

The Multinational Corporation and Direct Investment[@]

(Excerpt)

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When a firm embarks on production in a foreign land, it faces new choices and opportunities. It must deal in a different currency, it must pay different factor costs, and it will be taxed under different laws. The corporate response to these fresh alternatives is an intriguing subject that has attracted much research.¹ But the problems of multinational production have assumed more than academic interest with the rapid expansion of U.S. direct investment abroad from \$7 billion in 1935 to \$86 billion in 1971. This expansion has aroused fears for the prosperity of home countries and for the sovereignty of host nations (Servan-Schreiber; 1968; Levitt, 1970).

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1. Dunning (1958) and Wikins (1970 trace the ancestry of multinational enterprise, The Harvard Business School (under Vernon), the University of Reading (under Dunning), New York University (under Hawkins), the United Nations Conference on Trade and Development (UNCTAD) (under Streeten, Lall, et al.), and the National Bureau of Economic Research (under Lipsey) have housed major research programs on the multinational corporation. Other agencies and institutes with active research programs are listed by Erb (1973). Bibliographies of the literature on multinational corporations have been prepared by Burtis, et al. (1971, Lea and Webley (1973), Aronson (1973), the UN Secretariat (1973, and, perhaps the comprehensive,

Table 1 draws together figures for U.S. direct investment and for gross domestic product of host countries in a number of regions. On the whole, U.S. multinational corporate activity has expanded more rapidly than host-country gross product. During the year 1965-70 for example, U.S. direct investment in the United Kingdom grew 3.6 times as fast as U.K. gross product; in Western Europe as a whole it grew 1.6 times faster; and in Australia, New Zealand, and South Africa, 1.8 times faster. The principal exception to this pattern was Latin America, where, during the 1955-65 decade, U.S. direct investment grew more slowly than domestic gross product.

Table 1

U.S. Direct Investment Compared with Host Region Gross Domestic Product (billions of dollars and relative growth rates)

GROSS DOMESTIC PRODUCT

Year	United States	Canada	Western Europe		Latin America	Australia, New Zealand, South Africa
			Total	United Kingdom		
1950	284	17	134	32	31	12
1955	396	24	211	47	33	18
1960	501	32	290	63	52	25
1962	557	41	385	68	61	29
1965	681	48	459	89	74	35
1970	970	70	681	103	102	53

Lal (1973b). Among the leading essay collections, the works edited by Kindleberger (1970), Dunning (1970, 1971), Rolfe and Damm (1970), Machlup, Salant, and Tarshis (1972), and Brooke and Remmers (1972) and the studies compiled for the U.S. Senate Committee on Finance (1973a, 1973b) deserve mention. Brooke and Remmers (1970), Tugendhat (1971), Ragazzi (1973), Dunning (1973b), and Parry (1973b) offer good surveys. Corden (1974) has a useful analysis of the relationship between multinational corporations and orthodox trade theory, while Caves (1974b) has ably synthesized the relationships among international trade, investment, and imperfect markets. Leading books and papers have appeared over the names of Penrose (1956), Hymer, (1960) W. C. Gordon (1962), Mikesell (1962, 1971), Dunning and Rowan (1965), Vernon (1966, 1971, 1972), Servan-Schreiber (1968), Stevens (1965b), Caves (1971), and Horst (1972a, 1972b). Topical reviews of multinational corporation issues have appeared in the Wall Street Journal (1973), Newsweek (1972), and Fortune (1973).

U.S. DIRECT INVESTMENT

Year	Total	Canada	Western Europe		Latin America	Other Countries and Unallocated	
			Total	United Kingdom		Total	Australia, New Zealand, S. Africa
1950	11.0	3.6	1.7	0.8	4.4	2.1	0.4
1955	19.4	6.5	3.2	1.4	6.6	3.2	0.8
1960	32.0	11.2	6.7	3.2	8.4	5.7	1.2
1965	48.8	15.2	14.0	5.1	10.8	8.7	2.3
1970	78.1	22.8	24.5	8.0	14.7	16.1	4.3

RELATIVE GROWTH: U.S. DIRECT INVESTMENT
VS. GROSS DOMESTIC PRODUCT IN THE HOST REGION*

Period	Canada	Western Europe		Latin America	Australia, New Zealand, South Africa
		Total	United Kingdom		
1950-55	2.0	1.5	1.6	8.3	2.2
1955-60	2.2	2.9	3.8	0.5	1.6
1960-65	0.7	1.9	1.4	0.7	2.1
1965-70	1.1	1.6	3.6	1.0	1.8

* The relative growth is the quinquennial percentage growth in direct investment divided by the quinquennial percentage growth in GDP. The relative growth (similarly calculated) for direct investment by all foreign countries in the United States was: 1950-55, 1.3; 1955-60, 1.3; 1960-65, 0.8; 1965-70, 1.2.

Sources: GDP figures were compiled from IMF (1972) and UN Statistical Office (1970, 1972). The figures are translated into U.S. dollars at prevailing exchange rates. U.S. direct-investment figures are from *Survey of Current Business* (various issues). There are book-value figures, compiled by adding annual direct-investment flows and retained earnings to benchmark census data on gross book values (before depreciation). Note that the figures pertain only to U.S. equity ownership of the foreign affiliate and debt of that affiliate to its parent; the ownership interest of foreign shareholders and banks is excluded. In making comparisons between gross domestic product in current prices and the book value of direct investment I assume that the ratio between sales in current prices and the book value of the equity stake remained approximately constant between 1950 and 1970.

British direct investment overseas has also grown more rapidly than the domestic output of host countries, at least in the main industrial countries. The statistics appear in Table 2. Canada has been the principal area where U.K. investments have grown less rapidly than domestic product.

Direct investment by foreign countries in the United States and in the United Kingdom has likewise expanded more rapidly than gross product, a point brought out in the notes to Tables 1 and 2. Thus, faster relative growth is not restricted to the overseas operations of American or British multinational firms.

Table 2

U.K. Direct Investment Compared with Host Region Gross Domestic Product (millions of pounds sterling and relative growth rates)

Year	Total	U.K. DIRECT INVESTMENT				Other Countries	
		United States	Canada	Western Europe	Latin America	Total	Australia, New Zealand, South Africa
1962	3405	301	484	29	172	2419	919
1965	4210	387	531	42	213	3037	1242
1970	6415	762	716	91	264	4581	1901

RELATIVE GROWTH: U.K. DIRECT INVESTMENT VS. GROSS DOMESTIC PRODUCT IN THE HOST REGION*

Period	United States	Canada	Western Europe	Latin America	Australia, New Zealand, South Africa
1962-65	2.6	0.5	2.3	1.1	1.6
1965-70	2.3	0.8	2.4	0.6	1.0

* The relative growth is the period percentage growth in direct investment divided by the period percentage growth in GDP. The relative growth for direct investment by all foreign countries in the United Kingdom between 1962 and 1970 was 1.9.

