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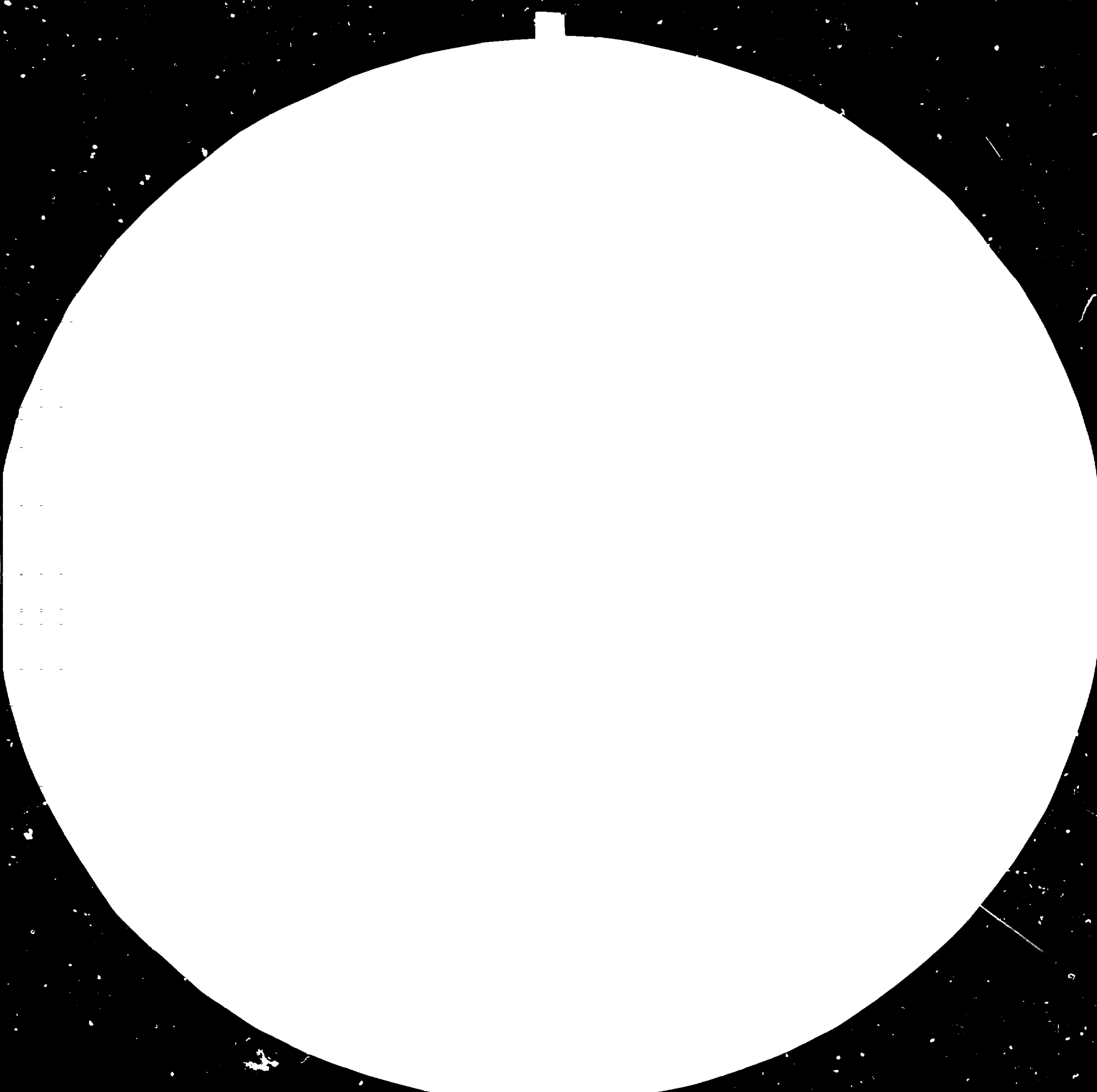

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Transnational Corporations and Third World Industrialization; An Overview *

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** IDC: Institute for Developing Countries.

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The Lima Declaration and Plan of Action involves much more than quantitative targets. It calls for a specific, qualitative _pattern_ of industrialization both among developing countries and within them. Special attention and emphasis should be given to the needs of the least developed countries for a net transfer of technical and financial resources and for the establishment of production facilities involving maximum utilization of human resources. Within the economies of developing countries, an integrated type of industrial development is envisaged in which natural resources, agriculture and certain basic heavy industries are linked together and oriented towards the satisfaction of the basic needs of the population, the replacement of imports and the creation of exports. Other qualitative goals are the assertion of national sovereignty over natural resources, the strengthening of the developing countries' bargaining power in the international market for technology, and an adequate role for the state and the public sector in the direction of industrial development.

