SOME ASPECTS OF THE CONTROVERSY OVER DIRECT FOREIGN INVESTMENTS BY MULTINATIONAL CORPORATIONS IN THE LESS DEVELOPED COUNTRIES

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Abstract

The governments of the industrialized countries are reviewing their policies regarding direct foreign investments in the less developed countries by multinational firms. In the industrialized countries national unions are concerned with job loss, domestic businessmen are concerned with competition from less developed countries, and government officials are concerned with relative declines in technological strengths.

Introduction

Since World War II, large corporations, particularly American firms, have invested substantial sums of money in the less developed countries (LDC's) of the world. The results of this process have been in many cases the creation of multinational economic empires that encompass the globe. The annual sales of some of the largest multinationals now are larger than the GNP of all but a handful of the richest industrial countries (U.S. Senate, 1975).

In the past, the governments of the advanced investor nations have generally considered that direct foreign investment (DFI) in less developed countries had beneficial, or at least neutral effects on their own developed economies. This view has recently come under attack in the industrialized nations from national unions concerned with job loss, domestic businessmen concerned with competition from LDC's, and government officials concerned with relative declines in technological strengths (Frako, 1978).

The crux of the matter seems to revolve around the actual economic and market impact of direct foreign investment by multinationals in less developed countries.

Policies and Attitudes Toward Direct Foreign Investments (DFI)

Until recently, few governments in the advanced investor countries of the industrialized world have seriously contemplated restricting direct foreign investment in less developed countries. The prevailing assumption of these governments was that direct foreign investment of multinationals to less developed host countries could cause no harm and might possibly even benefit the investing country's economy.

Benefits that investor countries assumed they would reap from direct foreign investments included:

1) anticipated additions to their respective GNP's from profits, royalties, and fees remitted home by investing MNC's.
2) LDC economic growth, which in turn expands their own countries' export markets.
3) increased access to LDC export markets, either because investor countries' exports would be promoted by that part of DFI used for distribution, service, marketing, and information gathering purposes or because multinationals exporting intermediate goods and components would have preferential market access if they were also direct investors in importing firms in LDC's.
4) preferential access to raw materials for countries whose firms owned deposits.

Basicallly for these reasons, the international tax, trade, loan, and insurance policies and programs of virtually all advanced investor countries either ignored or somewhat favored direct foreign investment in less developed countries (Frako, 1978).

Governmental exchange controls on international business operations have sometimes served to inhibit outward DFI. Nonetheless, exchange control has usually been enacted to allow would-be direct foreign investors to borrow abroad to finance the purchase of equity shares in foreign countries. This practice has tended to thwart the outward DFI by smaller firms, but it has generally allowed DFI by large, well-known multinationals who could borrow in international capital markets, to forge ahead. Ultimately though, such exchange control policies were primarily aimed at restricting portfolio exports and not directly invested capital (Klein, 1977).

Advanced investor countries (AIC) trade policies basically seem to ignore the existence of DFI. It has been argued that certain provisions of these countries' tariff codes, as such the Generalized System of Preferences, or the duty-free re-import provision of the U.S. tariff code, facilitate certain kinds of DFI by multinationals in less developed countries; specifically border or offshore plants for assembly work. However, these provisions, in principal, are also available to purely domestic firms who wish to subcontract on an arm's-length basis to unaffiliated firms in LDC's (Galt, 1977).

Due to the wide-spread treatment of taxes paid by foreign subsidiaries as a credit against domestic taxes, AIC tax rules are typically perceived as aiming at "neutrality" between domestic and foreign investment on the part of multinational firms. The currently universal practice of allowing deferral of home-country taxes on foreign income, until that income is repatriated in the form of dividends, is said, particularly in the United States, to violate this neutrality and to encourage foreign over domestic investment. It has also been argued that since deferral favors foreign over domestic investment, it also favors foreign production via DFI over pure exports of goods and services to LDC's (U.S. Senate, 1975).

Opposing forces contend that the extension to deferral to U.S. export transactions through the enactment of the U.S. Domestic International Sales Corporation (DISC) program, which tends to serve as a kind of domestic tax haven for U.S. exporters, nullifies the previous statement. Additionally, AIC's other than the U.S. have fiscal systems which allow their firms the freedom to use foreign tax haven countries as
The kind of DFI by multinationals most often criticized for causing job loss in the home-country has been in offshore production or assembly plants in countries with low wages at which they can compete against AIC’s. U.S. semi-conductor and radio companies have frequently criticized by U.S. unions for setting up such export-back plants in various Southeast Asian, Caribbean, and over-the-border Mexican sites. The criticism has been particularly strong when MNC’s, acting as global profit maximizers, undertook such investment in the absence of strong competitive pressures from LDC firms in their home markets. Much has been written, though, which argues that multinationals in fact only rarely undertake export-back DFI unless they are threatened in their home markets either by indigenous LDI competition, or MNC’s investments in LDC’s or by imports from other, low cost AIC sources (Stobaugh, 1976). However, since judgments concerning firms’ investment motivations are basically conjunctive, it is difficult to state whether export-back DFI is aggressive or defensive.

Criticism of export-back investment has become especially forceful, not only in the U.S., but in import competing industries in other AIC’s. This is attributed to the fact that it has become apparent that LDC’s, especially the relatively advanced, higher income LDC’s that are already the recipients of considerable amounts of FDI, are increasingly able to exercise power over the foreign affiliates of multinational corporations in the form of export performance requirements on these affiliates. Investing companies are increasingly aware of the power host-country governments have to affect both the market profitability of the past, and the possibility of future expansion. Consequently, LDC’s have increasingly extracted “guilt pro quo” deals, making approval of a multinational’s expansion plans contingent upon their adherence to specified export targets, similar to the type Brazil obtained from Volkswagen in the recent past (Tyler, 1976).

Although criticisms of and pressure against DFI in LDC’s have been strongest when investment has been associated with exports back to the advanced investor country’s markets, there is increasing political attack in advanced countries against foreign investment in countries that export goods. Some of this reprisal is directed at investing multinationals who are again accused of exporting jobs by undertaking unnecessary foreign production. As in the case of export-back performance requirements, though, an increasing part of AIC irritation is directed at LDC government interventions in markets, such as the imposition on foreign affiliates of local-content, import-substituting, performance requirements that are occasionally accompanied by threats to the viability of existing investments in plant and equipment (Franko, 1978).

Although job loss is the main point of contention in the attack on DFI by multinationals, technology transfer is increasingly becoming a concern as well. Fears center around the thought that the transfer of technology and skills to foreigners that generally accompanies DFI may eventually reduce the overall technological competitive advantage of the investor country. Consequently, this would lower whatever economic “rents,” i.e., export sales revenues, royalties, and profit remittances on investment income, that the investor country might have obtained if these transfers had never occurred. This sense of opportunity loss aggravated by a relative decline in a country’s prowess in technology and managerial skills, may be felt by government officials and