The Multinational Corporation in the LDC:

Is There Room for a Broker?

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Due to the memorandum form of the papers from which this paper was drawn, the reference credit list is incomplete. I wish, therefore, to give credit to all the material listed in the bibliography, while taking sole responsibility for this paper.

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This paper will attempt to find the direction from which some brokerage function might be introduced between the Multinational Corporation (MNC) and the developing country (LDC). The concept of a broker itself is not fully developed at this point. A variety of views of the strength or powers to be possessed by this broker will appear in the paper in the course of the examination of current ideas, but basically the author has assumed the role to be one of a mediating third party and information source for both the MNC and the LDC.

The paper will attempt to describe the Multinational Corporation, its size, behavior and effect upon its environment. The latter includes the monetary and fiscal policies of the host country and its public image in the host country. The state of the environment in the LDC depend on visceral variables such as public image of the firm or the balance of payments of the country and reactions to the MNC as a perceived perpetrator of imbalances. Other variables governing the reactions of the LDCs and the MNC include the sense of social responsibility of the host government and the regional unity of the area. In a group of countries where there is competition for common outside factors the MNC is in a position of strength, able to bargain for the conditions it can best use. The effect of the Andean Pact demonstrates that there is no need for exceptional conditions to attract investors and that regional solidarity will bring greater bargaining strength to the LDCs.

One of the more problematical aspects of finding solutions to the MNC - LDC issues is one of philosophies. That of the Western businessman, to be specific. He traditionally believes in laissez-faire and the right of an industry to the resources which it uses. The technology of the firm is likewise seen as the property of the firm. There is no traditional sense of responsibility to the outside world; little remains of the sense of responsibility forced upon a company by traditional English law. Formerly an obligation of performance of services to the people or the state, and the benefits to these, had to be argued before incorporation was granted.

Most corporate men have a sense of mission but they tend to see the corporation as a bearer of growth and social benefits. The good is seen as a natural by-product of the corporate system. The desire for a world-wide optimization of resources is the logical extension of the corporation but this comes at a time when the world requires a maximization of labour and resources. Optimization does not take care of the inefficiencies which constitute the real underdevelopment problems of the world. Regardless of the truths in the corporation argument there is profound lack of understanding between the LDC and the MNC. The important immediate role of the proposed broker would be to bridge this gap.

THE MNC: WHY IS IT?

There has been, to date, very little attempt to form a theory of the Multinational Corporation which will explain the direct investment phenomenon. Firms engaged in direct foreign investment operate, in fact, at a disadvantage relative to their host country competitors. They incur additional costs associated with the management of an enterprise at some distance and, further, they suffer political risks by operating abroad. Yet there must be advantages which cause firms to decide to locate abroad. A 1969 report by S.E. Rolfe [1] for the Congress of the International Chamber of Commerce reported direct foreign investment totalling about $90 billion, of which $60 billion was American and of which only $10 billion constituted foreign investment in the United States.

The popular explanation follows the Servan-Schreiber [2] thesis. This gives credit to the American management system and heavy government support of research and development. R.Z. Aliber [3] sees these advantages as internal to the firms and to some extent he feels they might be purchased by foreign firms, at least by those well established in the developed countries. Other advantages he discounts, however, are external to the firm and are inherent in the American environment. These advantages are comparable to those that other countries might have in the form of lower wages costs, and should be neutralized by the exchange rate. Such explanations Aliber finds to be inconclusive. He seeks, rather, the American advantage in factors which, cannot be acquired on comparable terms, and will not be neutralized by the exchange rate.

Aliber finds that the usual explanations of the rise of the MNC lack elements of "foreignness", that they do not include any of the factors that distinguish national economies, participation in customs areas, currency areas and tax jurisdictions. The theories are usually not direct foreign investment, but rather theories of growth of firms applied to an international economy. He feels that the key factors are really capital market relationships, exchange risk and the market's preferences for holding assets in selected currencies. These latter factors have a unique international element and are based on different currency areas. In his thesis it is the bias in the evaluation of exchange risk which determines whether a country is likely to be a source country or a host country for foreign investment.

The corporate form has certain characteristics itself which give it extraordinary advantages as a vehicle for doing business. It can count on perpetual life, it can hope to attain unlimited size, it can bear children or generate siblings, and it can endow each with such nationality as seem appropriate. It its Multinational form the corporation is able to increase the efficiency of transportation and communication with a resulting improvement in the capacity to develop and execute a strategy that embraces the activities of far flung members of the group. This allows increased speed of transfer or acquisition of knowledge in research and development, or even of important factors of foreign environments where the firm operates. J.H. Dunning [4] finds that the American subsidiaries in Great Britain have access to more knowledge and expertise at a lower price, they tend to be more capital intensive and their factor inputs are deployed more intelligently and effectively. They have advantage in better marketing and are able to demand higher academic and technical qualifications from their middle and top managers. Further to this they are more pragmatic, are willing to challenge convention, make more professional evaluation of risks and are better at eliminating waste.

The firm which comtemplates going international needs, ideally, to create a monopoly environment; it is this which will give it the advantage necessary to help it overcome the foreign factors of production, the foreign market, and the problems of operating long-distance from the centre of control. Vertical integration represents a form of monopoly; exploited in resource-extracting it is an international dimension of economy of scale where activities of the firm in several different countries are coordinated. In the case of oil, for example, it is separation of the production, transportation, refining and distribution. The economics of vertical integration involve the reduction in transaction costs, the costs of research and of holding inventories.

Of most direct and sensitive importance to the developing countries are the MNC's involved in extractive industry, Petroleum, minerals and base metals constitute nearly one half of the total value of the primary commodity exports. In 1964 they had an export value of $14.4 billion out of a total primary export value of $30.4 billion. The UNCTAD projection of the three commodities gives them a value of $30 billion by 1975, this is contrasted to a projected $20 billion worth of agricultural exports. In 1964 petroleum alone brought $10 billion or 31% of the total exports of the developing countries. Copper, iron, tin and bauxite are in the top few exports; except for tin all of these are in the hands of large international companies. American investment alone represents over one half of the value of total foreign investment in petroleum and about one half the value of foreign investment in mining industries in the developing countries.

