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Multinational Corporations in LDCs

The function of direct investments by multinational corporations in the economic development of less developed countries (LDCs) is a widely discussed problem. The following articles analyse the many aspect of this controversial issue.

Role of Multinational Enterprises

by Jamil Mohamed Jan, Kuala Lumpur *

The inflow of foreign capital has played a vital role in promoting economic growth in a number of countries. Many developed countries in the past obtained foreign financial assistance to supplement their meagre savings during the early stages of their development.

In the light of this experience, governments of less developed countries (LDCs) which are newly entering the process of economic growth are obliged to fully explore the possible contributions of foreign capital to the development of their economies.

In many LDCs, international flow of capital through "direct investment" by multinational enterprises is not something entirely new. In fact parts of Asia and Africa were originally governed as well as developed

by companies with boards of directors in Europe. These countries provided the foreign investors with raw materials for their factories. During those days, foreign private investment was to a large extent responsible for the economic exploitation of indigenous natural and mineral resources and the development of the basic infrastructure facilities like railways, roads and the building of certain associated financial institutions such as Commercial Banks.

Historical Background

Historically, "direct foreign investment" in the LDCs resulted from the industrial revolution in Europe in the nineteenth century. Countries like Great Britain, France, Italy and Germany were thrusting ahead with their indus-

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trial development. They were looking for raw materials to feed their factories. Their exploration brought them to the LDCs in Africa and Asia with their abundant resources of raw materials which were not fully developed. Research carried out by the foreigners led to the reorganisation of the economic activities of the less-developed countries; one of the important fields of research was agriculture. A series of agricultural experiments began which consequently led to the large-scale production of agricultural items. Examples of these are rubber in Malaysia and Indonesia, tea in Ceylon and cocoa in Africa. The development of the plantation sector was accompanied by the growth of foreign commercial houses which catered for the marketing of these agricultural products. Some of the commercial houses

took to planting these crops themselves.

Besides agriculture, interesting discoveries were also made in the field of mining. Mineral resources such as tin, coal and iron ore began to be exploited commercially. Initially these minerals were exploited by the local population with the aid of primitive methods. The foreign participants in this field brought with them new and more efficient methods. For example, the dredger was introduced in Malaya for the mining of tin. The use of dredgers not only permitted operations in swampy land but also made possible the extraction of tin from deposits of a lower content which could not be profitably exploited by any other method.

Growing Industries

The development of roads and railways was consequential on the growth of the plantation and the mining sectors. The infrastructure that was developed enabled the transportation of primary commodities to the ports for export to the industrial countries of Europe. With all these facilities, LDCs were able to increase their economic growth and trade flourished. Significantly this framework of infrastructure became an important contributing factor that enabled some LDCs like Malaysia to move smoothly and successfully into the mainstream of international industrial activity.

The financing of this international trade was largely confined to the banks. The merchants were the chief pioneers in this field. When the western banks first considered doing business with these regions, they appointed the commercial houses as their agents. Later this led to the formation of several banks that operated with head offices abroad thereby lending yet

another dimension to the participation of multinational enterprises in the economic development of LDCs.

The existence of these financial institutions and an adequate infrastructure laid the foundation for industrial development. Western business found its most profitable fields of enterprise in commerce and in the extractive industries where the abundant natural and human resources could readily be organised into new combinations. Industries developed during the early stages were those that involved processing of raw materials, with obvious comparative advantages due to low costs of transportation and cheap labour; furthermore manufacturers of simple consumer goods and service industries to cater for the needs of the primary industries and the nucleus of secondary industries. In the Malaysian context the processing of rubber, smelting of tin ore, manufacture of cement, bricks, tiles, etc., the production of shoes and ready-made garments, soaps, detergents, toothpastes, brushes, etc., as well as foundries and electrical and mechanical workshops are examples of a pattern that existed and is still prevailing in many LDCs.

Neglect of Malaysia

In the early stages, multinational enterprises pioneered the establishment of industries in most of the development areas in Asia such as India, the Philippines, Hong Kong, Singapore, Malaysia and Ceylon. In the case of India and the Philippines, the large populations permitted the establishment of numerous industrial enterprises. Besides, they were also endowed with the necessary natural resources. Hong Kong and Singapore, on the other hand, lacked the necessary natural resources but this was com-

pensated by their locational advantages. These two islands initially provided the ideal stopping points in the international trade route between East and West and have now developed into centres for primarily export oriented industries.

