Chittagong University Studies
Social Science, Vol. XIV No. 1
November 1993, pp. 26-34

Do Transnational Corporations Benefit or Harm Development in Less Developed Countries?

Mohammad Mafizur Rahman

Department of Economics
University of Chittagong.

The role of transnational corporations (TNCs, which are also popularly known as multinational corportarions, MNCs) in the economic development of less developed countries (LDCs) is a very controversial issue. The controversy has, in recent years, magnified as TNCs have excited a great deal of interest in LDCs because of the ways they affect the institutional framework for trade in goods and factors between countries. On one side, there are those who see the TNCs as making possible more efficient use of economic resources and whose presence is vital for the rapid growth and development of LDCs. On the other side, there are those who see the TNCs as the most important aspects of the imperialist penetration of the LDCs, heightening their dependency and deepening the process of dependent development. However, in order to ascertain whether TNCs benefit or harm development in LDCs, it is necessary firstly to explain the rationale behind their establishment; and secondly, to examine the effects of TNCs on various areas of the economy.

The Rationale Behind the Establishment of TNCs

A TNC can be defined as an enterprise which has singnificant production operations and controls assets - factories, mines, sales offices and the like - in two or more countries.

TNCs dominate in oligopolistic market structures and their behaviour patterns can be analysed within an oligopoly framework. Oligopolists compete with one another through product differentiation, advertising, rapid technological innovation of both products and processes and through competitive entry to LDC markets.

TNCs plan, organise and manage their operations on a global scale, viewing the world as a single economic unit. It is the parent corporation that determines corporate strategy, decides on the location of new investment, allocates research programmes and export markets to various parts of the corporation and determines the prices that are charged on intra corporate transactions (transfer prices).

Maximisation of global profits is the overall, long-run corporate objective of TNCs. To achieve this objective, TNCs have devised a variety of financial strategies which attempt to minimise both the risks they face and the taxes they pay, although these two objectives may occasionally conflict.

TNCs invest in LDCs for a variety of reasons - access to raw materials, utilisation of cheap labour and ability to supply host country markets. The reason for utilisation of the resources or the markets of LDCs via direct foreign investment (DFI), instead of exports or licensing arrangements, is that TNCs possess some advantages which local competitors do not have access to.

The reason for the attractiveness of TNCs to LDCs is that DFI by the TNCs provides in 'package' form, those resources otherwise not available to LDCs (technology, marketing skills) or only available in insufficient quantities (capital, enterprise). The major goals of LDC governments are job creation, transfer of usable technology and skills, creating linkages in the host economy, improving the balance of payments position and saving or earning foreign exchange. In addition, many LDCs seek foreign investment, particularly in natural resources, to help promote regional development objectives and to increase domestic tax revenues.

Effects (of TNCs) on Various Aspects of the Economy

The scant empirical evidence on employment expansion from foreign investment by TNCs is hardly convincing. Some observers mention that displacement of local firms by TNCs may actually reduce local employment (Sunkel 1972, cited in Gillis *et. al.* 1987). The argument is that TNCs transfer to LDCs technology which is excessively capital intensive in relation to their factor endowments and so cause an aggravation of employment problems. This also causes a worsening of income inequalities, distorting influences on technology used by other industrial firms and a bias in production towards the sort of high income sophisticated and differentiated products for which the technology has been developed.

Concerning linkages in the economy it can be seen that TNCs develop fewer linkages. Because both mechanisation and the nature of

the TNC products are more likely to demand imported raw materials, working against backward linkages, and the capital equipment is likely to be supplied by the parent company. The linkage possibilities that do exist (for example, packaging and printing requirements) are more likely to be exploited by other TNCs, rather than by local firms (Colman and Nixson 1978 : 232)

With regard to balance of payments, the initial act of direct investment (assuming that the capital comes from foreign rather than local sources) involves a capital inflow and thus a credit item in the balance of payments account. But the investment generates a stream of profit, interest, dividend payments and royalty payments during its life which can be repatriated and thus have a negative balance of payment effect.