Most of these petroleum and mineral outputs require the large international companies to explore, develop and market the resource. The standard system has been for the company to acquire a concession, giving it exclusive rights to explore in a particular area, and to develop and produce the minerals or petroleum found in that area for a stated number of years. The company generally pays state royalties on the minerals and taxes on the net earnings from its operations <u>within that country only</u>.

The latter point is the companies' unwillingness to consider their total gain, through their integrated structure from the resources of the developing country, and to pay accordingly. This is coupled with the troubles of the developing countries as they rely increasingly on fewer resources and the decreasing market values of these resources.

The most striking feature of the MNC today is its rapid expansion in recent years. In 1914 90% of all international capital movement took the form of portofolio investment, with direct investment held by American firms in that year totalling only $3.9 billion. In 1935 $7.2 billion, in 1950 $11.8 billion and finally in 1967 American firms held stocks worth $50 billion abroad. In the 1960s up to 1967, American investment of this kind increased by $22.4 billion. World international investment at this stage was, furthermore, increasing at two times the rate of World trade. In 1967 the value of American subsidiaries and branches were more than five times the exports of American manufacturers. The National Industrial Conference Board in the U.S. has predicted that by 1975 these same branches and subsidiaries will account for 25% of total world gross national product outside the United States.

When a company is allowed to operate as a subsidiary in a developing country it should be aware of the demands that will be made upon it in time. The first of these is within the concept of the knowledge it holds as its resource. While at the outset the firm may be accepted as holding rights on technology or method that it developed at home, this will lessen in time. The concept of private ownership of knowledge does not survive the actual discovery of the knowledge. Philosophically it is counter to modern thought that a man should have exclusive right to what might benefit the majority. There should, therefore, be a definite limit on the time of exclusive right to such information. Similarly, and on the same basis, the degree of ownership and control by foreign investors should decrease with time. As the unique importance of the contribution of the foreign investor decreases, so should his degree of ownership and control. The same decreasing control should be accepted as locally owned profits are pumped into the subsidiary; the profit re-investment capacity of the foreign firm would otherwise allow it a totally disproportionate power in developing countries. It may be necessary to work out a system of gradual disassociation of financial and policy control. This could be worked into a time table allowing for eventual local private or state purchase of the firms, or a partnership arrangement.

The Multinational Corporation is going to have to make concessions. It will not be allowed to run free in the developing countries, it will have to learn to understand new concepts of ownership rights, of rights to knowledge. It may find increasing difficulty in creating vertical integration throughout its system and when it does it may be required to provide a market for the developing countries' competing industry. The MNC does in fact, supplant many functions of local development and badly managed could replace development. Any developing country's government must be dedicated to development and cannot allow it to be replaced by foreign interests who regard it purely as a source of resources and energy. The multinational corporation by being transplanted into the developing countries is assisting them to jump directly one industrial generation. It would be reasonable to propose that the firm should be allowed approximately an equivalent length of time to profit from the new territory. In 25 or 30 years they should expect to be playing quite a different role in these areas. If the firm was to do its accounting on a time basis of an industrial cycle rather than on an annual basis - which is a centuries old tradition based on an agricultural economy - there would be more room for understanding the problems of the developing country.

MNC-LDC: FEARS, FANTASIES AND FINANCE

At times there is expressed a curious unity of view by the governments of both the developed and developing countries. They both are distressed by the ability of the Multinational Corporation to isolate itself from their policies. Both fears or laments are exagerated for if this were the true situation the MNC would be responsive only to itself. A paper prepared by the Division of Public Finance and Financial Institutions of the United Nations Secretariat [5] explores the "discretionary freedom of action" which allows the MNC to insulate itself to some extent from the policy actions of the governments to which it is subject. There is generally easy agreement that if the involved governments could coordinate their policies the MNC would be subjected to all the policies and no longer impervious ot the monetary policies of the host country. It is often claimed that the MNC is able to continue operating oblivious of the monetary policies the host country may try to impose on its own economy. The host country may, for example, decide to reduce credit throughout its economy or increase corporation taxes. Both of these policies may be evaded by the MNC by capital input from its parent in various forms or by shifting profits to a lower tax area of its activity. There are various tools the MNC can use, the issue here is to find out its likelihood of using them and the actual detrimental effect they may or may not have on a developing economy. Typical arguments against the MNC include its imperviousness to import controls enacted through tariffs and quantitative restrictions, they are further accused of placing restrictions on the undertaking of exports by its subsidiaries. With its own private sources of exchange the MNC is accused of detouring around exchange control and also of being able to protect itself from any foreseen devaluation. There is fear and resentment of such a powerful economic entity which appears to be able to operate with such a large degree of independence within the host economy.

The MNC does, in effect, have a wide range of weapons to suit its needs. It is free to set prices to suit the location of profits and the consequent taxes. It is able to transfer profits throught royalty charges, management fees or other forms of capitalizing the subsidiaries, such as by mixing equity and debt to get the best tax advantages. One form of providing capital for a subsidiary, for example is for the parent company to under-price capital equipment and managerial services in order to allow it extra cash for expansion.

With its tools the MNC is able to dictate where it wishes to pay taxes and where it will direct its cash flow. It is able to create a network of debtor and creditor relationships between different elements in the multinational system and within many financial markets. The MNC can manipulate short and long-term debt and open-book credit on accounts receivable and payable on accrued but unpaid roylaties and management fees. In each of these the

MNC is able to decide whether or not to pay interest or the speed with which it shall be paid.

What is less well known is how national firms have the same tools with which to work, in fact much smaller national firms than the typical MNC are able to use these to considerable advantage. The national firm generally has institutional means of under pricing, especially in countries with exchange controls and high tariffs. The basic difference however between the case of the MNC and the national firms is that the methods of transfer pricing of the former shifts the taxes and tariffs paid to another jurisdiction, whereas the latter avoids these costs altogether. The national firm has the further freedom of buying and selling commissions on its purchases and sales and uses these for tax reductions in the same manner as the MNC uses royalties and management fees.

The point of the Public Finance report should not be to excuse one behavior in the light of that of the other but rather to point out the complexities of the situation. General sweeping regulations will effect too many parts of the economy without taking into account the possible benefits of earlier legislation in favour of certain sectors. The point once again should be that individual cases should be negociated in the light of the increasing knowledge of the multinational Corporation.