Source: Gross Domestic product figures are from Table 1. U.K. Direct investment figures are from U.K. Reference Division (1970) and U.K. Dept. of Trade and Industry (1973)

When multinational corporations grow at the same pace as their host economies, there is little to explain. When they grow more slowly, the question becomes: Why are they disadvantaged? The MNC story is not one of universal growth. Yet I shall concentrate on more rapid expansion, because growth has been the dominant theme for the last quarter-century.

A fundamental question that faces all explanations of MNC expansion is whether the postwar boom is a stock-adjustment phenomenon or a continuous-flow process (Branson, 1970). Will the expansion of MNCs relative to local firms stop in a few years, or will it continue for the rest of this century? The fact that American direct investment abroad grew more rapidly between 1945 and 1970 than between 1908 and 1940 suggests the durability of MNC expansion. Just as the nineteenth century witnessed the ascendancy of the national corporation, the twentieth century has given rise to the multinational firm (Kindleberger, 1967). Further evidence on the durability of MNC growth might be gained by examining both rates of corporate expansion as a function of length of time overseas and the recruitment of new firms to the MNC ranks (Richardson, 1971).

How should a multinational corporation be defined? There are degrees of multinational involvement, but most authors focus on a few firms with operations in several countries. Vernon (1971) used the following approach (which I shall also use): He examined U.S. manufacturing giants with establishments in six or more countries.² On this definition, there are some two hundred odd U.S. multinational corporations (including nonmanufacturing concerns), and perhaps another hundred multinational giants based in western Europe, Canada, and Japan.

Despite their multinational character, such firms are almost always controlled from a single country. Effective multinational ownership does occur, but rather infrequently. Western Europe has witnessed corporate marriages between national concerns: Royal Dutch/Shell, Unilever, Agfa-Gevaert, Dunlop-pirelli. The ownership of Alcan is divided between Canada and the United States, while international Nickel is an American-British-Canadian venture. Joint ownership of a single affiliate by parent companies of diverse national origin occurs more frequently. This is particularly true of petroleum enterprises, for example in the Middle East,

2. In the terminology of U.S. official statistics, "affiliates" are establishments incorporated abroad that are controlled by American firms. Distinctions are further made between types of affiliates according to degree of parental control. "Branches" are unincorporated establishments operating abroad. Tax considerations largely determine whether an MNC opens branches or affiliates. I use the term "establishment" to encompass both types of operation.

and of banking ventures formed to enter the London capital market. Moreover, the multinational ownership of U.S. firms is growing, as foreign institutions acquire shares on the New York stock Exchange (Wall Street Journal, June 22, 1973).

I shall attempt to divide the literature on multinational corporations into several channels, each corresponding to a basic theme.³ In section 1, I review four major industry characteristics of multinational enterprise: access to cheap capital, portfolio diversification, technological rents, and industrial organization. In section 2, I examine the company choice between exports, foreign-affiliate production, and the licensing of independent foreign firms. Special attention is paid to the influence on this choice of tariffs and other government policy measures. In section 3, I review econometric forecasts of direct-investment flows and the balance-of-payments aspects of overseas investment. In section 4, I discuss welfare questions: the orthodox welfare analysis of capital flows and multinational enterprise, tax considerations and transfer pricing, the Marxist position, and the leading policy issues.

3. Data on multinational corporations have been collected by both public agencies and private scholars. I shall list the major source by country. For official statistics, only the agency name is given; for privately collected data, a citation to the source listed in the bibliography is given. A statistical overview is provided by UN Department of Economic and Social Affairs (1973). Most of the available figures are restricted to book values of direct investment, some sales data, and a very limited body of data on trade flows between affiliates. More information should be published of the factor stocks and output levels of a given company's plants in the different countries. Also, comparisons are needed between local and multinational firms operating in the same industry.

United States. The U.S. Department of Commerce, Bureau of Economic Analysis (formerly Office of Business Economics), publishes data in the *Survey of Current Business* and also issues special reports. The U.S. Department of Commerce, Office of Foreign Direct Investment, issues special reports. *Fortune* magazine has an annual listing of the 500 largest U.S. manufacturing concerns and the 200 largest non-U.S. manufacturing concerns. Bruck and Lees (1968) have published a list of the foreign operations of the larger firms. The Harvard Multinational Enterprise Project has a bank of data, in addition to the published work by Vaupel and Curhan (1969).

United Kingdom. The official statistics are regularly published in the U.K. Department of Trade and Industry's magazine, *Trade and Industry*. A compilation of data from 1962 to 1968 was issued by the U.K. Reference Division (1970). A wealth of unofficial data was published by Reddaway (1967, 1968). The University of Reading (under Dunning) has also gathered a bank of survey information. Dunning (1972) recently prepared an in-depth statistical study of U.S. industry operating in Britain. Forsyth (1972) has a survey of U.S. investment in Scotland. The Department of Trade and Industry sponsored a wide-ranging report by Steuer *et al.* (1973).

Europe. Francko (1974) is working on a broad study of European-based multinational firms.

Australia. The Commonwealth Treasury publishes an annual bulletin covering foreign investment in Australia. Brash (1966) put together the first unofficial survey.

Canada. The Dominion Bureau of Statistics publishes surveys from time to time on U.S. companies that control manufacturing operations in Canada. Annual data are collected under the Corporations and Labour Unions Returns Act and published in the *Annual Report of the Minister of Trade and Commerce*. There are detailed official studies

Effects on the Balance of Payments

Johnson (1970) has rightly stressed that arguments for the control of balance-of-payments flows seldom have validity unless they represent an underlying combination of optimum-tariff, optimum-tax, and infant-industry arguments. If a country is unhappy with its balance of payments, appropriate remedies involve the board sweep of fiscal and monetary measures and exchange-rate adjustments, rather than piecemeal policies of restraint. Even if, on some calculations, exports appear more helpful to the home country's balance of payments than direct investment abroad, licensing, or takeover bids, such calculations supply no independent argument for attempting to change the form of overseas business operations. The same dictum applies, with appropriate modification, to host countries.

Nevertheless the balance-of-payments effects of multinational enterprise have

of the Royal Commission (1957), the Watkins Commission (1968), and the Gray Report (1972). Safarian (1966) has published his unofficial survey results. The Government of Canada Office of Economics (1971) has issued a bibliography on foreign investment in Canada.

France. Bertin (1972) of the University of Rennes has an ongoing program of research on multinational enterprise. The history of U.S. Investment in France is traced by Kindleberger (1973a). *Revue Economique* (1972) published a special issue on multinational corporations.

Ireland. McAleese (1971/72) has assembled the available statistical material, and offers a good review of the fiscal incentives provided by the Irish Republic. P.J. Buckley of Reading University is writing a thesis based on a recent survey of multinational corporations operating in Ireland. Donaldson (1966) conducted on the first surveys.

Japan. The basic statistics on Japanese direct foreign investment are collected by the Bank of Japan; they are summarized by Hamada (1972). Other nonofficial sources include Ozawa (1968), Kojima (1973), and Sherk (1973).

