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STUDY OF PRIVATE FOREIGN INVESTMENT AND MULTINATIONALS

Dr. Roshankumar M. Bhigania
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ABSTRACT

Introduction - Merits of Private Foreign Investment – Demerits of Private Foreign Investment – Multinational Corporations and LDCs – Spread of MNCs – Merits of MNCs – Demerits of MNCs –

KEYWORDS:*Private Foreign Investment , electric energy , large domestic market.*

INTRODUCTION :

At the turn of the present century, private foreign capital mostly flowed in the form of indirect investments from Europe to the underdeveloped countries. Such capital as flowed to low income countries in the 1920s in the form of direct investments went mainly into production for export. Very little of it went to manufacturing for the home market. But since the Second World War, over half the private investment has been direct. Direct private investment has been concentrated mainly in the extraction of raw materials like iron, crude oil, manganese, bauxite, copper, electric energy, etc. Only a small percentage has gone to manufacturing and distribution. Not until the economy takes off that direct investment is made in manufacturing. That is why direct investment in manufacturing flows to those countries which are somewhat industrially advanced and have large domestic market.

Dr. Roshankumar M. Bhigania

MERI TS OF PRIVATE FOREIGN INVESTMENT:-

Private Foreign Investment (PFI) possesses certain advantages which are discussed as under:

(a) PFI not only provides finance but also managerial, administrative and technical personnel, new technology, research and innovations in products and techniques of production which are in short supply in

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LDCs.

(b) This may, in turn, encourage local enterprise to invest more itself in ancillary industries or in collaboration with foreign enterprise. In fact, foreign enterprise encourages local enterprise in two ways: directly by fostering local enterprise with men, money, and material, and by imparting training and experience to its personnel; and indirectly by creating demand for ancillary or subsidiary services (like transport and training agents) which are uneconomical for private foreign enterprise to provide.

(c)By bringing capital and foreign exchange PFI helps in filling the savings gap and the foreign exchange gap in order to achieve the goal of national economic development in LDCs.

(d)A part of the profits from direct foreign investment is generally ploughed back into the expansion, modernization or development of related industries.

(e)PFI adds more value added to output in the recipient country than the return on capital from foreign investment.

(f)PFI also brings revenue to the government of an LDC when it taxes profits of foreign firms or gets royalties from concession agreements.

(g)PFI helps in raising productivity and hence the real wages of local labour. When foreign investment induced industrialisation takes place, the real wages of the newly employed workers are higher than the real wages of workers in the rural sector of the economy. If PFI is in export oriented industries, it leads to much higher social benefit than it is in import-substitution industries. Because the former have large backward and forward linkage effects. And if export industries are labour intensive, they also provide large employment opportunities.

(h)Direct foreign investment also places less burden on the balance of payments of an underdeveloped country in the early stage of development. For, the time lag between the starting of new business concerns and the reaping of profits is large. Moreover, profits are likely to be small in the earlier stages of production. Thus the remittance of profits from direct investment brings less pressure on the balance of payments. If PFI mainly flows into agriculture and extractive industries which produce primary goods for export, it further helps in easing the balance of payments position of LDCs. In the case of a developing country like India, PFI has a greater salutary effect on the balance of payments since it helps in producing manufactured articles, not only for the domestic market but also for foreign markets.

(i)Lastly, PFI flowing into a developing country also encourages its entrepreneurs to invest in other LDCs. Firms in India have started investing in Nepal, Uganda, Ethiopia and Kenya and other LDCs while they are still borrowing from abroad.

DEMERITS OF PRIVATE FOREIGN INVESTMENT:-

PFI has certain disadvantages in the form of costs to the recipient country which tend to offset its benefits:

(1)The receipient country may be required to provide basic facilities like land, power and other public utilities, concessions in the form of tax holiday, development rebate, rebate on undistributed profits, additional depreciation allowance, subsidized inputs, etc. Such facilitates and concessions involve cost in absorbing an LDC's resources that could be utilized elsewhere by the government.

(2)To attract PFI, LDCs have to provide sufficient facilitates for transferring profits, dividends, interest and principal. If these payments lead to a net capital outflow, they create serious balance of payments difficulties. Thus the indirect costs of debt servicing and balance of payments adjustments create serious foreign exchange crisis, thereby adversely affecting the national economy.

(3)No doubt, PFI increases investment, employment, income and saving in LDCs, but it adversely affects income distribution when it competes with home investment. Capital and other resources may flow to foreign enterprises in preference to domestic enterprises. This may reduce profits in the latter, thereby discouraging local enterprise.