National policy makers often feel that the MNC policy will counteract their national policy. The UN Division of Public Finance report finds that this is not necessarily the case. The report finds that it is not at all clear that the MNC will bring in funds from abroad, in cases where it fears devaluation it may, in fact, attempt to move funds out in order to reduce accounts receivable and reduce its assets in the local currency. The report sees the possibility of the normal hedging activity of the MNC reinforcing the monetary policy of the host government. The fears that the MNC will transfer its profits if the host governemtn raises its taxes are not necessarily realized. Where local taxes are lower than U.S. taxes the profits go as dividends to the U.S., with no tax savings at all in most cases. There is a converse situation in which the revenue profits to one country may be transfered to another by the former raising its tax levels and causing MNCs to transfer profits.

In matters related to a country's balance of payments there are fears of the MNC's ability to evade import controls. There is a common assumption that tariffs or certain kinds of import restrictions will cause a reduction in the transfer prices that a company charges the subsidiary, this is true only if there is no control on profit remittances. When these are restricted transfer prices may well go up, on the other hand as pointed out earlier, if the subsidiary is to expand and if there are restrictions on capital export in the parent's country, or on capital import in the host country, it is likely that transfer prices may be lowered to facilitate lower cost and higher cash flow and higher retained earnings and investment potential. Import restrictions may motivate import substitution production and may bring about a rise in transfer prices.

On the export side indeterminacy is equally large, it is often argued that the MNC limits the amount of exporting its subsidiary may do. The converse to this is found where the MNC makes its own internal market available to the subsidiary, thus eleiminating the usual marketing costs. A fully integrated manufacturing industry, where subsidiaries export components to the parent plant, is the ideal example of the latter.

With devaluation there are conflicting tendencies, the MNC may hedge and hasten the crisis in anticipation of develuation. On the other hand if it anticipates restrictions on imports it is likely that the MNC will generate offsetting capital inflow. Such generation of heavy capital inflow will reduce the balance of payments problem.

There is a real need for greater knowledge of the empirical behavior of the MNCs in order to forecast their possible reactions in different situations. Some of their policies and actions are inimical to the developing countries, some are reinforcing and some are even neutral in effect.

There is a whole maze of possible interactions in a MNC system. The transfer price is the basic tool usually set at a level which will allow the highest after-tax earnings and set lower in countries with lower corporation taxes than those with higher corporation tax rates. Transfer prices are lower, on the other hand, where there are import duties.

Developed Countries have high corporation tax rates and low import duties, LDCs have the reverse of this, thus on corporate tax accounts the transfer price will tend to be high in DCs and low in LDCs. In addition the pricing will take into account the possibilities for shifting funds. If there is exchange control in a low tariff area it may still be in the interest of the MNC to fix a high transfer price. This will require it to pay a high tax but will provide it with a vehicle for the remission of profits. The cash situations of the participating companies should be a major consideration in assessing their likely behavior.

There are other variables which result in the setting of transfer prices, the inter-company receivable related to the purchase price of the goods and inter-company interest chargeable related to receivables have their effect. The amount of short and long-term loans, the former usually related to the sales value and the latter to the capitalization of the enterprise may also be reflected in transfer prices. Transfer pricing is more than just finding the lowest corporation income tax, it involves the whole equilibrium of the firm and is used as a tool rather than just as an occasional evasive ploy.

The complexity of the situation is further illustrated by the use of intra-company loans within a multinational corporation. These loans are used in lieu of purchases of stock to avoid paying dividend taxes. The repayment of principal in loans is a before-tax operation whereas the remission of dividends of an equivalent amount comes after tax. Dividends, then, are a much more expensive way of remitting funds than the repayment of loans. As a result loan capital is maximized and equity holding by the parent compnay is kept low.

CLASSIFICATION BY SIZE: A HARVARD STUDY

The Harvard Business School study has been examining 187 Multinational Enterprises which met a common set of criteria in 1965. Each of the firms is listed in the Fortune 500 and owned 25% or more of individual manufacturing subsidiaries located in at least six foreign countries. The firms in this list control 80-90% of all U.S. foreign direct investment. From this list of 187, 39 were selected for intensive examination. In this group each firm had manufacturing facilities in 6 to 33 foreign countries. In total these 39 represented 15% of the entire U.S. foreign direct investment, produced foreign sales in a range from $20 million to several billion and total sales valuing from $100 million to many billion. This group represents the MNCs which cause concern to the developing countries. The Harvard interviews with these 39 companies covered the whole array of corporation problems, making the initial investment, financing foreign subsidiaries withdrawing funds, managing current assets, protecting against exchange risks and measuring performance. The Harvard study made the important discovery that the level of foreign sales of a MNC was a good guage of many vital aspects of the firm's overseas activities, that there is a "significant relationship between foreign sales and the financial actions of the firm".

The Harvard study has divided the MNCs into three groupings. Those with foreign sales of about $50 million are listed as small MNCs; this group's foreign sales represents about 18% of their total sales and the members have, typically, manufacturing concerns in eight countries. Companies in this group do not have central financial staffs in headquarters to attempt a systems optimization approach. These companies operate, rather, on a decentralized system with relatively small subsidiaries and small financial staffs. The subsidiaries function without interference from the parent's headquarters as long as its operations are satisfactory.

As a firm's foreign sales level increases, the system of operations appears to change. At about $100 million total foreign sales a larger central staff is set up to make the financial decisions for the entire system. The turning point to this centralized system was found to be the occasion of some shock hitting the system such as by an inept action and resulting losses by a subsidiary. The responsibility of the central headquarters means a tighter reign, with the smaller overseas staffs implementing regular instructions. These medium sized MNCs have median overseas sales of $200 million, representing about 29% of their sales and have subsidiaries in an average of 14 countries.

As the MNC grows there are too many variables for a central headquarters to control, so that the policy changes to one of creating guidelines with the responsibility for financial management being returned to the subsidiary. In this case the subsidiary is large enough to support a staff which makes the financial decisions. The central parent staff is not reduced but issues guidelines, coordinates subsidiary actions and monitors the results.