Netherlands. Stubenitzky (1970) has written about multinational firms operating in the Netherlands.

New Zealand. Official statistics are collected from time to time by the Department of Statistics and the Reserve Bank of New Zealand. The authoritative unofficial study, including extensive survey results, was written by Deane (1970).

Sweden. The Industrial Institute for Economic and Social Research in Stockholm is conducting studies both of Swedish overseas investment and of foreign investment in Sweden. Samuelsson (1973), Swedenborg (1973), and Thiel (1973) have written the first report.

Other Countries. Ackerman (1971) lists some sources for Brazil. Hatti (1970) does the same for India, the principle source for that country being the Reserve Bank of India. May (1965) has data on Nigeria. UNCTAD commissioned a group at Oxford led by Streeten and Lall to gather data on selected foreign firms operating in Jamaica and Kenya (1970, 1972), India and Iran (1971/72), and Colombia and Malaysia (1973a). Drysdale (1972) had edited a volume on direct investment in Asia and the Pacific. Additional country studies are listed in the bibliographies by Burns *et al.* and Lall (1973b). The IMF's annual *Balance of Payments Yearbook* gives direct-investment flow figures by country.

stimulated considerable comment, mainly with a view toward capital controls on direct investment [W. C. Gordon (1961, 1962); Bell (1962) phillips (1964); polk *et al.* (1966); Behrman (1966, 1968, 1969); Moffat, (1967); Reddaway (1967, 1968); Hufbauer and Adler (1968); Bruck and Lees (1968) *Law and Contemporary Problems* (1969); Dunning (1969a, 1969b); Adler and Hufbauer (1969a, 1969b); Lindert (1970); Fieleke (1971); Morley and Smith (1971); Lipsey and weiss (1972a, 1972b); Hui and Hawkins (1972); Stobaugh *et al.* (1973); Wert (1973); UNCTAD (1970, 1971, 1972, 1973a, 1973b)].

W. C. Gordon (1961, 1962,) an institutional economist, first challenged Cairnes's (1874) description of the foreign-investment process. According to Gordon, and contrary to Cairnes, countries investing abroad have had little need to run a merchandise surplus to accomplish the transfer of real resources. Within a short period, foreign interprises have generated sufficient profits not only to accommodate future expansion but also to make remittances.

Bell (1962) looked at these questions quantitatively, taking into account initial exports of home-country capital equipment; subsequent exports of parts and components; dividend,⁴ interest, and royalty remittances; and other transactions between the parent firm and its overseas affiliates. Bell's calculations made possible the estimation of balance-of-payments "recoupment Periods" the length of time before an initial investment would be matched by income flows from the foreign subsidiary. As Wert (1973) has pointed out, recoupment-period estimates may be placed in a product-cycle context. From the viewpoint of the home country, the early phases of a foreign investment project bring positive trade effects (more exports) and negative investment effects (capital outflows). The later phases bring negative trade effects (reduced exports and more imports) and positive investment effects (remittance of Profits).

The estimation of recoupment periods critically depends on what would have happened in the absence of MNC activity-the "alternative position." Three Possibilities were distinguished by Hufbauer and Adler (1968, p. 6). Under classical substitution assumptions, direct investment completely supplements host-country investment and completely replaces home investment. Under reverse classical assumptions, direct investment fully substitutes for foreign local investment and does not diminish home formation of captial. Under anticlassical assumptions, direct investment supplements host-country investment but does not diminish home investment. Under both classical and reverse classical assumptions, international captial flows

4. Since Bell wrote, Mauer and Scaperlanda (1972) and Kopits (1972) have explored the dividend behavior of multinational corporations.

do not affect the total world volume of investment. Anticlassical assumptions imply that international investment *increases* world capital formation.

Reverse classical assumptions reflect the tariff-discrimination hypothesis, known in this context as the defensive-investment argument. According to this argument, the choice between home and foreign production is mainly determined by tariff and tax consideration. Since host-country policies are often designed to promote self-sufficiency, the assumption is that export markets were doomed to disappear. The reverse classical framework principally applies to manufacturing investment. In the fields of agricultural and mineral exploitation, MNC activity has more frequently worked to promote international specialization. In these areas, the classical assumptions come nearer the mark.

The anticlassical framework, which implies an increase in world investment when a firm goes overseas, need not be altogether farfetched. Multinational firms may carry out projects in the host countries that local firms were incapable of undertaking. A net addition could then be made to host-country investment. Meanwhile, two possible scenarios can be envisaged in the home country. The home country might lose exports and for this reason home investment could decline in certain industries. However, the home government could offset this decline through expansionary policies, leaving total domestic investment unchanged. The other scenario (urged by Behrman, 1968) is that home-country exports will be unaffected, simply because the host country already pursued such highly protectionist policies that there were no exports of that particular kind to displace.⁵ Accordingly, home investment would have no reason to decline.

Depending on which framework of assumptions is chosen, very different balance-of-payments recoupment periods emerge. The anticlassical scenario defended by Behrman (1968) leads to recoupment periods of two years or less. This is Gordon's thesis with a vengeance! On the other hand, the classical assumption can lead to recoupment periods of indefinite length.

Clearly, the estimate of recoupment periods is a speculative venture. More important, the recoupment period affords an incomplete guide to the welfare aspects of direct investment.

5. The circumstances envisaged by Behrman (1968) imply that host-country real output grows more rapidly than it otherwise would, as a result of MNC investment. According to the monetary approach to balance-of-payment theory (Johnson, 1972), faster real growth of output must displace imports or enhance exports, assuming a constant supply of domestic money. Thus, while MNC production might not displace the same kind of import from the United States, it could displace some other type of import or accelerate export.

Whether the recoupment period is long or short says little about the costs and benefits of multinational corporations to home and host countries. Nor does the recoupment period illuminate the basic institutional impact of the multinational corporation on the balance-of-payment adjustment process.

There are three major versions of the way in which policy measures work to restore balance-of-payments equilibria. The familiar elasticities approach (summarized by Kindleberger, 1973b) focuses on relative commodity prices at home and abroad and between traded and non-traded goods. To correct a deficit, the policy package must shift relative prices enough so that—given the elasticities of supply and demand—the payments gap is closed by an improvement in the trade balance. By contrast, the absorption approach stresses aggregate savings (Alexander, 1952). According to the Keynesian algebra of national accounts, a balance-of-trade deficit implies negative foreign investment and hence an unduly low level of domestic savings. Finally the monetary approach (synthesized by Johnson, 1972) emphasizes the relationship between the demand for money, the stock of real assets, the flow of output, and the price level. Two kinds of money are available to the nation, domestic and foreign, and each kind can be converted into the other. To correct a deficit, the policy package must stimulate home demand for foreign money. By assumption, a single interest rate rules in the international capital market, and a single price rules in each international commodity market. Thus, according to the monetary school, devaluation creates a general rise in domestic prices. The rise in prices enlarges the demand for money; provided the domestic money supply is held constant, the larger demand will be satisfied by selling commodities and assets abroad.

