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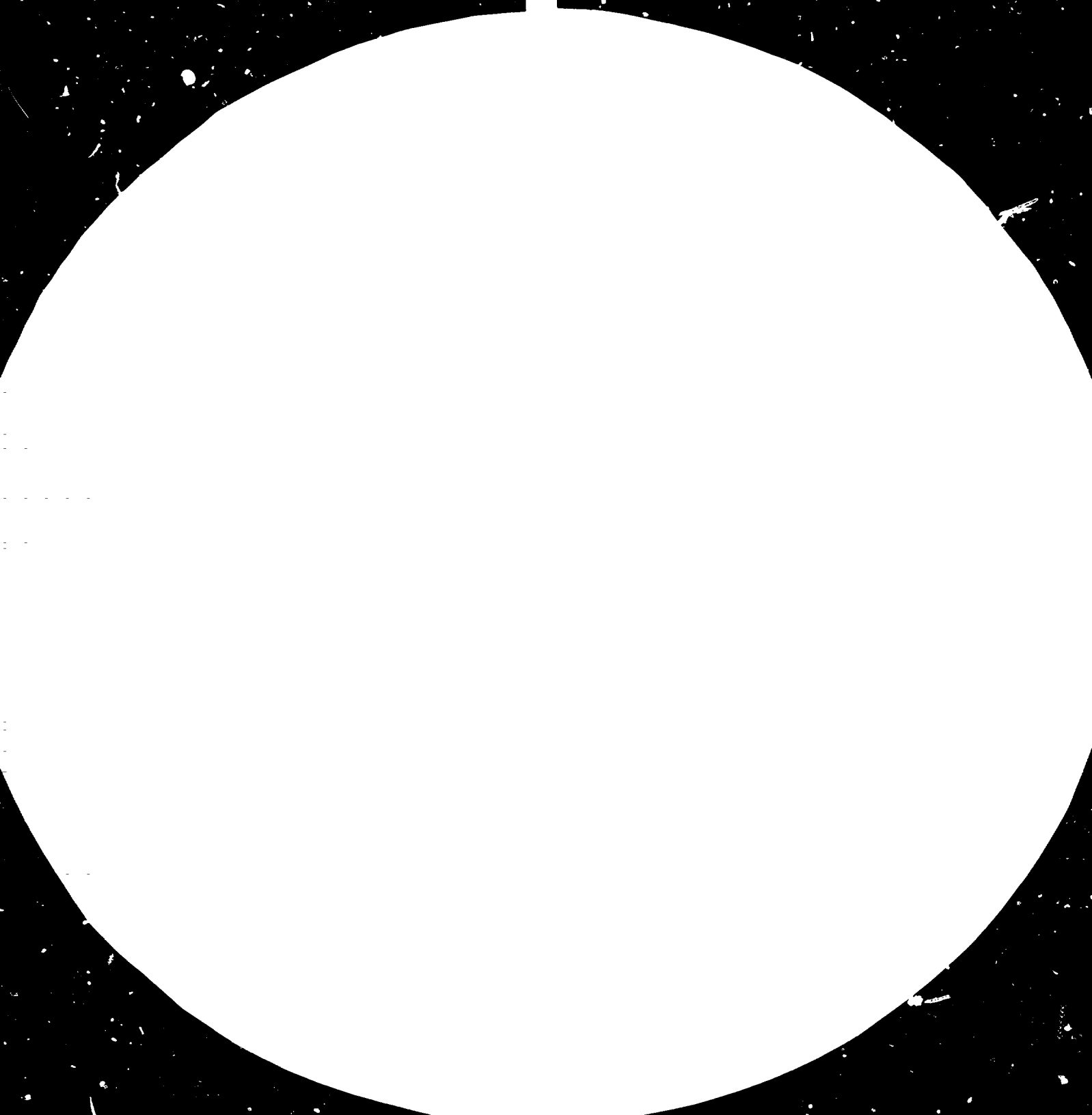
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to the Transnational Corporations"

Zagreb, Yugoslavia, 15-17 September 1982

Industrialization of International Economic Relations, *
Development and Economic Co-operation among
Developing Countries

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** IDC: Institute for Developing Countries.

Although frequently overlooked, the process of internalization of international economic relations (strengthening of the intra-firm transactions) has very important implications in the context of industrial development and economic co-operation among developing countries.

Without entering into a detailed analysis of the narrow or broader definition of intra-firm transactions, it suffices to say that intra-firm transactions are those among the entities of the system of enterprise (corporations) located in different countries, linked together by different technological, trade or other business inter-relations in the field of goods and services. In this context, intra-firm transactions should include not only those among the parent companies and majority owned foreign affiliates but also co-owned or minority owned and even long-term contractual related parties. The necessity for inclusion of services in the definition of intra-firm transactions stems from the increasing importance of the role of services in international co-operation.