As the MNC grows to a total foreign sales of approximately $500 million it enters the "large" category. At this scale the foreign sales represent 30% of the company's sales and the subsidiaries are spread through 21 countries. At this level foreign sales average $1 billion per annum. The large MNC apparently would like to optimize as the medium sized corporation does but it is too complex. It tends to be concerned with its public image and is unlikely to explicitly thwart government policy.

A ROLE FOR THE MNC IN TECHNOLOGY TRANSFER

Technological change in the industrial countries had an accumulative effect, with technical change in one area leading to a series of changes in other areas. It was, and is, a gradual and organic process with real synergy effecting both the supplies and the consumer sectors. In contrast to this the developing countries have until recently been dualistic economics "on the technological periphery and technologically static". [6] As an example of the lack of ongoing synergy in technical matters in the developing countries is the lact of everyday encounter by children with technology. A child in these countries is not normally exposed to machines and high technology, he does not develop a questioning or enquiring mind on these matters on his own. At this level where there is a lack of everyday confrontation with machines it is up to the schools to provide the interplay and make the contacts between child and machine.

The Multinational Corporation is capable of functioning as an international innovation system; without any real conscious attempt to do so American companies have become international specialists in the management of technological change. The most successful firms recognize in their system approach that technical innovation is the end result of many disparate activities performed by different groups of people. It is dependent on linkages among the various activities and groups and it is at its most productive when its many elements are oriented towards a common set of goals. The technical research of the firm is characterized by basic and applied research in the laboratory. The output of this research are ideas, discoveries and inventions that show technological promise. The development phase following the research takes this and transforms it into technology.

The corporation, furthermore, has an ideal structure for the job of transferring technology. It is a functioning body with market and communications networks. In any country where an MNC operates a manufacturing or resource extraction plant it has the machinery for spreading technology, for teaching its methods and promoting development. This development covers personal development of the individual to the more general development of the industry of the host country. The latter must start with the former in order to create the base for the industry and further development.

Technology in Economics tends to be ignored. Economics, in particular trade economics, is concerned with directions of trade and the volumes of trade. It concerns itself with the static factors which rely on overall trade increases, of changes in trade patterns but not so much in the more difficultly recognized growth patterns caused by changes in technology. Technological changes should be seen as an economic factor in most economic studies, with the results reflected in employment levels and patterns. In the case of international trade it is a very definite factor of growth. It is a part of the dynamic character and growth pattern of the environment in which the Multinational Corporation operates. It is possible that the growth potential seen by Judd Polk in developing countries is due to the process of catching up that they are going through. Along with the cheaper labour and cheaper resources, an on-going advance in technology will increase efficiencies and increase production. With the growth of a technological ability in one field will come spontaneous development in others, hopefully some diversification and thereby an increase in trade. It is through new technological capacities that the LDC will be able to decrease its reliance on too few of its natural products and a straight export trade. The LDC must be able to carry on more industrial processes at home, it must seek to employ more of its population in the secondary industries related to its exports and it must learn the market complexities of the countries in which it does business. The MNC can still profit from the growth potential of the developing country, it can still get onto the economic escalator while allowing the developing country to grow. The MNC must not regard the developing process of the LDC as a permanent condition of which it can take advantage. The rapid growth experienced by the developing country and as profited from by the MNC is a temporary process. It is a condition, which the MNC is able to fill and aid but is only a condition which represents the process of growth.

The role of trade and industrialization is a basic issue of any development theory dealing with national development. Baranson [7] found a very fundamental conflict in views based on static comparative advantage versus positive measures to foster domestic industries through import substitution, the former emphasizing current income maximization, and the latter long-term growth. The differences in the strategies implicit in the two views depend on the evaluation of the transformation capabilities of a developing economy and the need for restructuring the marked supply and demand as a prerequisite. In a more recent article Baranson [8] sees the International Corporation as having emerged as an important instrumentality of resource allocation in the world economy. The corporation has grown beyond the classical concept of market mechanisms. Now the major factors influencing the pricing and allocation efficiencies are how the contracting parties view the costs and benefits of technology transfer and the competitiveness in donor and recipient markets. From this Baranson feels that it does not necessarily follow that the intensification of technological dissemination will lead to more effective utilization of world resources. There is, in fact, a likelihood that transfer induced by the protection of national markets increases the overall resource costs of world production and nurtures technological stagnation. If there is flexibility, however, on the part of international enterprise in choosing other modes of transfer there can result a wider dissemination of technology and a better resource utilization on a world scale.

With the rise of the MNC has come new relationships. Earlier trade involved non internationally traded services and commodities which were not available in the developed countries. Now, with the MNC there is an opening production choice in the LDC for foreign and regional markets and the possibility of shipping the technology and productive factors to make the product there. The technology factor is an important one for the LDC, along with the lack of managerial skill and reliability which are often more urgent problems than the lack of capital.

Developing countries are demanding more in the way of technological transfer. It is often not defined in the demand but there is a general sense of magic within the term. Innocent LDC civil servants may comment that the fault lies in the DC policies or even go to the extreme of the man heard at lagos airport. Watching a Boeing 707 taking off he commented that were it not for DC restrictions on exporting technology the Nigerians would be making the planes themselves. While this reflects a lack of understanding of the complexities it reflects also something of the advantage of advance possession of technology, and the momentum of technology.

The LDCs will have to look more at their own resources their product range and the factor mix in adjusting to the appropriate scale for the market. In consumer items savings can be made in early stages by limiting the range of colour and quality options in order to adjust these to the raw materials. The very adaption to their conditions gives the LDCs the experience they need in building industry. Too rapid changes to Western machinery may prevent the small necessary changes for the local markets.

The automobile industries of Japan, India and Mexico are quite different in capacities of quality control, level of technical sophistication and engineering capabilities. Their research and development capability to adapt local materials and skills are also dissimilar. The Japanese automotive industry is geared to the American market while the Mexican is intended for local needs. In South America the auto industry adapts higher levels of assembly production of imported parts and adaption of locally available materials. Upholstry, for example, in the Brazil Renault plant was switched from rubber to more cheaply available local stuffing. At the same time some of the sheet metal parts imported from France were altered in shape to allow for better stacking on ship board. While both of these were foreign adaptions by a foreign firm they represent the kind of alterations that might be initiated by the LDC industry.