The growing ascendancy of multinational enterprise compels, I think, greater emphasis on a monetary approach to the balance-of-payments adjustment process. The multinational firm unifies a wider range of capital and commodity markets (for both traded and nontraded goods), and restores a single price more quickly after some disturbance, than a collection of purely national firms might have done. The multinational enterprise is uniquely placed to know prices and costs in several nations at once and to use this knowledge in adjusting production and borrowing levels so that it pays the same marginal money cost and receives the same marginal money return for a given quantum of output everywhere in the world. To be sure, trade barriers and capital controls continue to separate national markets. But barriers and controls drive wedges of fixed magnitude between the prices ruling in different countries. Multinational firms can better ensure that price differentials in fact correspond to these fixed wedges than can national companies. Thus, a key assumption made by the monetary

school -one market, one price-comes closer to realization under the new institutional framework.

Correspondingly the elasticities approach begins to fade (though, in 1974, it still has lots of life). With one market, one price, fiscal, monetary, and even exchange-rate policies cannot so effectively create the price differentials either between home and foreign goods or between traded and nontraded products which prompt a shift of output toward export and import-competing markets. Moreover, the unification of capital markets means that adjustment Problems cannot be analyzed solely in terms of the trade balance, a weakness shared by the elasticities and the absorption approaches. Instead, attention must also be given to the impact of policy measures on the capital account.

Misgivings are often voiced that the multinational corporation moves vast quantities of "hot money" around the globe, thereby worsening national balance-of-payments difficulties (U.S. Senate Committee of Finance, 1973b). But currency "speculation" can hardly be distinguished from the customary business practice of acquiring capital cheap and investing dear (Robbins and Stobaugh, 1973). No one worries about "hot money" moving in search of a higher return from one region to another within the United States, nor is anyone concerned when business tries to secure the cheapest available financing, but then we accept the unification of capital markets within a single country. At bottom, the objection to international "hot money" is an objection to the creation of an international capital market Kindleberger, 1967.

1. WELFARE QUESTIONS

The Orthodox Statement

Classical welfare arguments start off with two assumptions: They assume competition and they assume that the MNC is engaged in shifting capital from one part of the world to another. Among MNCs, oligopoly is more prevalent than competition, and MNCs probably move more technology than capital around the globe. The classical analysis nevertheless serves as a useful beginning. The basic statement was laid down by MacDougall (1960).

Private capital movements were once seen as beneficial for both home and host countries. The analysis was based both on the differential-returns argument and one classical assumptions concerning the relocation of capital stock. Capital would supposedly flow from A to B until returns in the two countries were equated. (For the moment, I shall neglect the role of corporate taxes. In Figure 1 home country A would experience a decline in domestically produced

output of trapezoid *cdef*, but it would earn returns on foreign investment of rectangle *ghij*. The net gain to the home country is thus indicated by the shaded triangle lying above its marginal productivity of capital curve. In the host country, the addition to capital stock would increase output by trapezoid *gmij*, of which only rectangle *ghij* is paid to foreign capitalists. Thus, the triangle *hmi* remains as incremental income to the host country

According to this analysis, flow of capital simultaneously achieves three goals. World income is increased because capital is now equally productive in all countries. The home country is better off because it is earning a higher social return on its capital abroad than it

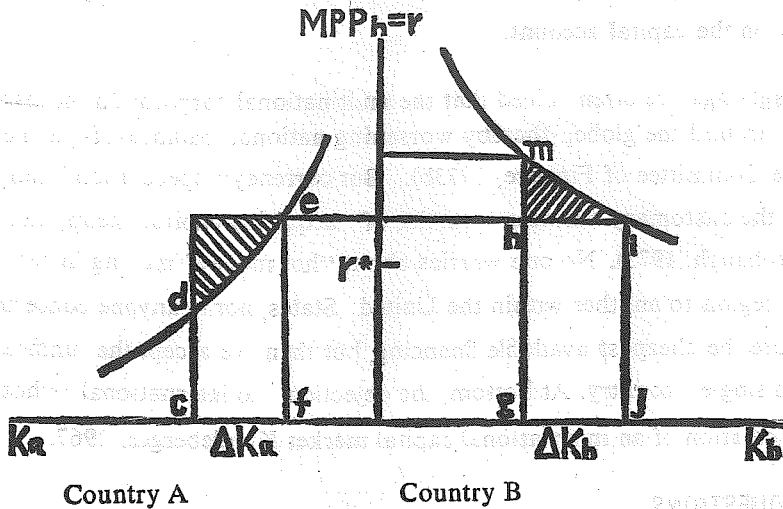


Figure 1 Gains from capital movement between two countries.

would have earned had the capital remained at home. Finally, the host country is better off because higher returns to other factors absorb part of the gain in output resulting from a larger stock of capital.

The classical analysis implies that the return per unit of capital rises at home that expense of other factors, while the reverse happens abroad. Thus, the flow of capital exerts a distributional effect. Relying implicitly on this analysis, the American labor movement has sought to halt "runaway plants" by altering U.S. tax laws and restricting trade (Cantor, 1972; Meany 1972, Babson 1973; Thurow, 1973).

One would also expect the MNC to depress returns to capital in the host country, as suggested by Figure 1. But Johnson (1970) has shown how the more efficient MNC can ins-

lead to depress the price of labor in the host country. If the MNC improves the production isoquant for capital-intensive goods, the benefits may be distributed to the host community in two ways: either through a lower relative price for the capital-intensive good or through an altered factor-price ratio, with higher returns to capital and lower wages for labor. If the relative price of goods is fixed by international markets (as it may be for a small country with an open economy), the benefits will be passed on entirely in the form of an altered factor-price ratio. The MNC presence depresses the relative reward of labor, and it might even depress the absolute reward. Local labor suffers at the same time local capitalists are being displaced.

B. I. Cohen (1972) has amplified Johnson's basic case. Foreign ownership of capital might be so extensive that the higher profit rate could actually serve to decrease total income accruing to residents of the host country. The main difficulty with the Johnson-Cohen case is that MNCs do not particularly specialize in the production of capital-intensive goods. Even if they did, the foreign-owned capital stock is seldom large enough so that the introduction and diffusion of more efficient technology would actually diminish host-country income.

More important than its effect on overall returns to capital, the MNC may reap exceptional profits on the new technology it brings to the host country (Hogan, 1967; Dunning and Steuer, 1969; Mason, 1970; Streeten, 1972; Mansfield, 1974). If the MNC enjoys a monopoly in its branch of technology, the fruits of improved products and processes can for a long while leave the country. Only as competition prevails will technological gains be reflected in higher factor prices or lower commodity prices in the host nation. The important question is how long it takes before the fruits of technology are spread to the domestic economy. It would be well worth comparing the diffusion of "best practice" techniques in local industries that have multinational corporations and those that do not. [For an exposition of analytic methods, see Mansfield (1968, 1974) and Mansfield *et al.* (1971).]