Transnational corporations (TNCs) are referred to explicite in the Declaration and Plan of Action. There is a

call for machinery and institutions to regulate and supervise foreign investment and the transfer of technology, and to ensure that these elements are effectively used by the developing countries for industrial development. The developed countries which are the home countries of the TNCs are specifically asked to co-operate with the governments of developing countries to ensure that the activities of TNCs are in conformity with the economic and social aims of the latter.

The internationalization of production which takes place under the aegis of TNCs exerts a profound influence on the rate and pattern of industrial growth as between countries and groups of countries, on the international division of labour in industry, and on the corresponding trade flows in manufactures. This process also influences the pace and nature of industrial growth within developing economies, through the medium of direct foreign investment and transactions in capital goods and technology.

A major caveat to be made clear at the outset has to do with the paucity of transnational data. The spread of TNCs and the internationalization of production has so far outstripped the capabilities of the international community to collect relevant data on the phenomena concerned, data which are also internationally consistent and reliable. Countries differ in their statistical practices, methods of estimation and coverage of the data collected: and many countries especially developing countries hardly collect data relating to TNCs at all. The picture which emerges from an

overview such as this, will depend very much on the qualitative interpretation and judgement of the reviewer, who must exercise selectivity and decide how much weight and emphasis should be given to different pieces of evidence. This is perhaps one reason why opinions on TNCs are so deeply divided, for there is much room for the introduction of personal and ideological bias.

In the decade of the 197cs, the outflow of foreign direct investment (FDI) grew at an annual average of 15 percent although, unlike the 196os, the upward trend was twice interrupted by severe contractions. FDI has continued to be a phenomenon mainly of the developed market economies: some 73 percent of the stock of FDI of the seven leading home countries was located in other developed countries in 1978. Nonetheless, certain important structural changes occurred in the geographic and sectoral pattern of FDI among the developed countries on the 197os. Federal Germany and Japan markedly increased their share in FDI outflows, by 1978 their share in the ownership of the stock of FDI of the seven leading home countries had doubled by comparison with 1971 - from lo to 2o percent. The United States, which used to account for about two-thirds of the annual outflows of FDI in the 196os, was responsible for less than half of the total by the end of the 197os. At the same time, the U.S. increased as a <u>host</u> country for FDI. Sectorally, manufacturing continued to predominate as the main field of activity for FDI, with its share in the total stock of five leading countries increasing slightly from 44 to 46 percent. But the most significant change was the growth in the share of the services sector which

displaced extractive industry as the second most important sector and accounted for almost one-third of the total stock of FDI of the five leading countries by the end of the decade.

Developing countries, moreover, accounted for about 30 percent of the change in the stock of FDI of the seven leading home countries in the decade, thereby raising their share in the stock of FDI from under one-quarter to about 27 percent. This increase must be considered significant, particularly in the light of nationalizations in the petroleum and mineral sector in the 1970s resulting in steep falls in the stock of FDI in these industries in a number of individual developing countries. About one-half of new FDI going to developing countries appears to be going to the services sector, with most of the remainder going into manufacturing. On the face of it, developing countries are now an integral part of the internationalization of production and service activity which is a prominent feature of the contemporary world economy.

The bulk of FDI in the developing world is concentrated in a relatively small group of countries. Within this small group in which the bulk of FDI is concentrated, there are a number of distinct categories. We should first of all distinguish small countries like Bermuda and the Bahamas, which are clearly in the top 20 because of their unique status as off-shore banking centres; and the Netherlands Antilles and Trinidad, which are there as a result of being off-shore petroleum refining centres. Then there are those countries dominated by FDI in the mining industry - Chile and Zaire are the only countries in the top 20 remaining in this category, although there are several others that are outside

of the top 2o.

The largest category consists of those countries in which FDI is concentrated in the manufacturing sector. Within this category there are at least three distinct sub-groups. First there are the "manufacturing exporters" (Malaysia, Hong Kong, Singapore and Korea) in which FDI in manufactuing is related to a vigorous expansion of manufacturing exports to world markets, utilizing relatively cheap and productive labour. Then there are the predominantly oil or mineral-exporting economies in which FDI was formerly concentrated in extractive activity, but has now shifted into manufacturing. Venezuela, Peru, and Indonesia fall into this category. Finally, there are those countries in which a large and growing domestic market provide he main impetus for the growth of manufacturing activity and the inducement for FDI - Brazil, Mexico, India, the Philippines, and Columbia.