Malaysia and Ceylon however "stood midway" between these two groups of countries. Here the multinational enterprises were faced with a situation where the populations (around 10 or 11 million) were just big enough to support protected minimum-sized plants for import substitution and where integration prospects were limited by market size and demand. In any event these countries, rich in natural resources, were primarily conceived as plantation economies by the colonial governments. There was no positive attempt by the governments to encourage the growth of secondary or tertiary industries.

Independence — Alternative Policies

With independence, economic growth in LDCs took a different course. Governments of LDCs were now faced with the choice of setting up public enterprises to take up projects with outside aid at the risk of increasing their foreign debt position or to leave industry entirely to the private sector while governments concentrate on the development of infrastructures and on raising the standards of living of the rural population. The latter policy benefits the majority of the population in LDCs, increases the general purchasing power and creates the demand required to support and expand import substituting industries. The third alternative was for the governments to leave the main thrust of industrialisation to the private sector and support public enterprises in selected industries where the private sector

is inactive or where they can play a complementary role. In Malaysia the Government has chosen this last course of action.

Today, direct investments by multinational enterprises have yet a bigger role to play in the economic development of LDCs. New techniques accompany the inflow of private capital, and by the example they set, foreign firms promote diffusion of technological advances in the economy. This benefit is highly important, for while domestic enterprises might not be adapt in the practice of innovating, they may make up for this deficiency by imitating the advanced techniques demonstrated by foreign firms. In addition, direct investments lead to the training of labour in new skills, and the knowledge gained by these workers can be later employed by local firms. In this respect the indirect benefits of "direct investment" are of considerable development value to the economies of LDCs.

Multiplier Effect of Foreign Investments

The influx of foreign capital and technology is not only significant for raising productivity of labour but also allows a larger labour force to be employed. In almost all LDCs, there is still unemployment and under-employment in the urban and especially the rural sectors and this situation needs to be alleviated by the absorption of the unemployed in the advanced sectors. If the lack of capital, entrepreneurial skills, know-how and markets limit the employment of the labour force in the advanced sectors where wages are higher, an inflow of "direct investments" is crucial for moving economies of LDCs into advanced economic activities. The social and economic benefits from such direct foreign investments in the advanced sectors would then be

greater than the profits devised from these investments due to external economies and multiplier effects that they would generate.

It is in view of these benefits that much promotional efforts are being made by LDCs to attract foreign investment. These have taken various forms; establishment of permanent trade commissions and despatch of missions abroad, wide publicity through advertising and cooperation with foreign governments, concluding double taxation agreements, attending of international trade fairs, bilateral negotiations and the like. Important has also been the provision of fiscal incentives which in Malaysia for example take the form of a range of tax relief provisions which use capital investment, employment and/or exports as criteria. Special incentives have also been devised for companies that have a long starting period before they make profits, companies that manufacture specific products, locate in depressed areas or incorporate increased domestic contents into their products. Other LDCs have developed other incentive programmes to suit the needs and aspirations of their respective economies.

Necessary Know-How

In the case of Malaysia, the Government realised the importance of foreign capital not only in terms of its past contributions but also of its future role. Foreign investment has transformed Malaysia into one of the world's largest producers and exporters of primary products. The growth of primary industries and overseas trade has been accompanied by the development of institutions and social overhead capital characteristic of modern commercial communities.

Today, direct investment by multinational enterprises has

yet a bigger role to play in the economic development of Malaysia, especially so in its strive towards industrial development. Capital is one factor that is not in short supply in Malaysia. However there is a need for entrepreneurial skill to channel this capital into industrial activity. The role of multinational enterprises in Malaysia would be to harness this capital in joint ventures with foreign capital and technical know-how. It is also recognised that such direct investment would among other things save foreign exchange, contribute to national revenue, assist in the creation of employment opportunities, contribute to the development of local entrepreneurship and provide overseas contact for capital and markets.