Although the phenomenon of intra-firm transaction has

only recently become an issue in international economics it is really not a new phenomenon. It existed even before the creation of transnational enterprise which are the major actors of the process of internalisation of international economy today. This process is a logical consequence and accompanying factor of internationalization of activities of enterprises, especially after the period when portfolio investments have been gradually supplemented and substituted by foreign direct investments and in the last few decades by all different forms of co-owned investments, and contractual forms of long-term economic co-operation including subcontracting. Initially intra-firm transactions had mainly emerged in the form of intra-firm trade in the supply of raw materials and food. After the Second World War, parallel to the increase of the role of science and technology in development and modifications in the international economy, characterized by its oligopolistic nature, the main feature of the process of internalization of international economic relations became the process of internalization of marketing and technological know-how and so the creation of the institutional monopoly by the actors of the process. The strengthening of internalization of international economic relations is therefore a logical result and characteristic of the processes of internationalization of capital in the world and concentration and centralization of capital nationally.

Measurement of the extent and growth of intra-firm trade and other transactions among the related parties is hampered by scattered evidence. Only for a few developed

countries like USA, Sweden, Germany, UK, etc. there are some more reliable sources. This doesn't change the fact that the incidence of intra-firm trade is uneven and that there exist considerable industry and country variations. The rate of internalization of export is for majority-owned affiliates almost twice that of parent companies (66% to 35% in 1970). Nevertheless, country and sectoral studies are indicating that intra-firm transactions are becoming a more and more important part of international trade and the new evolving form of the dominant position in the international market. Secondly, it could be assumed that the share of intra-firm trade and other transactions is rapidly increasing and is tending to become the prevailing characteristic of international economic relations, at least in some research and technology intensive economic sectors.

The bulk of intra-firm transactions is in trade among developed countries themselves: more than 90% of US intra-firm trade of manufacturing products flow among developed countries. But the relative intensity of intra-firm trade in the economic relations between developed and developing countries is stronger. For example, 31% of export of manufacturers of US affiliates in developed countries and 53% of export of US affiliates located in developing countries are intra-firm transactions.

It is becoming obvious that a certain link exists between technology or research intensity and the intensity of the internalization of international trade: the higher the technology, research or marketing intensity of certain economic

sectors the higher the level of internalization of their international trade. The intensity of internalization also tends to grow by the level of value added of products.

The increasing role of transnational enterprises in the international economy is the result of the process of internationalization of the activities of these economic entities which are accompanied at an increasing rate by the internalization of markets, technology and know-how. Intra-firm transactions have grown in the last decade much faster than international trade in general, so the share of intra-firm trade in international trade has substantially increased. According to the most sceptical assumptions, intra-firm trade represents at least 30% of international trade. Michalet estimates that 45% of international trade is intra-firm trade of transnational enterprises. The Secretary General of UNCTAD stated in his report at the UNCTAD V in Manila that the share of transnational enterprises in international trade exceeds 50% and that it could represent almost two thirds.

Additionally, taking into account that a large part of international trade actually takes place among member countries of different integration groupings, what can also be defined as a special type of internalization of international trade, one could assume that internalized trade is becoming the prevailing characteristic of international trade. This conclusion is supported by the fact of the important role of the European Economic Community in international trade as well as by the fact that out of 2% of international trade which is accounted for by socialist

countries about half is actually trade among socialist countries themselves.

The starting point in an analysis of the qualitative nature and implications for international economic relations is the fact that transnational enterprises are not a malign construction of the international system as was advocated by traditional economists when monopolies were created. They are instead a result of laws governing development, a manifestation of the evolution of the capitalistic form of production, internationalization of capital and the need for ever larger articulation of the division of labour.

Enterprises have gradually come to the conclusion that only by internalization of all the stages, from the initial innovation to the marketing of products and through use of their own channels within their system of linkages among related parties, they can maximize profits and simultaneously prevent rapid imitation by their competitors. Internalization is thus regarded as a mechanism by which the innovative enterprise can maximize its ownership-specific or other oligopolistic advantages based on the ownership of technology and know-how.

The internalization of transfer of technology and know-how within the system of transnational enterprises raises doubts as to whether it could be regarded as a real transfer of technology or rather a commercialization of technology. Utilization of technology is spread, while know-how does not change the owner or the control. Only a certain type of co-managing of the technology utilization is established. The real transfer of technology should have meant

the transfer of the capabilities of the creation of technology. This is not usually the case in the internalization of technology transfer within the system of transnational enterprises i.e. in the case of related party transfers of technology. That does not strengthen the capacity for the creation of own productive capabilities for the technological innovations which is today the basic factor of structural changes and development.

The other important characteristic of internalization is that maximization of profits by the translocation of economic activities abroad can be achieved only through the combination of factors such as technology, marketing, management, trade-marks, distribution etc. in the comprehensive package (system) which give superiority to the transnational enterprises over other firms. The combination of all these, along with the technique of transfer prices, restrictive business practices, tying purchases of spare parts and goods in general, is gradually evolving in the institutional monopoly of the system of transnational enterprise. This institutional monopoly could represent a higher stage of monopoly compared with only technological or only marketing monopoly, although at the same time it reaffirms both technological and marketing monopolies and strengthens and reproduces the dominant role of transnational enterprises in international economic relations.