There are some trends which have led many to argue that such a process is indeed taking place. The emergence of the "Newly Industrializing Countries", (NICs) most of which are present in the largest category above, associated with a high growth rate of manufacturing exports from these countries to the developed market economies, has produced theories of the "new international division of labour". It underlies a view that redeployment of industry from the developed to the developing world should be a major element of an international development strategy and that TNCs could be an effective instrument to bring this about. It has given rise to at least two distinct kinds of policies characteristic respectively of many developing countries on the one hand and

of many developed countries on the other.

The first are those policies instituted by developing countries aimed at attracting an increased flow of TNC investment into their manufacturing industry, especially for export. Its most prominent expression is the rapid proliferation of "export-processing zones" in the developing world; where manufacturers are free to import components and re-export semi-finished or finished products without duties or taxes of any kind, and free from the normal social, labour or fiscal regulations of the host country.

On the other hand, there are those policies adopted by many developed countries, defensive and protectionist in nature, which are designed precisely to curb this phenomenon. These now include the multi-fibre arrangement, and a wide variety of administrative mechanisms and restrictions aimed at controlling imports of clothing and textiles, cutlery, bicycles, televisions and other electrical components, and steel; as well as direct state subsidies to protect domestic industries threatened by such imports.

Given the presently poor prospects for recovery of growth in output and trade through the first half of the 1980s at least, the expectations for a continued high growth of the Newly Industrializing Countries are not good. Indeed the difficulties now being experienced in maintaining growth rates in countries like Brazil, Mexico and Korea are ample demonstration of this. The prospects for more and more developing countries joining the presently select group of industrializers must correspondingly be counted even poorer.

The advantages of countries offering cheap labour in such heretofore labour-intensive activities are liable to be considerably undermined.

In the light of this the fact that significant FDI in manufacturing, together with the phenomenon of "new industrialization", is confined to a relatively small group of countries, becomes a matter of more serious concern. This development, in other words, may not be part of a process of continuous horizontal expansion across the developing world, but may be more in the nature of once-and-for-all structural shift limited to a special group of countries. Here it is significant to note that, while the share of the developing world of FDI may indeed be growing, the distribution among countries within the developing world is becoming more concentrated. Available data show that the ten largest recipients accounted for 33 percent of the developing world total in 1967 and 54 percent in 1978, with the Newly Industrializing Countries being responsible for the growing concentration.

Of particularly serious concern here is the fate of the least developed countries, a group singled out for special attention by the Lima Plan. During most of the decade of the 1970s this group received only about 10 percent of the total flows of FDI to the developing world as a whole or some $ 2.8 billion between 1970 and 1977.

On the face of it, TNCs would appear to be an irrelevant element in the achievement of these aspects of the Lima Plan. But, TNCs do play an important part in the economic structure of most least developed countries, being frequently

involved in the import-export trade, plantation agriculture, mining, services such as banking and finance, and the nascent manufacturing industry. The second is that while significant FDI may not be going to these countries, there are other forms of TNC activity which impact upon their economies, for example sales of capital goods and of technology. For both these reasons TNCs will remain an important element - possibly both positive and negative - to be taken account of in any efforts at industrialization made by the least developed countries.

All this begs an important question. Even accepting that TNCs may have played an important role in the industrialization of a small group of countries, to what extent does the type of industrialization involved correspond to the qualitative aims of the Lima Plan. This question is probably the central one in the whole issue for the nature of the policies required for both the Newly Industrializing Countries and the least developed countries will very largely depend on the kind of answers provided.

The 1970s saw the emergence of a number of developing countries as significant exporters of manufactured goods. While world trade in manufactures grew by 96 percent in volume terms, the manufactured exports of the middle-income oil-importing developing countries grew by almost 300 percent. The growth was concentrated in a small group of NICs; 3 developing countries with less than 3 percent of the developing world's population accounted for 45 percent of its manufactured exports in 1978, three-quarters of the total came from 10 countries with 45 percent of the population.

TNCs have been strongly involved in this growth: in the mid 1970s TNCs accounted for 70 percent of Singapore's total manufactured exports, and well over 40 percent of both Mexico's and Brazil's. TNC involvement is also reflected in the growing volume of intra-firm transactions in international trade. About 30 percent of world trade presently consists of transactions between related parties, according to UNCTAD estimates. Much of this is in manufactured goods and consists of inter-affiliate TNC shipments among the developed countries and between the developed countries and the NICs.