The orthodox statement needs further qualification when there are infant entrepreneurs in the host country. It is often claimed that multinational corporations thwart local entrepreneurial effort (Levitt, 1970; Safarian 1973.) The argument can apply to the domestic formation of either capital or technology. If the infant-entrepreneur argument is valid, a first best case may exist for restricting inward multinational investment and even, perhaps, for limiting the inward flow of technology. Clearly, we need studies on the development of a given industry in different countries to see if the extent of multinational presence makes any difference.

In addition, the orthodox statement needs qualification when there are domestic distortions. If domestic prices do not accurately reflect social costs, the MNC can impose a burden on the economy. The most important distortions are those created by tariff and nontariff barriers, Multinational corporations are attracted to protect markets like bears to honey. The result may be small and inefficient plants, as in the Australian chemical industry (Parry, 1973a). Or profits could be generously inflated, with multinational corporations sharing in the windfall earnings. For example, Vaitsos (1970) has shown that the combination of protection and domestic monopoly gave excessive profits to foreign investors in the Colombian pharmaceutical industry.

The prevalence of factor-market distortions in less developed countries raises the question of "inappropriate technologies." Do MNCs use techniques there that are too capital-intensive, given the abundance of labor? The techniques that MNCs use in less developed countries can be evaluated against two standards. They can be compared with the techniques adopted by local firms or with those that MNCs use in developed countries.

Mason (1973) examined 14 matched pairs of U.S.-owned and locally owned firms (9 matched pairs were located in the Philippines and 5 in Mexico), and concluded that American firms used more capital per employee. But B. I. Cohen (1973b) got mixed results when he compared the mechanization (measured by electricity consumption) of 4 U.S., 5 Japanese, and 10 matched Korean firms operating in Korea. Both the Mason and Cohen studies were conducted with great care, but the samples are small: more work is needed before a clear picture emerges. Turning to the second standard of comparison, Courtney and Leipziger (1973) estimated Cobb-Douglas production functions for some 1,484 U.S. affiliates operating in developed and less developed countries. In 9 of the 11 industries, the capital-labor ratios were lower in the less developed countries, indicating some degree of factor substitution. But Morley and Smith (1974) suggest that much of the observed "substitution" results from the correspondence between scale and capital intensity: larger plants enable the use of more automated production methods.

Other possible distortions qualifying the orthodox welfare statement deserve mention. Owing to an improper exchange rate, the MNC might purchase or sell foreign exchange at bargain prices; owing to the absence of environmental controls, it might degrade the environment. The national income of the host country can decline when an MNC introduces marginal-cost pricing to only one sector of the economy, while other sectors continue to use an average-cost approach in the employment of productive factors (B. I. Cohen, 1972). In the home country the MNC might displace jobs rather than merely shift employment to alternative industries

(Hawkins, 1972). At the international level, the multinational corporation might lead to the pervasive cartelization of world production and trade. Indeed, the question has been raised whether free competition in international markets can be reconciled with the free flow of capital and technology (Shaffer, 1972). Appropriate solutions to these various distortions are lower trade barriers, antitrust measures (on both the national and the international levels), correct exchange rates, and countervailing taxes and subsidies. Restriction of MNC activity is a possible second-best solution but not a very effective or enlightened one (Corden, 1967; Johnson, 1970).

Corporate Taxes and Transfer Prices

The taxation of corporate profits leads to a classic conflict between social rates of return (used by countries and economists to assess projects) and private after-tax rates of return (used by companies to guide investment). Furthermore, corporate taxation creates a difference between internationalist and nationalist criteria for appraising social rates of returns. Jasay (1960), MacDougall (1960), and Balogh and Streeten (1960) were among the first to raise the question of taxes in the context of direct investment. Perhaps, they argued, overseas investment was not so beneficial for the *home* country as the orthodox statement implies.

The major capital-exporting countries either allow a credit against their taxes to the extent of profit taxes paid abroad or they make no claim to tax foreign income. The complexities of tax credits and kindred arrangements are spelled out by Richman (1963), Krause and Dam (1964), Musgrave (1969) and N. N. Gordon (1971). Basically, these arrangements are designed to avoid "double taxation." If the corporate tax rates in the home and host countries are equal, the flow of capital will still serve to increase world income. Capital will be moving from a low-productivity country to a high-productivity country, and the result will be larger world income. But the home country may take a social loss from the outflow of capital. The relevant selfish comparison for the home country is between *before-tax* returns at home and *after-local-tax* returns abroad. Thus, if foreign investment is pushed by private companies to the point where after-tax returns are the same in both areas, the capital-exporting country is earning a lower social return on capital placed abroad than on capital employed at home. In terms of Figure 3, if host country B captures part of rectangle *ghij*, that amount is lost to the home country. If the MNC equalizes after-tax returns for both nations, say at point r^* , the domestic social earnings on foreign investment are much less than the before-tax contribution of capital to domestic output.

Grubal (1974) has applied these theoretical considerations to an analysis of private and social rates of return on U.S. manufacturing investments in Canada and Western Europe.

In 1969, before tax rates of return on equity averaged 24 per cent in the industrial host countries and 19 percent in the United States. The effective rate of taxes collected by the host countries was about 46 per cent (taking into account dividend withholding tax), compared with a 40 per cent effective corporate tax rate in the United States. Thus, the private after-tax rate of return earned by U.S. manufacturing firms was about 12 percent on equity in the United States and 13 per cent on equity in the industrial host countries. However, the social rate of return to the United States on domestic equity capital was 19 per cent (the before-tax return) compared with 13 per cent on equity capital located abroad (the after-local-tax return). The United States therefore lost about 6 per cent per year in social return on its manufacturing investments in Canada and western Europe.

As these calculations suggest, the existence of corporate taxes leads to two quite different concepts of "tax neutrality." On the one hand, there is the international school, which says that capital should migrate to the location of highest (before tax) return so as to increase world income. On the other hand, there is the national school, which asserts that a country should receive the same social return on its capital whether invested at home or abroad.

Under a tax-credit scheme, where the credit is limited to the amount of home tax otherwise payable, private capital movements will serve the international criterion for socially efficient allocation of capital (in the sense of leading to the worldwide equalization of before-tax returns), provided only that corporate tax rates are no lower in the capital-exporting country than in the capital-importing country.⁶ But when the home nation asserts no claim to tax foreign income, the test is more demanding: private capital flows will serve the international criterion only if tax rates are the same in the capital-exporting and capital-importing jurisdictions. The United States and other capital-exporting nations have so far pursued the international criterion, mostly by using tax-credit schemes.