(4)Many foreign concerns operating in LDCs, reserve all senior executive posts for their nationals and pay them very high salaries with many perks which are a huge drain on the resources of the recipient country. At best, they train local nationals for lower and middle level posts having little independent decision making. Moreover, the

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lavish spending habits of foreign nationals have an undesirable demonstration effect on the nationals of LDCs and create social tensions.
(5)PFI brings in highly capital intensive technologies which do not fit in the factor proportions of LDCs. Often obsolete and discarded machines and techniques are imported which involve high social costs in terms of replacement after a few years.
(6)PFI also involves costs in the form of a loss of domestic autonomy when foreign firms interfere in policy-making decisions of the government of an LDC, which favours the foreign enterprises. Such interference is usually resorted to by the multinational corporations.

MULTINATIONAL CORPORATIONS AND LDCs:-

A multinational corporation (MNC) is a company, firm or enterprise with its headquarters in a developed country such as the United States, Britain, West Germany, Japan, etc. and also operates in other countries, both developed and developing. They are spread not only in the LDCs of Asia,. Africa and Latin America, but also on the continents of Europe, Australia, New Zealand, and South America. They are engaged in mining tea, rubber, coffee and cocoa plantations; oil extration and refining, manufacturing for home production and exports, etc. Their operations also include such services as banking, insurance, shipping, hotels and so on. Thus "like animals in the zoo, MNCs come in various shapes and sizes, perform distinctive functions differently and their individual impact on the environment.

Sanjay Lai and Streeten define the MNCs from economic, organisational and motivational viewpoints. The economic definition lays emphasis on the size, geographical spread and extent of foreign involvement of the MNC. According to this definition, a typical multinational company is one with net sales of 100 million dollars to several thousand million dollars having direct foreign investment in manufacturing usually accounting for at least 15 to 20 per cent of the company's total investment. Direct foreign investment means at least 25 per cent participation in the share capital of the foreign enterprise.

The organizational definition stresses on some organizational aspects of an MNC, besides the economic ones. In this respect a truly MNC is that which is that which " acts as an organisation maximizing one overall objective, for all its units, (b) treats the whole world (or the parts open to it) as its operational area, and (c) is able to coordinate all it function in any way necessary for achieving (a)and(b).

The motivational definition highlights "corporate philosophy and motivation in laying down criteria for multinationality. Thus, 'True' multinationality is generally indicated by lack of nationalism, or a concern with the firm as a whole rather than with any of its constituent unit* or any country of its operations." On this basis, firms are distinguished between ethnocentric (home-oriented), polycentric (host-oriented) and geocentric (world-oriented), on the basis attitudes revealed by their executives.

Lai and Streeten define MNCs in general as very large firms with widespread operations whit h are clearly international in character and have more than five foreign subsidiaries or more than 15 per cent of total sales produced abroad, and acting in a cohesive manner to achieve maximum profits or growth.

SPREAD OF MNCs:-

MNCs overwhelmingly dominate not only global investment but also international production, trade, finance and technology. But adequate and reliable up-to-date data regarding the spread of MNCs in terms of subsidiaries, production, trade; finance and technology are rarely published and hence are not available. A pioneering study, Sovereignty at Bay (1971), by Raymond Vernon listed 300 colossal MNCs whose total production (not sales) of goods and services totaled $35(1 billion a year. Of these, 187 were U.S. controlled raw material producers and manufacturing concerns, half of the remaining third were British and Dutch, and the other half European and Japanese. Among the first ten, eight were American and the remaining two were British-Duh It combines, the largest being General Motors with the total world sales of $25 billion which exceeded the GNP of all but a dozen countries in 1970. An American magazine Forbes (November 15,1971) published a list of 50 major American corporations which revealed that on an aver.ige 40 per cent of their total revenue came from their fields like tea (115 branches), pharmaceutical (24 branches and subsidiaries), cosmetics, food products,

manufacture of industrial products and consumer goods of wide range, oil exploration, book publishing, automobiles, chemical fertilizers, etc.

MERITS OF MNCs:-

The advantages flowing from the MNCs to the LDCs are based on the theories of direct foreign investment. Such theories are related to oligopolistic interdependence and monopoliser behaviour of the MNCs. Hence they confer the following advantages on MNCs:

1)MNCs are financially very strong and hence provide large and cheap capital to the LDC by way of direct investment.

2) They undertake great risk in investing their funds in LDCs in the face of imperfect infrastructural facilities like power, transport, skilled labour, etc., low market demand and short supply of inputs.

3)They start new ventures and bestow the advantages of superior management, training, education and enterprenurial ability in LDCs.

4)They transfer superior technology to LDCs based on R & D in the parent concerns because they are able to spend huge funds on R & D. This leads to the discovery and introduction of new processes and new and differentiated products in LDCs which tend to raise the standard of living of the people in LDCs.