The export surge of these countries has been spread over a number of industries, such as textiles, clothing, footwear and sportswear, electronics and electrical appliances, machinery and transport equipment, and steel. TNCs have been most strongly involved in the electronics and clothing product groups. Technological changes in production, transport and communication have made it feasible to locate different stages in the production process of these products in different countries linked by relatively cheap, efficient and rapid transport and integrated through a worldwide system of centralized control. Hence the labour-intensive phases of the process - chiefly semiconductor assembly and simple testing in electronics and garment assembly in the clothing industry - can be "redeployed" by TNCs to areas with an abundant supply of relatively cheap unskilled and semi-skilled labour, and which are well-placed to serve international markets.

It is perhaps the operations of the export-processings zones (EPZs) that provide the clearest indications of the industrial bias of the TNC strategy. EPZs, by removing customs duties,

income taxes and social legislation, and by providing subsidised infrastructure, establish the "ideal" conditions for the worldwide rationalization of the location of production operations to take advantage of international differences in the cost of labour. A recent survey of 37 TNCs accounting for over 9o percent of world semiconductor production showed that the total number of their ventures in developing countries grew from 23 in 1971 to 87 in 1979. After electronics, textiles and garments are the most important activities in the EPZs. However, TNCs are important here as purchasing and marketing agents for the local firms undertaking production for export; frequently, this includes formal subcontracting arrangements.

Export growth has not only been concentrated on a certain limited range of products, but, more specifically, on certain processes in the production chain of these products. Export performance will therefore be sensitive to future trends in the international comparative advantage of the developing countries <u>in these processes</u>, as it is expressed in the international location calculus of the TNC. This could change as a result of advances in the technology of automated assembly, upward drift in the wage rates of workers employed in these activities, or protectionist measures in the developed countries which are the main markets for the finished products. The irony here is that the very technological advances which made these activities internationally mobile and therefore capable of being relocated to developing countries, also makes countries vulnerable to the sudden loss of the activities as a result of shifting corporate strategy.

Much importance will therefore turn on the extent of technological spin-offs and backward linkages to the local economy from such activities. It has generally been concluded that transfer of technology in EPZ activities has been extremely limited. This is an almost inevitable consequence of the concentration on unskilled and semi-skilled repetitive assembly tasks. The technological core of these activities, which consists of the research and development leading to product and process innovation, is located in the home countries of the TNCs. Backward and forward linkages are also limited by virtue of being an integral part of a worldwide system of production and assembly, in which the chief local input is seen to be cheap labour. There is some evidence that while backward linkages may be minimal to begin with they may increase over time: thus, for example the domestic content in the raw materials purchases of foreign firms in Korea grew from 18 percent in 1974 to 3o percent in 1978, and in the EPZ only the share moved from 22 to 31 percent.

Nonetheless there remains the broader question of how far this corresponds to or contributes to the broad type of balanced, basic industrial development envisaged in the Lima Plan. Another question that arises is, even conceding the limitations of TNC-initiated export growth, can developing countries turn some elements of the TNC strategy to their advantage by more active policies to facilitiate technology transfer and develop local capabilities, and independent penetration of external markets.

There are two elements to be considered in examining

the role of TNCs in industrialization for the domestic market in developing countries. One is the process of import-substituting industrialization, which provides the framework of market demand and government policies to which TNCs have been responding, while the other is the dynamics of international marketing and production strategy of the TNCs themselves.

TNCs have been involved in all stages of the import substitution process, and the pattern of this involvement has changed over time. TNCs, operating in highly concentrated and oligopolistic industries at home, invest in foreign production where the host-country markets for their products are large and/or growing, and where there is the need to preserve their market from competitors (defensive strategy) or the opportunity exists to win markets from them (offensive strategy). The oligopolistic advantages of the TNC may be based on control over proprietary technology, including patents, brand names and trade marks and reinfoirced by advertising and product differentiation; or it may be capital requirements and/or high minimum scale of operation which pose barriers to entry; or a unique firm-specific combination of a number of attributes. Hence while in many instances the foreign investment takes the form of the establishment of a new production facility in the host country, in many others it consists of the acquisition of a host-country domestic enterprise. As a result, the pattern of FDI and of TNC involvement in any given host country tends to be positively related to a number of structural features in industry: the share of the product group in total manufacturing and/or

high growth-elasticity of demand, capital-intensity and high minimum scale of operation; oligopolistic and concentrated market structure, and high or above-average profitability.