The LDCs cannot control the transfer of funds between the subsidiary and any other part of the TNCs (by using foreign exchange control regulations, tax regulations, direct controls) as TNCs attempt to avoid legally or illegally the LDC regulations. The most powerful weapon that they have at their disposal in this respect is the use (or abuse) of transfer pricing.

TNCs make a number of other payments from host countries for the factors and services provided by the parent corporation and these payments are growing rapidly (UN 1974, cited in Colman and Nixson 1978 : 229). Barnet and Muller (1974, cited in Colman and Nixson 1978 : 225) quote figures which show that between 1960 and 1968, US TNCs took, on average, 79% of their net profits out of Latin America. Thus TNCs send out of the host country profits made on capital that may be borrowed locally and reduce the rate of capital accumulation within the LDCs. As Lal and Streeten (1977 : 54) state, "host economies do not gain much financial benefit from direct investment, and would be seen to gain even less if hidden remittances in the form of transfer pricing were fully known."

As far as foreign exchange is concerned, it is argued that due to the TNCs' massive contacts abroad and their marketing skills, their investment might promote exports and therefore generate additional foreign exchange earnings.

But studies have shown that on account of import substitution policies adopted by the LDCs in promoting industrialisation, the overall effect of permitting TNCs behind tariff and quota walls is often a net worsening of foreign exchange earnings. For example, showing empirical evidence, Barnet and Muller (1974, cited in Colman and Nixson 1978 : 230) quote that US TNCs in Latin America had a worse export performance than local firms for exports outside Latin America and did no better (with certain exceptions) when it came to exporting to other Latin American countries.

Furthermore, when TNCs transfer technology to a locally owned firm, the contract often forbids the sale of goods produced using that technology outside the host country. Vaitsos (1974, 1975, cited in Colman and Nixson 1978 : 230) indicates that such restrictions are widespread. This hinders the development of new overseas markets and the earning of additional foreign exchange.

Thus TNCs prevent or retard the emergence of domestic capital goods industry and the activities of TNCs prevent the emergence (or destroy the existence) of an entrepreneurial class dedicated to national development.

In addition, TNCs also cost the host LDCs through special concessions. To encourage foreign enterprises, the government of the host country may have to provide special facilities, undertake additional public services, extend financial assistance or subsidise inputs. All these have an opportunity cost. Tax concessions may also have to be offered and may, for political reasons, have to be extended to domestic investment.

However, there are some positive effects of TNCs too. In recent years the LDC governments have been seen to become increasingly successful in regaining control over their non-renewable natural resources, or at least obtaining a greater share of the revenue derived from their exploitation : oil is perhaps the best example of this process.

Barnet and Muller (1974, cited in Colman and Nixson 1978 : 225) mention that in spite of the outflow, unrepatriated profits account for a large share of net investment in certain sectors of the Latin American industry.

The final issue to be considered is the contribution that TNCs can, in principle, make to the development effort. It is true that the TNCs can make contributions providing appropriate technology, foreign market, management techniques, technical personnel, organisational and technical skills, and innovations in products and production techniques. Given the low organisational and technical level of many LDCs, these are indeed indispensable elements in their development process. In many cases, only TNCs have the financial resources and technical expertise to develop new and better products which are essential for agricultural development, exploit mineral resources, and large scale construction projects. The capital provided by TNCs supplements domestic savings which, in turn, accelerates economic growth through increased investment in productive activities. In helping to raise productivity a number of benefits accrue to the host nation. Beneficiaries are domestic labour in the form of higher wages

and increased skill through local training; consumers by way of lower prices; and the government through higher tax revenue.

Therefore, LDCs can develop their economy through some form of arrangement with TNCs and the formulation of effective foreign investment policies (policies for labour-intensive technology, investment to the sectors whose output is socially desirable, and reinvestment of earned profits).

Some Empirical Evidences

To obtain empirical evidences on the activities of TNCs is really hard as TNCs operating in LDCs are conservative in disclosing any information regarding their operation. Hence, any objective study on them is very often practically impossible. However, based on the existing literature, efforts will be made to present some empirical evidences on the above mentioned issues.

