Do multinational enterprises block or help in bringing about development in LDC's?

A countries international financial situation as reflected in its balance of payments and level of monetary reserves depends not only on its current account balance but also on its balance of capital account. The international flow of financial resources takes two main forms: private foreign direct and portfolio investment (MNE's) and public or private development assistance (foreign aid, NGO's).

Few developments have played a critical role in international trade and capital flows as the rise of the multinational corporation. An MNE is an enterprise or corporation that controls and conducts productive activities in more than one country. These huge companies mostly from North America, Europe and Japan provide opportunities as well as host problems in the LDC's that they operate. The growth of FDI in LDC's was extremely rapid in past decades. Annual rates have increased from $2.4 billion in 1962 to $11 billion in 1980 and $35 billion in 1990. MNE's are not in the development business. Their objective is to maximise their return on capital. This is why over 90% of global FDI goes to other industrialised countries. MNE's seek out the best profit opportunities and are largely unconcerned with issues such as poverty and inequality. The table shows FDI in LDC's between 1970 and 1997, and the major 1997 recipients.

MNE's carry with them styles of living, managerial philosophies, diverse business practices and advertising. They therefore engage in a number of activities non of which involve development aspirations in the country which they operate.

There are two crucial characteristics of MNE's. The first is their large size and the second is their worldwide operations tend to be centrally controlled by parent companies. MNE's are a major force in the globalisation of world trade. 350 largest corporations control more than 40% of world trade and dominate production in cars, footwear, electronics, tobacco and clothing. They have in effect become global factories searching for opportunities anywhere in the world. Many MNE's have sales volumes in excess of the GDP of the LDC in which they work.

The interests of these companies in their dealings with countries collide. Sales abroad are rabidly expanding, the high concentration of corporations are only in a few countries such as Japan, US, Germany and the UK. Their characteristic of enormous size means great economic power vis a vis the Third World. Their power is strengthened by their oligopolistic market position, giving them the ability to manipulate prices and profits, collude with other firms and restrict potential competition. Such factors have fuelled a lot of controversy and discussion over whether MNE's facilitate or inhibit development in LDC's.

The first argument in favour of MNE's grows largely out of the traditional neo classical and new growth theory analysis. It is argued that foreign private investment is a way of filling the savings gap. I will r ecall the Harrod-Domar model when referring to this factor which points out that there is a relationship between savings and the rate of output growth,

$g = s/k$.

If demand output growth is a rate of 7%, with capital output ratio at 3%, savings required ar e 21%. If domestic savings only amount to 16%, a savings gap of 5% is said to exist. If the country can fill the gap with foreign financial resources, it will be better able to achieve its target of growth. So thus, filling the resource gap is a very impor tant point in favour of MNE's, seeing that a lot of the LDC's suffer from this problem of lack of savings.

A second argument is filling the gap between targeted foreign exchange requirements and those derived from export earnings. This is the trade gap. An inflow of private foreign capital can not only alleviate part or the entire deficit of balance of payments but also function to remove that deficit over time. However the overall effect of MNE's to establish subsidiaries behind protective walls is often a worsening of both current and capital account.

The third gap is said to be filled is that between targeted government tax revenues and locally raised taxes. By taxing MNE profits and participating in operations, LDC governments are better able to mobil ise financial resources. It is often quite intimidating inviting a huge, renowned corporation to operate in your country but through interacting in operations governments can still remain authoritarian, strong and in control. The fourth argument focuses around management, technology, entrepeneurship and skills which these companies bring to the country. This advancement gap between the north and south to an extent is filled by the operations of MNE's in the Third world. Not only do enterprises provide finan cial resources to these countries, but they also supply a package of needed resources – management, expertise, technology, technological know how, which are all transferred to local counterparts by means of training programmes, learning by doing process. Managers are also educated about efficient, marketing, advertising and promotion techniques. Finally they bring the most sophisticated technological knowledge about production while transferring modern machinery and equipment to LDC's. Such transfers are de sirable and productive for recipient nations.