The dynamics of domestic market expansion and the nature of government policies in the host developing countries provide the context within which TNCs have been operating and to which, it can be said, they are responding. However, the literature offers compelling evidence that the association with industrial concentration, oligopolistic market structure, capital-intensity and high minimum scale, and high profitability, may be as much the consequences of TNC expansion and investment strategies as the inducements. For example, the food-processing industry in developing countries is one of the major areas of TNC involvement: as of 1976 some 137 TNCs had an estimated 813 affiliates in these countries, representing about one-quarter of the food industry's total foreign investment. TNCs produce about one-eighth of the processed food in developing countries, but the proportion is higher than 25 percent in a number of the larger, more advanced countries with heavy FDI in the food-processing industry. This is attributed to the effectiveness of TNC marketing, advertising and promotion strategies in winning consumer acceptance of their branded food products originally produced for their home country markets; and to their acquisition strategies vis-à-vis locally owned enterprises. TNCs also play a part, but rather limited, in the staple-food sector and the export-oriented food sector.

TNCs have also been criticised for the limited ap-

propriateness and the costs of their food-processing technology, their displacement of locally-owned enterprises, their orientation towards higher-income consumers, rather than the broad mass of population, and the limited nutritional benefits of certain of their products.

For example in fertilizers it appears that TNCs have generally preferred to supply markets in the developing countries through exports, with very limited local production. A small number of TNCs dominate the market for the supply of basic process know-how and engineering construction in fertilizers, this technology is commercialized through licensing agreements and "turnkey" contracts. TNC strategy has been to retain the crucial elements needed for effective technology transfer within their control, with licensing agreements covering only the less crucial areas.

Given the limited market for agricultural equipment in developing countries, the TNC strategy has been to service the markets with exports from manufacturing facilities in the developed countries, with very little developing-country production. Moreover, when local production facilities are set up they are usually initiated with the assembly of imported kits, as the TNCs prefer to minimize the local content and maximize the imported components of their products. As a result the industry in developing countries is frequently characterized by high unit costs, excess production capacity, generous government subsidies and other incentives together with high profitability to manufacturers; while the needs of the peasantry for small-scale, labour-intensive and inexpensive equipment are neglected.

The pharmaceuticals industry is similar to food-processing in the heavy emphasis of TNCs marketing strategies on product differentiation based on brand-names established in the developed countries; accordingly the orientation is towards the higher income end of the consumer market, product modification to suit local health needs is low, and backward linkages even less than in food processing. The automobile industry is far more widespread in developing countries than tractor manufacturing; nontheless assembly operations tend to predominate, at least initially, with similar features of high unit costs, excess capacity, and import-intensity. The power-equipment industry is an example of capital-goods industry in which TNCs have become involved, at least in the larger and more advanced developing countries. The pattern of industry expansion under oligopolistic TNC dominance is also alleged to have adverse effect on employment creation and income distribution.

Based on findings of this kind from both industry and country-case studies, some authors have argued that in a process of import-substituting industrialization under TNCs there are systematic biases towards (i) growing capital-intensity, (ii) falling share of wages in value added, (iii) employment creation lagging behind output growth,(iv) high import-intensity, (v) high technological dependency, (vi) high concentration and (vii) orientation towards higher-income markets. Certainly, the literature lends strong support to the view, expressed in the Lima Declaration, that "the unrestricted play of market forces is not the most

suitable means" of achieving its objectives of an equitable distribution of industrial growth among developing countries, and a balanced pattern of industrial development within each one. Rather it appears that the natural tendencies of such a process are (a) to concentrate industrial expansion in a small number of countries, and (b) to impart certain characteristic features to industrial growth in these countries which may frustrate some of the qualitative objectives of the Lima Plan.

The Lima Declaration calls for the regulation and the supervision of the activities of TNCs in order to ensure their compatibility with the development plans and policies of host countries. It also, *inter alia*, calls for an adequate role for the state and the public sector in the direction of industrial development.

Policy measures to regulate and supervise TNCs activities fall into a number of well-defined categories. Price controls have been used to counter the oligopolistic market power of TNCs, especially in industries whose products are deemed essential to the welfare and health of consumers, such as staple-foods and pharmaceuticals.

Another measure, which has been used to mitigate the effects on consumers in the food-processing industry, is regulation of the use of trademarks and of certain types of advertising and marketing techniques. A large number of countries have also taken steps to regulate contractual clauses in licensing agreements under which trademarks and brandnames are used. Such measures have been applied more generally across all industries and enterprises, and has met

some success in reducing the costs of contractual technology transfer to developing countries from TNCs.