Private capital movements would serve the national criterion for efficient allocation of capital if the home jurisdiction taxed foreign income and allowed a deduction but no tax credit for corporate taxes paid to foreign countries. As Grubel (1974) has pointed out, whether tax arrangements based on the international criterion detract from the welfare of any particular

6. Note, however, that the deferral of corporate taxes until dividends are remitted from incorporated overseas affiliates is not an ingredient of the international approach. Deferral is even more inconsistent with the national approach. Corporate tax deferral, which has been standard U.S. practice for many years, amounts to an interest-free loan. It thus subsidizes the export of capital to jurisdictions that have lower tax rates than the United States.

country depends on that country's balance of direct investments. At the close of 1970, direct investments by U.S. firm abroad had a book value of \$ 78 billion, while direct investments by foreign firms within the United States were \$ 13 billion. The comparable U. K. figures were £6.4 billion and £3.4 billion. Thus, under present circumstances, these two countries might benefit from a national criterion of tax neutrality. The Burke-Hartke bill is intended to move U.S. tax practice part way toward the national criterion (see the essay by Senator Hartke in Kujawa, 1973). However, the static homecountry gains from national tax neutrality might over time be offset by a lower of capital formation (Browlee, 1974).

If the United States, the United Kingdom, and other MNC base countries shifted to a national criterion, the result might be a substantial diminution of MNC *ownership* of foreign affiliates. Yet the MNC form of business might well continue in the guise of managing agencies. The agencies could coordinate and control their overseas affiliates, exact a fee for this service and for the export of technology, but let local investors own the equity capital. Disputes might arise over transfer prices, dividend policy, and global strategy, but, as Gabriel (1967) points out, Hilton International has thrived for years on a management-contract basis.

Several interview studies have been designed to look at the impact of corporate tax practices and other fiscal measures (such as capital grants) on direct investment flows (Shulman, 1967; Duerr, 1972; Dunning and Yannopoulos, 1973). Dixon-Fyle (1967) concluded that tax concessions had not attracted much direct investment to Africa. Hughes and Seng (1969) found that tax concessions played little role in bringing foreign firms to Singapore. However, Schollhammer (cited in Dunning and Yannopoulos, 1973) found that tax considerations ranked third in a list of nine locational determinants for the 140 MNCs he surveyed. Donaldson (1966) and McAleese (1971/72) found that fiscal incentives played an important role in bringing MNCs to Ireland and persuading them to locate away from the Dublin area. Forsyth (1972) suggests that British regional policy has attracted MNCs to Scotland. Dunning and Yannopoulos (1973) cite additional evidence on the effect of regional policy in Europe.

Mellors (1973) used the portfolio approach in a ingenious way to gauge the impact of corporate tax rates on the geographic location of British MNC investment. He asked whether the actual geographic distribution of *company portfolios* more closely resembled optimal portfolios predicted from the history of before-tax mean earnings and variance, or optimal portfolios predicted from the history of after-tax mean earnings and variance. The actual portfolios of sixteen manufacturing companies With operations in seven countries were in fact

more similar to the after-tax optimal portfolios. The result suggests that tax rates do influence the geographic distribution of investment.

Not only do differing national tax arrangements influence the geographic distribution of MNC investment, but they also stimulate tax avoidance through the judicious use of transfer prices and misleading cost allocation in transactions between members of the corporate family. Arpan (1972) and Lall (1973a) have summarized the literature. There are two quite distinct management principles on which transfer pricing can be based. In the first approach, each affiliate is treated as a "profit center". The management of the affiliate is evaluated by its contribution to overall corporate profits. This approach requires that each affiliate be free to determine the price and quantity of intracorporate sales. Intracorporate pricing will then resemble an "arms-length" or "market Price" standard.

In the second approach, the MNC seeks to maximize global profits. A profit-maximizing strategy requires marginal-cost pricing for sales *within* the corporate family. Otherwise, members of the family will buy unnecessarily from outside sources, thereby sacrificing global profits, and they will not expand sales to outsiders to the profit-maximizing point where corporate marginal cost equals marginal revenue.

The story becomes more complicated when affiliated firms operate in different countries. Corporate tax rates and customs duties differ between jurisdictions. A given before-tax income therefore has a different after-tax value depending on where it is realized. In addition, some jurisdictions may restrict capital flows. These considerations almost compel the MNC to adopt a global strategy rather than the profit-center philosophy.

Horst (1971) and Vaitos (1972) have worked out the interactions between income taxes, tariff rates and export duties when a global strategy is pursued. For example, in the Horst formulation, if T is the tariff rate confronting imports by a firm from its foreign affiliate, and t_1 and t_2 are the effective profit-tax rates at home and abroad, the following conclusions may be drawn. When $T > (t_1 - t_2)(1 - t_1)$ the firm will want to pay the lowest possible transfer price for the exports of its foreign affiliate. when the inequality runs in the other direction, the corporation will maximize global after tax profits by paying the highest possible transfer price to its foreign affiliate.

Lall (1973a), however, points out that transfer pricing is often inspired not so much by the wish to minimize taxes as by restrictions on the movement of capital and profits, and by a corporate desire to conceal profits from the gaze of nationalists and trade unions. These latter

considerations are particularly important in less developed countries.

Most industrial countries require (at least in principle) that transfer prices conform to an arm's-length standard. The arm's-length price is determined by reference either to market prices or, if those are not available, to some mark-up on prime costs or mark-down on final selling price. A totally different approach would require a formula for the allocation of profits among jurisdictions. Each company's global profits would be allocated among countries on the basis of some weighted function of capital, labor, and sales in each jurisdiction (Musgrave, 1972). However, the formula approach raises more problems than it solves (McLure, 1973). For example, all jurisdictions must agree on the formula. Otherwise, part of the tax base will be double-taxed and part not taxed at all.

Johnson (1970) has offered suggestion, seconded by Vaitos (1974) and Streeten (1972): MNCs ought to sell component products to their subsidiaries in the less developed countries at the marginal cost of production. No charge should be levied for research and overhead costs; supposedly, these costs have been fully met in the markets of the home country and other advanced nations. Horst (1973) rightly questions the wisdom of this supposition. If invoice prices were changed to the recommended marginal-cost basis, profit taxes and customs revenues would be relocated between taxing jurisdictions. The shifts might enlarge the *total* tax take of developed and less developed countries. But whether such changes would ultimately put more resources in the hands of LDC governments depends very much on the bargaining position of the countries and the companies.

Insofar as multinational firms can use transfer prices to shift profits from one country to another, their investment decisions need not correspond to the mean and variance of reported earnings in different nations. Perhaps this explains why Paxson (1973) discovered such a poor correspondence between optimal and actual portfolios of British-American Tobacco and the Unilever Group. If vertically integrated multinational companies were in fact forced to use arm's-length pricing for intracorporate sales, the portfolio approach might work better. Moreover, since there might be some increase in customs duties and corporate taxes, and some decrease in the freedom to shift capital around the globe, corporations might alter the geographical distribution of their investments. But it is debatable whether the geographic shift in production would benefit developing countries.

Optimal Taxes

Since the quantity of capital and technology flowing from one country to another

affects their prices, there is always the unpleasant possibility that countries might go beyond the concept of national tax neutrality and impose optimal taxes on capital and technology flows, analogous to the optimal tariff on goods. The theory of optimal taxes was developed by Kemp (1962a, 1962b, 1969) and Jones (1967), and has been explored by Connolly and Ross (1970).

