (6)
1. Food, drink and tobacco	1104	840	264	28·1	76·1	23·9
2. Chemical and allied	684	571	113	17·4	83·5	16·5
3. Electrical engineering	498	417	81	12·6	83·7	16·3
4. Textiles and footwear	298	233	65	7·6	78·2	21·8
5. Mechanical engineering	263	236	27	6·7	89·7	16·3
6. Paper, printing, publishing	262	239	23	6·6	91·2	8·8
7. Metal manufacture	143	126	17	3·6	88·1	11·9
8. Rubber	134	93	41	3·4	69·4	30·6
9. Motor vehicles	93	70	23	2·4	75·3	24·7
Other	455	343	112	11·6	75·4	24·6
Total	3934	3168	766	100·0	80·5	19·5

Source: UK Government, Department of Industry (1974), Part II, Table 37.

differentiate among them in order to distinguish differences in the attitudes or national composition of management, the spread of ownership or level of organisation, or even to imply differences of a political kind. It is natural at this stage to have such a looseness of definition, since the phenomenon is a relatively new one, and different people analyse it with different ends in mind. As the tradition in economic analysis has been to think in terms of small firms operating in competitive environments, with some exceptions in the case of (domestic) oligopolies, and to conceive of foreign investment simply as a part of 'capital flows' (direct and portfolio) between nations, the emergence of gigantic firms dominating world markets, trade and investment, and operating as integrated units across national boundaries, has led to new definitions being framed as contrasts to the traditional concepts.

In order to characterise the TNC, we can distinguish three areas in which such contrasts are emphasised: we may term them 'economic', 'organisational' and 'motivational'. The *economic* definition stresses the *size, geographical spread* and *extent of foreign involvement* of the TNC. It brings out the difference between the TNC and (a) a large domestic firm which does little investing abroad, (b) a domestic firm which may invest abroad but remains a small economic unit, (c) a large firm which invests abroad but only in one or two countries, and (d) a large portfolio investor who does not seek to control his investments or to take entrepreneurial risk.

This sort of definition has been used by the Harvard Multinational Enterprise Project, which, on the basis of their having six or more foreign subsidiaries, has selected from the 500 largest US industrial firms 187 TNCs in manufacturing.[10] The US Tariff Commission has suggested that 'a typical multinational company is one with net sales of 100 million dollars to several [thousand million] dollars. Direct foreign investment in manufacturing facilities usually accounts for at least 15 to 20 per cent of the company's total investment. "Direct" is generally thought to mean at least a 25 per cent participation in the share capital of the foreign enterprise, i.e. a large enough share to imply operational control of the enterprise rather than portfolio investment.'[11] Similarly, a recent work by Parker classifies 613 of the largest manufacturing firms in the world into MPE2, MPE1 and not-MPE (MPE standing for 'multinational producing enterprise'); the first are firms 'which are clearly international in character', and have more than five foreign subsidiaries or more than 15 per cent of total sales produced abroad, the second are 'less globally orientated' and have two to five subsidiaries or 5–15 per cent of sales produced abroad, and the rest are not-MPEs.[12] On these criteria, 349 (57 per cent) of the total are in the MPE2 category, eighty-eight (14 per cent) in the MPE1 category, and 175 (29 per cent) are not-MPEs.[13]

The *organisational* definition generally takes the size and spread of TNCs for granted and analyses factors which make some *more* transnational than others by virtue of the nature of their organisation, their centralisation of decision-making and authority, their global strategy, or their ability to act as one cohesive unit under changing circumstances. This sort of definition, used more by

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