5)MNCs bring in new techniques of marketing in LDCs through market research at their headquarters. They adopt novel advertising and promotional methods which impart information to buyers and create demand for particular brands and products. This encourages competition.

6)Above all, MNCs are socially desirable in LDCs because they lead to a net increase in capital formation, output and employment.

DEMERITS OF MNCs.:

MNCs have come to be regarded as agents of exploitation in LDCs because of their invidious operations which are highlighted in their modus operandi.

The US-based MNCs insist on cent per cent ownership in LDCs and they have succeeded in this in Singapore, Mexico, Hongkong, Brazil and Taiwan. With low rates of taxation in these countries, they have been exporting "super profits" to America.

In countries like India, where since the 1960s, the MNCs are allowed to operate as joint ventures with 25 to 40 per cent participation, they enjoy a number of privileges which again tend to increase their profits manifold. Such concessions or privileges are in the form of dividends, payment for installation fee, royalty on the use of patents, payment on know-how fee, payment for imported equipment whose price is 30 to 40 per cent higher than the competitive international price, and tax holiday for a number of years if the concern belongs to the priority sector industry. Besides, the staff which comes in the wake of an MNC is paid very high salaries. Some of their top executives get much more than the highest paid executive head of the state in which they serve. Not only this, the MNCs pay to the locally employed labour twice and even three times more than what they might earn in local firms. This not only leads to social inequality but also breeds discontent and unrest among the workers employed in indigenous industry.

The MNCs are pre-empting local savings by overpricing the imports and underpricing the exports of LDCs. In cases where there is competition from local entrepreneurs, the MNCs undercut them by charging low prices for their products. As a result, the local firms are squeezed out of business. But if there are very few local firms to compete with, the MNCs buy their majority shares or merge them to exercise control over them.

The MNCs transfer second rate and overpriced technology to LDCs. More often, they try to minimise the transfer of technology' to such countries by

(a) carrying out R & D in the parent company located at the headquarters;

(b) neglecting the training of local personnel for R & D posts; and

(c) holding closely' the technology itself. Moreover, the technology which the MNCs transfer into the LDCs is capital-intensive and hence unsuited to their capital-scarce and labour- surplus economies.

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Besides, the long-term effect of direct and indirect investment by the MNCs on the balance of payments is usually negative as they repatriate huge amounts in the form of royalties, profits, interest, dividend capital, etc. Last but not the least, the MNCs influence the internal politics to the detriment of the LDs by bribing the legislators not only directly but also indirect!. I hey offer posts in the higher echelons of their companies to the privileged sections of the society, especially to the friends and relatives of the local politicians, bureaucrats and the economic oligarchies. They also subvert dome (M fiscal and monetary policies in LDCs.

CONCLUSSION:-

It is not that the MNCs are simply the agents of exploitation, they also act as agents development. By establishing manufacturing plants, providing production, managerial technical, organisational and marketing skills, and by harnessing their resources, the MN have helped in augmenting the GNP of Singapore, Hongkong, Taiwan and Canada. But as pointed out earlier, these benefits accruing to such countries have been the outcome of the self interest of the MNCs, that is, the need to meet the US domestic market.

The LDs should also take advantage of the expertise and superior technical know-how of the MNCs by entering into 'turnkey agreements' with them whereby a foreign company undertakes, to build a plant or help in exploiting their natural resources, imparts training to local personnel provides technical know-how, starts production and then leaves the country for good by entrusting the entire operations to the local firm. In lieu of these services, the MNC should I paid either a fixed fee or cost-plus fee. India has entered into such agreements for the exploration of its off-shore oil resources.

It is advisable, as suggested by Streeten, that the governments of LDCs should not press I lie MNCs to pay specially high wages to local labour. Rather, the MNCs should be asked to employ local people at the prevalent rates for the same jobs in the country. On the other hand, Hw should tax the MNCs more heavily so that the people of the country benefit rather than the few people who work for them. This increased tax revenue may be spent in providing greater infrastructural facilities to the people which will benefit all sections of the society including I lie MNCs. Moreover, foreigners receiving higher salaries and better facilities than their loc al counterparts in similar jobs should also be taxed equally.

Given the conditions laid down above, the MNCs should be encouraged to establish plants in backward areas or regions of LDCs so that regional imbalances are ironed out.

Since there is no likelihood of any agreement on the international plane over a 'code of conduct which may govern the operations of MNCs, every LDC should have its own independent agent y to report on the working of MNCs from time to time in that country and should not hesitate In take stern actions against the offending giants which may even be tantamount to nationalization.

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