When an LDC confronts the problem of making choices between accepting a straight subsidiary, a joint venture, or a licensing arrangement with a firm, the question of the method of transfer of technology will be of paramount importance.

Joint venture will usually bring the technology of the home plant to the host country. In a chemical plant or a synthetic rubber factory, such as that run by Polymer in Mexico in conjunction with the Mexican government agency, the technology is always three or four years behind due to the incubation period of R and D at the Canadian Plant. Once again the Mexicans also demanded a high technology plant for Butadiene rubber which is now using an obsolescent technology to produce rubber for a saturated world market. [9] It is apparent in such a case that control by the Mexicans can be undesireable for their own interests as they are not aware of, or choose to ignore the true market situation. A foreign corporation involved in such a minority interest of a joint venture lacks the board room control and even interest to prevént such mistakes. The solution to the market problems is the one to seek, and this does not appear to be near at hand if UNCTAD III is any indication.

In a licensing venture there is again a problem of up to date technology as any agreement can only include present technology. Polymer was able to make an agreement along these lines with South Africa but when it pulled out later South Africa had the wherewithall to continue production and research. An LDC lacks the industrial infrustructure and market on its own. Multinationals are usually willing to enter into licensing agreements in developing countries as they feel there is less threat to their market areas from these countries and that there is less likelihood of theft of patented knowhow. Once again a restructured world trade system would alter this pattern of technical transfer.

While the developing countries are crying out for technological transfer and production facilities there are very real and severe problems to be confronted in providing both of these. Import substitution, without an assured and sufficiently large market, may lead to a small scale high cost industry for a small domestic market, artificially insulated from competition. There is a danger that such an industry will be self defeating as it spreads the scarce resources and the technical and managerial abilities to run the plants. There is even a further possibility that it will generate demands for importing parts as the national industrial infrustructure may not have the capacity for all the necessary components of the finished product. By spreading the high costs and inefficiency throughout the economy, import substitution policies may, on occasion, have the effect of pricing domestic industries out of world markets.

These drawbacks to technology transfer apply in particular to those industries which operate in the developed countries in capital intensive and highly automated forms. The Baranson Cummins Diesel study demonstrated the higher production cost of individual finished machines. The higher rate of rejection caused by inexperienced workers, the less precise work by men where machines normally did the work in the DC and the workers' less disciplined attitude to working with the machines all contributed to higher costs. The finished diesel engine cost more than an imported engine would have cost. The question of alternative sources of engines must be asked when production facilities such as that by Cummins is being examined. Patterns of industralization and rates of industrialization must be considered within national policies and regional policies. Production techniques adapting plants to small scale operations must be made to reduce capital expenditures intended in developed countries for high volume runs.

Innovation must be used in both the adaption of production methods and in the finished product design, the latter extending even to the scale of the machine. Where one Mexican bus company built the bodies from locally available materials in a labour intensive plant a Turkish tractor plant made changes in engine design. In the latter case the oil sump of a tractor for use on rough, steeply inclined roads was shaped differently in order to allow full oil circulation, with the motor at a steep angle. Similarly in another production innovation in India, several welders did the work of what would have been an expensive oil sump press in a Detroit plant.

On the other hand a capital intensive highly automated plant makes sense in a fully developed market. Pharmaceuticals in India are a case in point. The present Indian market warrants high scale production run as efficiently as possible to reduce costs of medication. This as a choice over the use of labour intensive methods in a high employment policy. The economic theories are complicated by political necessity and lack of regional coordination. National scale plants are used where regional scale would be more efficient, and high employment is sought where market saturation and low cost to the consumer should be the primary social policy. Political divisions push expensive production plants into areas where one larger scale plant would better serve. A new Nigerian automotive rubber plant competes with a Kenyian firm for the same regional supply and market. In Canada and the US, political forces push Polymer to produce from several smaller plants what would be more economic to them to produce in one world scale plant. Economics founder in the face of political and social demands. Once again the broker-liaison office is seen as a necessity.

Any LDC country bargaining for technological transfer should look into a country's motivation for foreign operations. If there is a scale factor at the DC manufacturing level which forces the company to move abroad the LDC may have a strong case for some demands as the company needs the new market area. However the needs of the company should be kept in mind as a small shift in policy for the company may mean drastic changes for the host country. Australia, for example, was badly hit when GM decided to move its production facilities for the Japanese market from Australia to California. Japanese cars at the same time continued to flood the Australian market and produce a very important imbalance of trade with that country.

Where small scale industry cannot always work in satisfying the requirements of modern market structures and mass production it may well serve a very useful purpose in parts of the developing world, or at early stages of their industrialization. In the Japanese practice firms as small as ten or fewer men are able to co-exist with huge corporations. (In 1968 14.5% of the Japanese labour force was in small firms of 4-49 workers) 10 They are able to perform well because of a good infrustructure; transportation is reliable, and there is good access to the auxiliary services such as dyeing, mercerzing, electroplating and case hardening. While the conditions which allow this system to function successfully in Japan do not exist in all developing countries, an attempt at creating the resultant structure may be a solution in some areas aspiring to industrialization. Singapore already has industrial parks reserved for small scale industry with the necessary services provided to make them a useful part of the island's industry. Whereas infrustructure has traditionally been seen as a necessity for growth of industry it may be cheaper and easier to bring the small producer to where infrustructure can be provided. The slum areas of the large LDC city must be full of potential small industrialists. The services are nearby, the transportation is available and the labour is there. This may well be the solution with the best social implications.

The multinational firm is in a unique position to incorporate design parameters drawn from the developing countries into other world requirements. Baranson reported that Cummins Diesel has been able to adapt their Indian engine model to several other uses. In the U.S. it serves as a stop and go urban delivery truck engine, in South America it powers a line of small trucks and at the time it was planned to use it in a new line of British economy cars. While new technologies and adaptions can move out from the developing countries, the results of new scientific work can also create new industries. As a reversal of the problematic synthetics industries we have the example of the Kenyian Pyrethrum flower crop which will help offset the uncertainty of the coffee and tea cultivation in the Kenya highlands. These kinds of programmes require a combination of technological and marketing research which is generally beyond the capability of the local LDC firm.