The optimal tax on capital could be exacted as a lump-sum levy when capital crosses the border, but the literature customarily speaks of an annual tax on earnings. A country's optimal capital tax will depend both on the nature of its commodity specialization and on its degree of trading power. A small country, completely specialized with little trading power, will not improve its welfare by taxing capital flows. A large, incompletely specialized country may benefit by applying a high capital tax, whether it imports or exports capital. Of course the benefits depend on an assumption of no retaliation, and this assumption becomes less plausible for larger countries.

Jones (1967) has analyzed cases in which the country is not free to vary tariffs because of international commitments (commercial policy is inactive) or is not free to tax the flow of capital (capital taxes are inactive). With one or the other of these restrictions, the country is not able to optimize its position. But provided one policy is active, a second-best optimum can be reached, since the imposition of tariffs will affect capital returns, while capital taxes will affect commodity prices.

Following the path laid down in Jones's analysis, an optimal technology tax could also be devised (Johnson, 1970). Second-best optimization might be applied to those technology flows which are inseparable from the sale of capital and skilled personnel services, although the analysis would be complex and tedious. But practical attempts to alter the selling price of technology are seldom cast in terms of optimal taxes. Instead, the focus is on the form of sale.

Technology may be sold through the export of goods, through the direct-investment process or through the takeover of technology-rich firms. Governments often act on the belief that a given quantum of knowledge commands a different price depending on the form of sale. Official preferences also reflect a protectionist concern for the welfare of factors that complement technology. Thus, importing countries customarily favor licensing and jointventure arrangements over wholly owned subsidiaries, and wholly owned subsidiaries over imports (Gabriel, 1967). Exporting countries prefer the reverse order, and they are least happy about takeover bids aimed at their technology-intensive firms. In different eras, Flanders, France, Britain, Germany, and

the United States have attempted to keep vital production techniques within their national boundaries, preferring to export the finished product. In the long run, none of these attempts has worked. At the most, they temporarily slowed the diffusion of knowledge.

Government concern with the form in which technology is sold is partly dictated by the very real administrative difficulties of levying a tax on knowledge is highly differentiated, since the costs of generating technology bear little relation to its value (at least in individual instances), since overt royalty payments often poorly reflect the value of transferred technology, and since technology sales are frequently commingled with the sale of capital and labour, the orthodox sort of tax, where a rate is applied to a base, can hardly be used to restrain the outflow or inflow of technology. Accordingly, governments have concentrated their efforts on modifying the form of technology sale.

To the extent that exporting countries attempt to modify the form of technology sale, their efforts could be misdirected. Sellers of knowledge are by definition quasi-monopolists. If the technology were widely available, no one would want to buy it; there would be no implicit payment for technology in the export of goods, direct-investment undertakings, or takeover bids. Thus, in order to justify national restraints on the sale of knowledge, there must be some evidence that owners of technology are not properly exploiting their monopolistic positions. After all, an optimal tax imposed by the government merely achieves the same goal for a competitive industry, in its dealings with foreigners, that a monopolist will gladly achieve for itself.

Countries that import technology have greater reason for official intervention, since they normally face monopolistic sellers. But intervention by buying countries can (and has) spurred countervailing intervention by selling nations. These measures could easily lead to a self-defeating spiral of retaliation. Moreover, the technology-importing country that insists on licensing and jointventure arrangements may find itself acquiring risk as well as return.

As yet there is no evidence that the mode of technology sale significantly influences the ultimate diffusion of production techniques. Production techniques may leak out just as quickly when a good is exported as when an MNC establishes a foreign affiliate. Nor is there evidence of a systematic connection between mode of sale, average returns, and the variance of earnings on technology. The pronounced preference of MNCs for wholly owned subsidiaries, particularly when technology and marketing skills are key ingredients (Stopford and Wells, 1972), is suggestive but not conclusive.

Marxism and Imperialism

When I speak of a Marxist approach to economic imperialism, I am using labels loosely. Marx, himself, did not explicitly offer a theory of imperialism (Karsten, 1971, p. 35). Nevertheless, the critical literature linking imperialism to capitalism has been dominated by the Marxist school (Magdoff, 1969; Wolff, 1970). In the marxist view, multinational corporations agents of economic imperialism. B. J. Cohen (1973) has recently published an authoritative and highly readable account of imperialism, and I shall merely touch on the high point.

In the early socialist literature, which can be traced back to Sismondi (1819), economic imperialism was linked to underconsumption in the home country. According to this view, which was brought to popular notice by Hobson (1902), capital exports are necessary to take up the economic slack created by the pressures of the capitalist system. In modern parlance the savings rate of the mother country was kept high, although the growth rate was low. Foreign investment was necessary to utilize capital and avoid home unemployment.

Abroad, the consequences of foreign investment were no better. Capitalism, together with wage slavery, would be exported to the host country. Not only is the capitalist system attacked as bad economics but it is also charged with unnecessary wars and the political subjugation of innocent people (Ackerman, 1971). As I do not have space to review the origins of war and subjugation, I shall instead concentrate on the economic aspects of imperialism.

The modern Marxist view concerning foreign investment stresses the Baran and Sweezy "suction pump" thesis. Departing from Hobson's earlier theory, Baran and Sweezy (1966, pp. 107-108) argue that "... foreign investment far from being an outlet for domestic generated surplus, is a most efficient device for transferring surplus generated abroad to the investing country." Zweig (1973) has expressed the suction-pump thesis in the mathematical language of Domar (1950).

The suction-pump thesis pays no attention to the distinction between stocks of capital abroad and flows of current income (Nisbet, 1970, 1971; Du Boff, 1971). The role of reinvested earnings is neglected. Nor does the thesis consider the productivity of capital (Part of which is captured by local income taxes) and the external effect of foreign enterprise. Thus, suction-pump statistics (remitted earnings vs. fresh capital outflows from the home country), such as those quoted by Levitt (1970, pp. 168-169), provide no reliable guide as to whether less developed countries gain or lose on balance from their total relationship with multinational corporations (Hunt, 1972).

Indeed, the suction-pump thesis is merely a Marxist attempt to draw Policy guidance from balance-of-payments statistics. Interpreted sympathetically, the thesis seems to be addressed to this question: Regardless of total gains or losses over the corporate lifetime, at what point should the host country expropriate the foreign enterprise? When has the relationship "turned the corner" so that the host country loses from a continued MNC presence? This is essentially the golden-goose question raised by Bronfenbrenner (1955), debated by Garnick (1963, and explored in useful essays by Hirschman (1969), Kindeberger (1972), and Zink (1973). The golden-goose question raises complex analytic issues. Balance-of-payments statistics, as used by Marxist advocates, are quite inadequate to the problem. They take no account of the ability of the country to manage the enterprise, the impact of nationalization on capital and technology flows, or retaliation by the mother country. They furnish only the crudest indication as to when the corner has been turned. A much more comprehensive approach, which makes allowance for these objections, has been used in the studies commissioned by UNCTAD (1970, 1971, 1972, 1973a, 1973b), in which p. p. Streeten, S. Lall, and others at Oxford have examined foreign investment in Jamaica, India, Iran, Colombia, and Malaysia. The added realism of the UNCTAD studies makes their conclusions less clear-cut than the Marxist school might like.