Employment : Due to TNC operations, employment in some extractive industries has actually fallen in many countries. Taking 1970 as a base year, C. V. Vaitsos,(1974)found that employment in the tin industry in Malaysia declined from 100 in 1965 to 84 in 1973 and in Chile (in all extractive industries) from 140.6 in 1964 to 98 in 1973 (Cited in Kumar 1980 : 6)

In contrast, there has been a continual rise in employment in manufacturing TNCs since late fifties. For example, the employment in US manufacturing TNCs increased between 1966 and 1970--an average of 8.3 percent yearly and about 4 percent for all developing nations (ILO 1976[a], cited in Kumar 1980 : 7). A study on Korea indicates that between 1970 and 1973 the share of employment of foreign corporations increased from 3 to 11 percent (UN Report 1978 cited in Kumar 1980 : 7). Another study in USA on 121 TNC firms during the 1960s also showed a higher rate of employment increase than the national average (Mannan 1986 : 137).

One of the most harmful aspects of TNC employment is brain drain from LDCs. Quoting from an UNCTAD study Mannan (1986 : 140) showed that during the period 1961-1971, more than 5300 high quality brains from LDCs have been drained into the service of the US economy and American TNCs operating from the American soil.

Linkages : A few studies have investigated linkages statistically and found negative backward linkages. For example, Biersteker (1978 : 89-91) found that TNCs' affiliates in Nigeria purchase a larger portion of inputs from abroad than do local firms. Cohen (1973) also found that the foreign subsidiaries import more (cited in Caves 1982 : 271).

Profit transfers and payments : Profit transfers by TNCs from LDCs are enormous. For example, Magdoff (cited in Chowdhury 1993 : 78) showed that between 1950 and 1965 only USA TNCs were able to transfer three times the profit of their investment in LDCs.

Mannan.(1986) mentioned that eight transnational pharmaceutical companies remit an annual profits of about 30 crore taka from Bangladesh to their home countries. The annual remittance of profits by TNCs operating in the tea sector is around 25 crore taka. In 1978, only Bangladesh Tobacco company remitted profits more than 1.5 crore taka (Mannan 1986 : 153-154).

This is possible through transfer pricing—over pricing of the goods imported by LDCs and under pricing the export items produced in such countries. A study on ten Latin American countries, during the 1966-69 period, shows that TNCs under priced exports from their affiliates by an average of 40 percent (Mannan 1986 : 149).

Moreover, payments by LDCs for patents, licences, know-how and trademark as well as management and service fees are also high. The following table indicates this.

Table : 1
Selected Developing Countries : Payments of Royalties and Fees in relation to GDP and to export-earnings.

Share of payments (Percent)

Country	Year	GDP	Exports
Argentina	1969	0.72	7.9
Colombia	1966	0.50	5.3
Mexico	1968	0.76	15.9
Nigeria	1965	0.78	4.2
Sri Lanka	1970	0.51[a]	2.9[a]

a. 1969

Source : UN Secretariat, quoted in Mannan, 1986 : 162

Exports, Productivity and GDP growth : Data for Mexico and Brazil show that TNCs generally have lower ratio of value added to sales than domestic firms in the industry (EPW 1979 : 106)

In India, it was found that the total sales turnover by the transnational engineering firms increased by only 18 percent, during 1973-74 to 1976-77, compared to 49 per cent increase in Indian firms.

The ratios of exports by a transnational firm to those by an Indian firm were as follows :

1973-74	1 : 3
1974-75	1 : 2
1975-76	1 : 2
1976-77	1 : 4

With regard to productivity also the transnational firms were not better than the Indian firms. The ratios of net sale value of production by transnational firms to Indian firms were like this :

1973-74	1 : 1
1974-75	1 : 2
1975-76	1 : 1
1976-77	1 : 1

(Source : Kapoor and Saxena cited in Roychoudhury 1981 : 201).