On the other hand, there are a number of arguments against MNE development in LDC's, both economic and philosophical. On the economic side, the factors pointed out above regarding filling certain gaps are counteracted by detrimental cases and arguments. Firstly, although MNE's provide capital they may actually reduce domestic savings and investment rates by stifling competition through exclusive production agreements with host governments, failing to re invest much of their profits. They may also inhibit the expansion of indigenous firms that might supply them with intermediate products by instead importing these goods from overseas. Due to their size and dominant market position these MNE's can also act as deterrence as well as a barrier to domestic firms wishing to expand or start up, as the gap is so large.
Secondly, although the impact is to improve the foreign exchange position, long run imports may actually reduce foreign exchange earnings on both the current and capital accounts. The current account may deteriorate as a result of importing products and capital goods, and capital accounts may worsen because of overseas gain of profits, interest, royalties, managers fees and other funds.
Thirdly, although MNE's do contribute to public revenue through corporate taxes, their contribution is actually far less than it should be. Considering the extraordinary amount of profit which these companies earn the proportion which is directed to the host country is only a small fraction. This is due to a number of factors such as liberal tax concessions, transfer pricing, disguised public subsidies, and tariff protection provided by the host government.
With regard to the management, skill and technology provided by MNE's, they actually have very little impact on local sources of these scarce skills and may actually inhibit their development through stifling indigenous management.

The next few criticisms and arguments are more fundamental. Third World countries have often raised a number of objections toward the settlement of MNE's. Firstly, the impact of MNE's is very uneven which reinforces duelistic economic structures and income inequalities. They promote the interests of a small number of local managers and greatly incr ease wage differentials. They divert resources away from needed food production to the manufacture of sophisticated products catering demands of local elite's and foreign consumers. They also tend to worsen the imbalance between urban and rural economic opportunities through a magnetism effect. As a result, regions become segregated fuelling the migration process. The less fortunate areas become deserted and continue to collapse. The residents who cannot afford to relocate suffer. MNE's therefore encourage the process of core-periphery development and growth pole regions. A classic case is India, where the growth poles surround the four major industrial areas that are Delhi (north), Bangalore (south), Calcutta (east) and Bombay (west).

The next argument, one put forward also by Galbreith, relates to the goods being produced. MNE's typically produce inappropriate products, for the small minority, which stimulates inappropriate consumption patterns through advertisement and power with inappropriate technology of production. This stems out into major argument against these corporations as it results in employment problems in LDC's.
As a result of the first two factors resources tend to be allocated for socially undesirable projects, aggravating the already sizea ble inequality between rich and poor.
MNE's use economic power to influence government policies in directions unfavourable to development. Some government officials are known to have been corrupt, signing unfavourable contracts in return for sales or commissions fees. Taken from a report 'Urban Development in Ecuador' by Stella Lowder, the article indicates that governments in Ecuador have been very unstable and short lived, with political parties representing institutional interests rather than national po pulations'. MNE's are able to extract economic and political concessions from competing LDC governments in the form of protection, investment allowances and cheap provision of sites and social services. As a result, private profits exceed social benefits. Transfer pricing is also a common practice of MNE's resulting in lost revenue for the host country.

MNE's may damage host economies by suppressing domestic management using superior knowledge, contacts, advertising, skills and essential support services. They can crowd out investors and appropriate the profits for themselves. For example, a study of 11 developing countries carried out by Fry and Fisher in 1993, showed foreign direct investment was accompanied by lower national savings, larger deficits and slow growth. On the political level, the power of these corporations can gain control over local assets, jobs and influence political decisions at all levels. In extreme cases, they may even pay off to corrupt public officials as occurred with the Internat ional Telephone and Telegraph Company in Chile in the 1970's. A last point, which also links in with the downfall of foreign aid, is the over reliance on outside income. Countries may become too dependant on the attraction of these MNE's, and as their only incentive is to increase profits as oppose to LDC development, these countries may find themselves in a large dilemma when the income has ceased.

The ultimate debate centres on the different ideological and value judgements about the nature of the meaning of economic development. The advocates in favour of private foreign investment are the laissez faire proponents, who believe in free market mechanisms. However, MNE's tend to be oligopolies or monopolies – price setting does not occur through natural forces of markets. Pessimists toward MNE's are motivate by self-importance and national control over domestic economic activities.
Arguments for and against MNE's are still debated to this day. Clearly a real assessment requires a case studies of specific countries. However, MNE's are likely to intensify their global strategies around the world and thus strengthening bargain powers on behalf of LDC's is required for survival.