The problems that the LDCs have in getting the new technologies are not so much caused by an evil monopolistic plot as by dichotomous forces in action within the LDC and the MNC. Within the MNC, on one hand, are the pressures to react to the market and to make decisions on the basis of what is in the interest of the firms. In the LDCs the constraints are more subtle, these countries lack the abilities to shift or adapt resources and techniques in response to the changing conditions of demand or supply. While one party reacts to the market the other is prevented from making appropriate decisions and changes on the same market conditions. Only a very determined and specific technology programme and policies will be able to help the LDC.

The industrial and agricultural progress in the highly developed countries is a result of investments affected largely by autonomous entrepreneurial units in response to market prospects, and to a lesser degree by consequence of government investment motivated by social demands. Recent industrialization involving the technology of consumption has required infrustructure investments in order to facilitate opening the markets. A country with poor infrustruture requires a much higher investment in development of these lines of communication, and a means to bypass the infrustructure which is largely that of the MNC or local business interests. Short of the LDC having its own very expensive capacities in this area, an international broker might well serve to bridge the gap.

THE COMMERCIAL STRUCTURES: THE EXPERIENCES OF THREE AREAS

Different types of commercial structures provide solutions to specific problems of MNC - LDC relations. The problems are common but the various perceptions of importance depend on social and economic factors. The contract, the joint venture and straight subsidiary have their peculiar traits and provide solutions for different problems. Commercial arrangements can be arranged by the governments and corporations involved and can be designed according to need. The following section demonstrates the uses made of the three by several developing areas, each with its own historic background of colonialism, and each in different stages of social advance. The three methods will not solve the problems of negociation, in fact the MNC tends still to have the upper hand, but an understanding must be had of these before there can be a change in the bargaining processes. While any country may attempt policies to better control the situation, it is important to examine the behavior parameters of the corporation.

The three sizes of these corporations have different financial behavior. The small MNC is less likely to invest more in its subsidiary once it is started, it is expected to grow on its own earnings and borrowings. Interest is usually charged on inter-company accounts and it is less likely to make loans to make up for local restrictive monetary policy at the location of the subsidiary. The small MNC receives funds from the subsidiary mainly as dividends, as technical and management fees are not usually significant. The behavior of this type of MNC is similar to that of the national company without extensive foreign contact. It presents no real problems for national economic policy makes other than transfer of profits or repatriation of capital.

The medium sized MNC, with its concern for optimization, takes interest differentials into account in financing its subsidiaries. It is less likely to borrow, as the parent will provide funds when this is necessary. There tends to be an ad hoc system of shifting funds between subsidiaries or to the parent depending on the potimal choice for the hole system. Profits, for example, are shifted from high to low tax countries. The centralized system results in the use of dollars in monitoring anc controlling the corporate network, with the parent acting as a clearing-house to purchase the necessary foreign exchange. It expects to borrow from the parent with the result that a credit restrictive policy of the national government will not have too great an effect. With its interest in potimization of its operations it is the medium-sized firm which may be most troublesome to the developing countries.

The large MNC operating as it does with guidelines from the parent does allow some measure of subsidiary independence. The Harvard group found that these large firms tend, as policy, to let equity equal fixed assets. This is in order to forestall complaints over home country loans or over their obtaining a large return in relation to the original equity. Such a policy gives the subsidiaries more independence and makes it easier for them to obtain local loans at a later date.

Loans from the parent of a large Corporation are likely to be paid off rather than converted to equity. In the face of a sudden local currency risk the large MNC is likely to defer local payments and accelerate its collections. The size and power of the large subsidiary enable it to do this more easily than the smaller MNC. These large subsidiaries provide cash for payment of domestic dividends,doing this on a set percentage rate rather than on an ad hoc basis.

LATIN AMERICA

Latin America provides a good area study of direct private investment, and the reaction to the problems it poses. Investment is still very light in the area, totalling only $14.5 billion in 1964, or considerably less than either Canada or Europe. Venezuela alone holds about 35% of the foreign investment in Latin America and most of this is in oil. Argentina, Brazil and Mexico together held another 35% and Peru and Colombia 10%. The rest is divided among twelve smaller countries.

Modern technology is controlled by the big corporations and from the point of view of the Latin Americans they are being charged too much for this technology through licensing arrangements, which the corporations, on their side, feel to be a capital contribution on which profits are to be made over a long period. The alternative to the developing countries would be a second class technology but this would perpetuate backwardness and claims of technical colonialism. In Colombia there is a particular sensitivity towards this kind of exclusive rights, for earlier forms of capitalism were represented by the big landowners. These people owned the most profitable land, and like the modern MNC payed little in taxes while controlling agriculture and industrial credit. There is no law or power in the state which can stand against the monolithic advance of the MNC, so the modern fears are certainly well grounded in past experience. The new corporations are unwilling to share ownership by the sale of equity on the incipient Latin American capital markets. The countries feel robbed of profitable opportunities in their own home, in fact the foreign corporations are able to get short and middle term loans from the local banks making capital scarce for local interests. In the inflationary economies of South America credit is hard to get in the strong competition for it, so that the big foreigner is able to rob the local even at his own bank.

The MNC is unwilling to share management, in fact R. Vernon found quite explicit reasons written out for corporate excutives of one firm. These included an arguement against joint capital ventures for the restraint which they impose on the international corporation's efforts to maximize its worldwide sales and profits. The firms feel they need to be free to shut down redundant plants, change their product mix, integrate the production of one plant with others in different national markets, or shift the sourcing for some market from one area to another.

ARGENTINA

Argentina has made good use of the Service Contract in its relations with the foreign companies. The Service principle has been a useful means of harmonizing the principle of state ownerships and control of mineral resources with the importation of capital, skills and management of foreign enterprise. In 1958 Argentina signed a number of service contracts for oil as an answer to that country's lack of technical and managerial ability, and lack of capital for rapid expansion of oil output. The Frondizi government (1958-63) used three types of service contracts. In the first, used in drilling arrangements, the foreign companies agreed to drill a certain number of wells for a fee based on depth and number of hours work. The second were development contracts for private companies to produce oil where reserves were known to exist; payments were made according to the amount of crude oil delivered to the Argentine State Petroleum Agency (Y.P.F.) at prices comparable to those in the world market. The third type of contract were those in which private companies undertook the exploration and development in new and semi-proven areas, payments to the foreign companies are made for crude oil sold to the Y.P.F. at agreed prices. In the case of a Shell Oil Company exploration and development contract the payment was made in the form of a portion of the crude oil produced. Between 1958 and 1963 thirteen contracts were made with foreign companies which were providing risk capital, the return to these companies was a direct function of their succes in producing petroleum in the area assigned to them. Except for the Shell contract the Y.P.F. maintained marketing control by purchasing all of the output and then reselling it almost entirely on the domestic market. Argentina provides some security to contractors by the fact that the country has never defaulted in repayment of any loan in the 20th century. The company is not required to engage Argentine nationals, nor is it required to accept Argentine capital participation.