A second category of measures is aimed at increasing the local content of TNC-owned manufacturing through backward integration of the enterprises, sub-contracting to local suppliers, and substitution of local for imported inputs generally. Such measures have been applied in industries such as pharmaceuticals, and in mechanical-assembly industries especially automobiles, tractors and transport equipment.

A third category of measures are those aimed at protecting the position of domestic enterprises vis-à-vis TNCs, and promoting their growth in strategic sectors as an alternative to TNCs. However in industries where product differentiation, and/or capital requirements and scale constitute powerful barriers to entry, such measures have not largely been successful in eroding TNC dominance.

Various experiences mentioned above serve to show the possibilities for developing countries to secure technological inputs for the expansion of national industry without the disadvantages of oligopolistic domination by TNCs which seem to be concomitants of foreign direct investment.

One of the most important developments in recent years has been the rapid growth and proliferation of forms of TNC transactions with developing countries other than through wholly or majority-owned subsidiaries via FDI. These forms include joint ventures, licensing and franchising, management contracts, contracts for the provision of engineering and consultancy services, and turnkey operations. The

policies of developing countries' governments have a great deal to do with this development. In the late 1960s and 1970s a number of the most important host countries for FDI adopted policies insisting on the involvement of local capital in new or existing foreign-owned ventures, with the object of diluting foreign ownership and control over the economy, reducing the outflow of profits and dividends, and facilitating technology transfer to local capital. Nationalizations, the growth of state enterprises and reserving of certain sectors for local ownership has given rise to a variety of contractual arrangements for the provision of technology and technical services, ranging from licensing and franchising agreements in consumer goods industries to engineering consultancy and turnkey projects in heavy industry and infrastructure, and management contracts in all sectors.

TNCs have seen the need to respond to these policies, partly out of necessity and partly because they provide new business opportunities that can be turned to their own advantage. Many of such oriented transactions make it possible for TNCs to earn substantial returns on their technological and organizational assets without the commitment of equity capital and the attendant risks of expropriation or failure of the operation. In fact, during the 1970s the available evidence suggests that the earnings of the developed market economies from licenses for the use of industrial property rights, management and consultancy services, engineering and consultancy services, and the sale of capital goods to developing countries, grew at a much higher rate than these

countries' total outflows of FDI.

The interest of the developing countries in such arrangements lies in the possibilities of separating certain key elements in the FDI package - such as management, organization, proprietary technology and other "know-how" - from other elements such as equity ownership and control over decision-making. As financial capital became more freely available to many developing countries (the oil-exporters and the middle-income oil-importers) in the 1970s this could be provided independently of FDI.

In such circumstances TNCs have found it possible to exercise a high degree of control over an enterprise without formal majority ownership and sometimes without any equity involvement whatever. Joint ventures are often combined with management contracts and licensing agreements involving the same TNC partner, and special provisions covering the rights of the minority partner in decision-making, arrangements which give de facto control to the TNC even with a minority equity holding. Even where full nationalization is undertaken, a package of management and marketing and technical service contracts between TNC and state enterprise can substantially dilute local control and leave the enterprise an effective part of the TNCs network of operations.

This leads to the issue of bargaining power and the related issue of technological capability. Bargaining power here means the general leverage of the developing countries in their transactions with TNCs, and can be examined at two levels: The first level is that of the country as a whole. It

lies in the ability of the government to set general terms and conditions for the transactions of TNC with the local economy which conform with its development objectives, while maintaining access to these inputs. The second level is that of the leverage of local enterprises in negatiations with specific TNCs in specific projects.

This raises the issue of what may be the basis of bargaining power of countries without such assets, such as the least developed countries. Two points are relevant here. First, there is a growing number of enterprises seeking to secure international business in activities traditionally dominated by the oligopolistic giants. These include small and medium-sized enterprises from the developed countries, and some of the more advanced developing countries, and state enterprises from the developed countries as well as the socialist countries. Such enterprises have shown a willingness to do business with smaller developing countries on terms that are normally not acceptable to large TNCs.

For them, they represent an opportunity for "learning" about conditions in the developing world and establishing a basis for more significant international expansion. Secondly, developing countries generally can increase their bargaining power by careful study of the international market for technology in the activities they propose to establish. Thorough evaluation of alternative sources and study of the characteristics of potential suppliers can do much to enlarge access and conclude satisfactory bargains.