Moral Obligations

Over and above the mere factors of profit, employment earnings in foreign exchange and a host of other obvious benefits that accrue to LDCs as a result of "direct foreign investment", multinational enterprises should not lose sight of their other obligations, perhaps not so tangible. Multinational enterprises, if they wish to profit from and grow with the development of LDCs, should be very conscious of the needs and aspirations of the LDCs. They should attempt to adapt their corporate policies into the economic and social fabric of the country of investment.

They should take pains especially to keep out of domestic politics and adopt a low profile even on international politics should this involve their country of origin. They should take active interest in social programmes being organised by the respective governments be it in welfare, sports or education. Experience has shown that there is a considerable contribution,

not only monetary but also in services, that multinational corporations can make towards this end with their knowledge born from international experience. Also in periods of national emergencies e.g. natural disasters, multinationals can take the lead and their contribution here in service and kind can be often crucial in alleviating the suffering of masses of people. The goodwill that such activities create will, in the long run, bring about benefits that should show on the balance-sheet of such companies.

The above points may well seem to simplify the issue of the function of multinational enterprises outside the sphere of economics. However they are examples of the real issues that face all multinational enterprises operating in LDCs.

Areas of Conflict

There are several important areas of conflict between multinational enterprises and LDCs which should be touched upon. Among these are questions relating to joint ventures, technical agreements and foreign personnel.

In the past when many LDCs were beginning their economic development programmes, many of the above arrangements were "lop-sided" in favour of the multinational enterprises. The companies used to insist on 100 p.c. foreign equity participation regardless of the nature of the project. In the case of joint ventures very high licence fees were insisted upon thus draining off much of the revenues, leaving very little as profits for distribution to local parties. In addition to this, companies made it a practice of bringing in foreign personnel to fill many levels of employment even where such skills e.g. of clerks, executive officers, etc., were available in the LDCs.

In this context and in view of changing times, multinational enterprises should also be sensitive to the needs and aspirations of the developing countries. An uncompromising attitude regarding equity participation and foreign personnel can lead, and has in many cases led, to political pressure being exerted within such LDCs and caused extremist groups to express fears regarding foreign economic domination. Governments of LDCs have become sensitive to these local pressures and this sometimes has resulted in the nationalisation of foreign companies. In other cases like in Malaysia, the Government has taken a flexible attitude and adjusted policies to suit the changing times.

In Malaysia, during the early days of economic and industrial development, foreign firms were allowed to hold a 100 p.c. ownership in companies regardless of the nature of the project. Very little attempts were also made to supervise licence agreement fees and the coming in of foreign personnel.

Crucial Function of Multinationals

This policy regarding foreign equity participation changed after some time and a more or less rigid policy of 51 p.c. local and 49 p.c. foreign participation for all projects was insisted on. Now, however, the Government has re-assessed the situation and adopted a flexible and practical policy in regard to these matters.

In cases of equity participation foreign firms that are 100 p.c. export oriented are allowed to retain 100 p.c. equity ownership. Companies that are entirely dependent upon the local market for their sales are required to have a 50 : 50 or 51 : 49 equity structure for their project. Foreign companies that export

a substantial portion of their production can negotiate on the exact ratio of equity participation.

For licence fees the Government inspects the draft agreement between foreign companies and Malaysian private sector parties to ensure that there are no unreasonable conditions imposed on the local parties due to the general weakness in their bargaining positions and also to advise the companies as to existing rules and regulations.

The bringing in of foreign personnel for setting up a project and training Malaysian staff is allowed liberally. However, firms are required to submit a programme of Malaysianisation whereby local skills will be trained to take over from foreigners. However, any such project will be allowed a number of key posts to be retained indefinitely by foreign personnel if they so desire.

Other LDCs have developed similar or different methods in approaching these problems depending upon the nature of the needs and aspirations of the individual countries.

In conclusion, the function of multinational enterprises in the economic development of LDCs is recognised as being crucial to the speedy development of these economies. The aggregate benefits they bring often outweigh by far the direct benefits of specific investments. However, such multinational enterprises must also recognise their individual and collective responsibility to these countries. Within the context of this mutual respect and understanding of the needs and aspirations of both the multinational enterprises and the LDCs, one can predict that such enterprises will continue to play an important role in the economic development of LDCs for some time to come.