MEXICO

Mexico in spite of its 51-49% ownership regulations, has a system which proves attractive to foreign business by the way in which regulations are clearly delineated. An essentially non doctrinaire approach to question of economic development is conducted by the Nacional Financiera S.A. (National Financing Institution) or NAFIN which is a product of Mexican growth experience since 1934. NAFIN has elements of public and private influence, it is technically a public institution and responsive to the President, yet it leaves much of its promotional initiative to the private sector. This is done even while making heavy committments of public funds. NAFIN is a stockholder, policy maker and competitor in a broad range of activities. It lends money to private and public firms in the same industry; as of mid 1961 the body was creditor, investor or guarantor for 533 business enterprises of all kinds.

It held stocks in 60 industrial firms, was majority stockholder in 13 firms producing steel, textiles, plywood, paper, fertilizers, electric power, lumber and refrigerated meats. Its loans at that time were equal to one half of those of private Mexican credit institutions and its long-terms loans were greater than all private loans together. Total capital invested was thirty times that of NAFIN but it was very important in specialized industries such as fertilizer, iron, steel and sugar refining.

The objectives of NAFIN were spelled out in the law which created it. It stated its function to be that of regulating the securities market, promoting business enterprises, aiding financial institutions, and acting as fiduciary for the federal government. It is further intended to be the advisor and agent for the sale of public securities and counselor to the Comision Nacional Bancaria (National Banking Commission). In its promotional activities it is charged to direct its help to enterprises which use unexploited national resources,.... "which advance technology or substantially increase output in important industries, or which help improve the balance of payments ."

NAFIN has seen three administrations but it can be seen as having been through three stages. 1934-40 was the experimental stage when it tried several roles, rejecting some much in the pattern of the presidency of Lazaro Cardenas and his reforms. 1941-47 saw uninhibited industrial promotion deriving from the stimuli provided by the war. In 1940 Avila Camacho used NAFIN to extend the public Sector into many industries without undoing the reforms of Cardenas. It was obvious by 1941 that the war was going to become World wide with a resultant continuing demand for Mexican agricultural and mineral exports. Imports were slowed by foreign government allocation programmes, and there was a reduced transfer of earnings and inflow of capital in response to fears and taxes elsewhere. This war-time effect resulted in a high level of foreign exchange in Mexico and justification for major industrialization. Since 1947 NAFIN has been working at developing the infrustructure, and providing import substitution.

INDIA

India's colonial experience reflects directly in her direct investment policies. The Industrial Policy Resolution of 1948 sought to define the independent government's attitude toward foreign capital. This was primarily that regulation should be aimed at the national interest and that "The major interest in ownership and effective control should always be in Indian hands." The resolution further specified that legislation..." will provide for the scrutiny and approval by the central government of every individual case of participation of foreign capital to be invested on terms and under conditions that are "mutually advantageous." In cases of compulsary acquisition,the compensation was to be made on a fair and equitable basis.

There has been a recent increase in foreign participation in India which is bringing an increased pace of industrialization. The need for foreign technology and the shortage of foreign exchange made it necessary to permit increased foreign participation. This participation is particularly encouraged where it does not involve majority control by the foreign partner. The pre independence pattern was one of extractive industries but now new investment is encouraged in the processing and manufacturing industries. Since 1962, 65% of foreign investment has been British, 15% American and 1% or less from each of the other countries.

The criteria for decisions on foreign investment in India must be taken from specific cases, as the full policy has been only recently defined. No foreign collaboration, in the form of capital or of a technical nature, is allowed in non manufacturing activities. Foreign interests are, as a rule, also kept out of banking, although some American banks have been allowed.

There is a selective policy of permitting collaboration that is not to be in established industries or where indigenous technology is not available. This has been allowed in the cases of the cotton, jute, cement and sugar processing industries. Foreign collaboration is kept out where it is felt it might jeopardize existing units of the manufacturing industry. In one such case foreign financial participation was not allowed in a cement company where a new process would have rendered the existing competitive plant obsolete.

The third main feature of foreign regulation along with the rule on collaboration and technology is one aimed at alleviating foreign exchange problems. Collaboration proposals where there is dependence on importation of raw materials, coumpounds or spare parts are not allowed. "Tie in" arrangements requiring the Indian partner to buy from the foreign partner are not allowed. Nor is "package" licensing where the Indian partner is required, in effect, to pay for unused patents allowed in any agreement. Collaboration agreements are encouraged in cases which are in agreement with the government's policy of import substitution or export promotion.

India has permitted some exceptions where capital was allowed on special terms. In the 1950's three refineries were set up with 100% holding by the parent companies of the Indian companies. In return for the capital they were protected from nationalization for 25 years and they were exempted from the Industries Act regualtions. These kind of exceptions have been allowed in cases where in major consideration is an export guarantee. In 1965 a nitrogenous fertilizer plant was allowed for this reason, and also IBM was permitted 100% ownership because of the sophisticated technology and the guaranteed export. India would have little choice in the face of a monopolistic company such as IBM in any case. Majority participation has been allowed in areas while India has made little progress - SKF bearings (Sweden), Henley Co. cable (G.B.), Ceat tires (Italy). The criteria has been that they reduce the strain on foreign companies. Companies which were subsidiaries or wholly owned before independence have been gradually induced to accept Indian participation, Hindustan Lever, Unilever (Netherlands/GB) Philips (Netherlands), Pfizer (U.S.), Glaxo (GB). When expansion is involved or further share capital is envisaged there is a trend for the Indian government to use the opportunity to induce the companies to reduce the extent of foreign participation.