Closely related to the golden-goose question is the concept of nationalism as a public good. This concept was introduced by Breton (1964), pursued by Johnson (1965), and emphasized in the multinational context by Kindleberger (1969). Foreign corporations encroach on national sovereignty in a fashion that antagonizes many people. France was greatly offended by the presence and manners of American multinational corporations in the early 1960s (Johnstone, 1965). Levitt (1970, p. 3) writes that American corporations "are manifestations of a new mercantilism of corporate empires which cut across boundaries of national economies and undermine the national sovereignty of the hinterland countries and branch plants are located." Moreover, in the Marxist view, the state will be corrupted by foreign firms and become increasingly reluctant to take appropriate measures (Levitt, 1970, p. 17). The MNC, like any private or public bureaucracy, will of course attempt to persuade the government to pass favorable legislation and grant administrative favours. This is the stuff of political life. A celebrated example was the role played by the International Petroleum Company (a subsidiary of Standard Oil of New Jersey) in the politics of Peru for several decades prior to the 1968 expropriation (Pinelo, 1973). Another example was a Brazilian government instruction giving multinational corporations preferential access to foreign exchange (Ackerman, 1971). But

despite the supposed MNC domination of economic events, the countries that have conspicuously nationalized MNCs during the twentieth century - Mexico, Cuba, and Chile stand out for an abundance of foreign investment, not a lack of it (de Vries, 1969). Canadian and Australian hostility to the MNC likewise suggests that political antagonism increases with foreign presence.

Another element of economic imperialism is the displacement of local by foreign capitalists. Since capitalists are enemies of the people (in Marxist eyes), it might seem that nationality would make no difference. In fact, since foreign capitalists often invite more hostility than local capitalists, they could be viewed as better servants of the dialectic. But this is not the Marxist view. In Ackerman's (1971, p. 3) account, Baron Maua, a nineteenth-century Brazilian entrepreneur who suffered bankruptcy partly because of foreign machinations, comes across as a minor hero.

The orthodox reply to Marxist concerns is brief. The host government can redress any of the enumerated abuses that in fact exist. Through appropriate tax, trade, and antitrust policies and with the help of honest public servants, the government can rectify the distribution of income, penalize parasitic firms, and end improper interference with public affairs. The government can even play to nationalistic sentiment, and favor domestic firms over MNCs. The Marxist retort is equally brief. Government policy is not independent of the underlying economic structure. As Levitt (1970, p. 17) puts it:

The economic power of producing organizations and the legislative power of government are believed [by orthodox economists] to be independent of each other: the former subordinate to the democracy of the market place, the latter to the democracy of the ballot box. In this cowboy and Indian world of nineteenth century make-believe, the will of the people can always be made to prevail by the appropriate stroke of the legislative pen.

According to Marxist litany, the make-believe never comes to pass, either because the host government is corrupted by overseas firms, or because the mother country employs its military, economic, and diplomatic strength to thwart local wishes (Levitt, 1970, p. 102). The only answer is revolution and expropriation.

Policy Agenda

Government dissatisfaction with the multinational corporation is rife, fueled as much by orthodox reservations as by Marxist complaints. In the United States, organized labour

is vigorously promoting the Burke-Hartke bill (Meany, 1972). Senator Church has held hearings critical of the MNC. The Watkins Commission (1968) in Canada issued an unfavorable report. The twenty "eminent persons" chartered by the United Nations wrote a critical review of the impact of MNCs on less developed countries (UN Economic and Social Council 1974). The MNC issue is making its way to the top of the UNCTAD agenda (Krause, 1972) And so on,

These rumblings point to a series of international conferences and perhaps ultimately to multilateral and bilateral agreements. Goldberg and Kindleberger (1970) and Bergsten (1974) have speculated on the scope of these negotiations. I shall briefly review some of the major themes.

The groundwork for negotiations has already been laid in various international agreements that regulate business practices (Smith, 1973). Mechanisms of consultation are provided in GATT procedures, OECD procedures, the EFTA agreement, and the Treaty of Rome. In addition, bilateral treaties of friendship, navigation, and commerce often provide for discussion of restrictive business practices by firms based in either country.

Home and host governments are unhappy with MNC practices for different and often contradictory reasons. But just as countries sacrificed some of their own economic interests to negotiate the General Agreement on Tariffs and Trade, they might develop agreed rules for the conduct of multinational business operations. There are other morals in the GATT precedent. As Goldberg and Kindleberger (1970) point out, GATT was implemented only because its program for modest reform enlisted the support of the business community. Moreover, the agreement operates by mutual consent rather than legal sanction; there are numerous escape clauses for the dissatisfied member state. International agreements on the MNC will function in similar fashion.

The most important agenda item could be government forbearance on tax policy and investment controls as a device for inducing or thwarting the movement of capital and technology. The interaction between trade barriers and capital movements will also have to be considered, since many decisions on location of MNCs are taken in response to protection rather than taxes.

The sharing of potential tax revenues between member states is another agenda item. The problem is particularly acute between countries housing different layers of the same vertically integrated MNC family. Tariff revenues, income taxes, and - in the case

of mineral resources -- royalties are all involved. The bilateral-tax-treaty approach would set up government machinery to review transfer prices, in hopes of correctly attributing import values, export values, overhead costs, and ultimately profits to each affiliate. Another approach would allocate the global profits of each MNC to the member states by a formula that takes into account each country's shares of capital assets, wage payments, sales, and other measures of economic activity.

Host countries may attempt to "untie the package" so that they can import technology alone or with little foreign investment (Gabriel, 1967 Hunt, 1972). But joint ventures and licensing arrangements are not panaceas: they involve a sharing of failure as well as success (Vernon, 1973). Meanwhile, home countries will want more equitable rules on compensation in the event of expropriation. As Vernon (1973) amply illustrates, corporate virtue provides no guarantee of corporate survival in the developing world.

The United States and other advanced nations may press for uniformity of wage and environmental standards, ostensibly as a means of protecting the host countries, but really as a device for slowing the migration of industry. There is little economic reason for harmonization, since countries differ greatly in their underlying conditions. Host countries would be well advised to resist the imposition of uniform standards.

Finally, there is the question of an effective international antitrust policy. Nations have long tolerated, and even encouraged, export and import cartels. OPEC is merely the latest chapter of a history that can be traced at least to the fourteenth century with Edward III's profitable control of the Staplers Company. But the cloak of respectability that has been laid on international price fixing schemes must be replaced by an effective antitrust policy if we are to avoid the monopolistic use of multinational enterprise.

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