However, Dixon *et. al.* (1986)showed that some LDCs with extensive and largely transnational controlled and financed manufacturing sectors continued to exhibit rapid rates of growth for both GDP and exports, despite the deepening recession. Between 1970 and 1980, for example, South Korean economy maintained an average annual growth rate of 10.1 percent of GDP and 37.2 percent for exports. Thailand maintained an average annual growth rate of 10.1 per cent for GDP and 37.2 per cent for exports. Thailand maintained an average annual GDP growth rate of 6.9 percent for the same period (Dixon, *et. al.* 1986 : VIII).

Conclusion

In the light of the above discussion and empirical evidences, it is very difficult to draw a concrete conclusion regarding benefits and harm by the operations of TNCs in the economic development of LDCs. The benefits that foreign investment through TNCs bring to a developing country are considerable. On the other hand, TNC involvement can also carry costs to a host country and. unfortunately, it is the costs that attract the most interest and controversy.

To place things into perspective requires resolution of a fundamental question. What would have happened in an LDC if there had not been any TNC activity ? Would the LDC have been able to develop without external investment and technological input ? If so, how ? The answer is that development would have been most unlikely. Like arguments concerning the United Nations, it seems that if a TNC did not exist then it would have to be invented.

Finally, it can be noted that even if a particular LDC is lacking in achieving development as a result of TNCs operation, TNCs cannot be directly blamed. Their prime objective is global profit maximisation and their actions are aimed at achieving that objective, not developing the host LDCs. Various aspects of the operations of TNCs are open to negotiation. So it is up to the LDC governments to pursue policies which will eliminate the causes of their problems. East Asian countries, particularly NICs, for example, have been successful in this regard through appropriate policies. Within a modified framework and working within an agreed set of guidelines and rules, the TNCs, through ownership of and control over technology, capital and marketing skills, can still make a unique contribution to the development effort of LDCs.

References

Biersteker, T. J.
1978 *Distribution or Development : Contending Perspectives on the Multinational Corporation.* Cambridge, M. A. : MIT Press.

Caves, R. E.
1982 *Multinational Enterprise and Economic Analysis,* Cambridge University Press, Cambridge.

Chowdhury, H.
1993 *Samaj O Unnayan* (in Bengali), Bangla Academy, Dhaka.

Colman, D., and Nixson, F.
1978 *Economics of Changes in Less Developed Countries,* Philip Allan, Oxford, London.

Dixon, C. J.*et. al.* (eds.)
1986 *Multinational Corporations and the Third World.* West View Press, USA.

Dunning, J. H.
1981 *International Production and the Multinational Enterprise,* George Allen and Unwin, London.
1979 *Economic and Political Weekly (EPW).* Vol. 3, Jan. 20, 1979. Bombay.

Helleiner, G. K.
1989 *Transnational Corporations and Direct Foreign Investment,* (in Handbook of Development Economics Vol. 2, Chenery, H. and Srinivasan, T. N. eds. 1989, North Holland).

Hood, N., and Young, S.
1979 *The Economics of Multinational Enterprise*, Longman, London.

Kumar, K. (ed.).
1980 *Transnational Enterprises : Their Impact on Third world Societies and Cultures.*, Westview Press, Inc., USA.

Lall, S., and Streeten, P.
1977 *Foreign Investment, Transnationals and Developing countries*, Oxford, London.

Malcolm, G., *et. al.*
1987 *Economics of Development*, London.

Mannan, A.
1986 *Multinational Corporations in the Third World Countries with Special Reference to Bangladesh*, Chittagong University Studies, Commerce Vol. 2, 1986.

Meier, G. M.
1989 *Leading Issues in Economic Development*, Oxford University Press.

Roychoudhury, P.
1981 *The Transnationals*, Firma KLM (P) Limited, Calcutta.

United Nations (UN).
1978 *Transnational Corporations in World Development : A Re-examination*, E/C. 10/38. New York.

World Bank.
1985 *World Development Report*, Washington D. C.