Although the strengthening of intra-firm transactions could be regarded as one of the possible manifestations of internationalization of capital in general there is a sub-

stantial contradiction between the real process of internationalization of production as a process of socialization of production on the one hand and the process of internalization on the other. Internalization really means a tendency to evade the system as much as possible independent of external conditions and so reducing its vulnerability and establishing an autonomous system of economic processes. Such internationalization of capital is basically its own negation (denial), demonstrating how capital optimum differs from social optimum.

Between the system of international economic relations, oligopolistic by their nature tending towards internalization itself, tending to negate international economic relations, there, exists a paradoxical contradiction. It is therefore becoming more and more obvious that internalization is in contradiction with the existing system of international economic relations as well as with the efforts to establish a New International Economic Order. Globalisation of the activities of transnational enterprises, internalized within their own functional system, practically means an internal division of labour among the companies and their affiliations although appearing as an international division of labour.

Internalization is therefore a certain form of accommodation of transnational enterprises to the modified "law of value" in the international economy at an achieved level of development of international economic relations and simultaneously representing a certain modification of these relations. Although transnational enterprises were created as a product of the functioning of market forces on one hand, they are, on the other hand, a manifestation of

the tendency towards transformation into anti-market forces, at least to the extent in which they are undertaking intra-firm transactions, and thereby substituting the market mechanism.

With internalization of transactions the system of transnational corporations is becoming more and more autonomous. The prices are actually becoming administrative prices. They are set in accordance with the criteria of transnational enterprises and not arms length prices (prices set in the relations of unrelated partners).

One of the implications of the intensification of the intra-firm transactions, together with a transfer pricing mechanism, is a tendency to circumvent or substitute the functioning of market forces, thereby strengthening the role and power of transnational enterprises in the international economy, and reproducing and enriching their dominant market position. The use of transfer pricing could substantially deform the allocation of resources in the world economy with all detrimental development implications.

Parallel to the process of the internalization of trade among countries, financial and monetary transfers are also to a great extent internalized. Instead of multilateralism, declared by the IMF, transnational enterprises are actually balancing an increasing part of their transactions within their "internal" system, by bilateral payments channels, substantially private clearing arrangements. Today a certain tendency towards stronger mobility of production factors in the international market rather than inside national economies, in the operation of already established transnational enterprises,

could be noticed. Such an internationalization of capital with prevailing intra-firm transactions is offered as a way of integrating world and mankind and the manifesting interdependency and as the most appropriate and efficient mechanism of resolving of world economic and political problems.

The underlying idea of the maximalization of individual profits is combined with the acceptance of the idea of the Code of Conduct for transnational corporations which is in contradiction with the tendency of internalization, meaning a substitution of the market forces and the principles of the "free trade". Intra-firm trade is only free for transnationals, while the foreign constituting members of the transnational enterprises are in the subordinated, dependent position. On the other hand the idea of the Code of Conduct is based on the belief in the necessity of intervention as a corrector of market mechanisms.

The analysis of the internalization of international economic relations by transnationals is demonstrating certain modifications of international economic relations. Internalization processes are expected to intensify in the future. But it cannot be mechanically extrapolated in the future, to what would at the final outcome mean the total internalization of international market. Nevertheless, the tendency towards internalization of substantial parts of international economic relations by vertical, horizontal and conglomerate directives is introducing in the international division of labour many new elements. Economic policy instruments as well as the whole institutional framework of international economics is

becoming insufficient and unefficient. Therefore it is necessary to seek new instruments of economic policy as well as the system of international economic relations which could be sufficiently efficient in influencing the internal transactions within the system of transnational enterprises.

The comprehensive activities of transnational enterprises, to a large extent internalized and flexible, are of such a nature, that they are difficult to control by ordinary instruments of economic policy. Apart from the necessity of seeking new mechanisms and instruments for the control and regulation of such activities, especially internalized ones, it is necessary to search for ways to actively utilize the advantages which the real, symmetrical processes of internationalization of production can offer. This is especially relevant for developing countries and their participation in the international division of labour, international economy as well as the effectiveness of their systems of stimulating export. In such new circumstances, traditional export promotion measures could not be sufficiently effective. Export and import are more and more the result of so called long-term business technological co-operation with foreign partners. Therefore developing countries have to strengthen the internationalization of the activities of their enterprises also as the vehicles for promotion of their exports.

In other words the strengthening of the tendencies toward internalization of international economic relations additionally and unavoidably necessitates the establishment of a complex long term strategy of developing countries vis-

-a-vis transnational enterprises. To be effective it has to be both, defensive, seeking the minimization of costs of such a co-operation, and active maximizing the advantages of the global combination of production factors.