A curious feature of the Indian economy is the participation of foreign assistance in the public sector. This technical aid comes mainly from socialist countries but also from big Western companies. Association of Electrical Industries (GB), Alco, locomotive (U.S.), Bauchet, photographic film (France), Nippon Electric (Jappan) Olivetti, teleprinters (Italy). The American Oil Company and National Iranian Oil have been allowed private investment in the public sector in a special exception.

India's industrial base has broadened considerably in the last 20 years so that it can bargain from a position of strength and the Western countries will realize that they are not always the only source of technology. There is a lot more aid India will need from the West, however, if it is to enter the newer technology and research-based industries. Collaboration will continue and expand particularly in instrumentation electronics and petro-chemicals.

SOCIALIST - CAPALIST AGREEMENTS

The experience of Western Corporation in some of the Communist countries might be very useful in seeking tools for international agreement. The problems associated with making arrangements with developing countries are similar in that the local governing body is the state and there is a very strong sense of resources and industry as national property, a concept still very new to the Western businessman or firm.

In Yugoslavia's case, prior to the enactment of foreign investment legislation in 1967, international economic transactions were governed by:

1) A very dogmatic interpretation of socialist ownership,
2) Constitutional and statutory provisions for establishing enterprises,
3) A dogmatic interpretation of the concept of workers self-management, and
4) Statutory provisions under which cooperation agreements with foreign firms permitted only a creditor-debtor business relationship.

The new legislation has resulted in Yugoslavia signing the GATT and passing new investment laws throught which the old interpretation of worker ownership and self management has been removed. Capital is attracted now and encouraged as long as it does not run counter to the development of the economy or to the fundamental philosophy of self management. The partners are free to negociate the division of profits, the method and conditions of the sharing arrangement are to be fixed by contract.

It is the novel system of profit extraction which may be of some use in development of a pattern for the developing countries in their problems. The profits of the investor may be reinvested in the same or another new agreement, but the investor is committed to 20% reinvestment of his profit after tax or to depositing it in a Yugoslav bank at the prevailing rate of interest. The foreign investor in Yugoslavia has the same tax and trade duties as the Yugoslav partner and he must observe the same regulations. He is neither privileged nor discriminated against relative to other Yugoslav economic organizations.

The real advantages to both parties is the increased market opened to the firms, and for the Yugoslav there are the advanced technology and management systems. The Yugoslav also has a new market in that of his partner, and the resulting foreign exchange. The wide variety of present conciliation systems of business arrangements is indicative of the problems. Developing countries appear to perceive their problems in different ways and the variety of collaboration arrangements shows the wide range of perceptions of similar problems.

The Latin American countries have, of late, placed priority emphasis on the need for massive transfers of technology and on the divorcing of these from the inflow of private capital. Licensing is viewed with increasing suspicion as it is seen as a means of evading taxes on profits, the trick used by foreign companies has often been to label profit as a licensing charge or technical assistance fee in taking it out of the country. Other arguments against licensing concerns inter-company licenses where they amount simply to a division of markets for benefit of the international parent or a parcelling out of exclusive rights to sell. Similar objections to licensing have been voiced in Australia and Canada.

Further problems have come from an insistance that the ownership and control of foreign subsidiaries must rest in the hands of their own nationals. The foreign companies' importation of management personnel is seen as a reflection of the lack of local capital participation and confirms to the Latin American mind that foreign owned companies do not want to become an integral part of the local societies. These personnel policies are also claimed to represent a major obstacle to the spreading of managerial know-how in the capital receiving country. Only by the spreading of this knowledge will these countries be able to develop a domestic entrepreneurial class. There has been some experience by American companies with locally recruited managers in Brazil and Mexico. They have, in fact, proven just as efficient, and in some cases the companies did better. Men from home tend to be more expensive, less adaptable, and because they are concerned with their own job security they seem less capable of training others for eventual take-over.

In 1964 the Latin America Fee Trade Area (L.A.F.T.A.) advisory commission was set up to draw together ideas on regulating trade and financial arrangements within the area. Their first recommendation involved the coordination of policies on foreign investment. As the LAFTA members already had a wide range of policies any possible coordination would have to be taken in stages. The first step was seen to require the "freezing" of investment legislation, or at least for no country to liberalize its policies more than the most liberal of the members. From this point the advisory commission saw application of common treatment in three definite fields.

1) The first of these concerned capital movements, the transfer of profits and interest. Royalties and technical assistance fees were also to get common treatment in all member countries.

2) The importation of machinery and equipment not produced in the zone, and needed for new plants or modernization, would also come under the agreements as would

3) The revaluation of assets of foreign owned enterprises for fiscal purposes.

After these initial three areas had been acted upon there would be consideration of, and reconciliation of, accelerated depreciation schemes. There would be tax freezes for foreign enterprises and bilateral or multilateral agreements would be worked out to cover double taxation and convertability.

Of more interest in terms of a serach for precedent in control of direct investment was the suggestion by the LAFTA commission that a permanent consultative organ be set up to act as a watch-dog over foreign investment policies and to "harmonize" them progressively. Such an organ would do the spade work for specific large industrial investment projects which would be intended to serve the whole region. It would promote the use of private capital originating in the area itself in order to generate enterprises producing for the whole zone. To date joint ventures have been started with Mexican and Argentine capital going into the less developed countries of the area. In addition the Inter-American Development Bank is working at becoming an "Economic Integration Bank" to redress, eventually, the imbalance of local private investment and foreign owned corporations.

The solutions to the problems presented by the MNC and its direct investment will be found in larger political structures, larger than the nation state. The MNC could be required to consult with an international body and harmonize the differences between it and the receiving country before making its committment. The body must be credible and yet cognizant of the problems of the corporation. It must represent regional and national interests and yet be able to offer terms which are attractive to the foreign firm.

The International firm must be able to operate in terms of its own world structure and integration. From the point of view of the MNC the drawback of local ownership interests is in that they think in national and not in world terms. They tend to impress their narrowly focused views on vital policies having to do with prices, dividends, employment and the use of plant facilities in one country rather than another, even to the source of component materials. Once the central management of a global company is restricted to the divergent interest of national partners it loses its ability to pursue the true logic of the global economy. George Ball sees the solution to this dilemma not in nationalizing local subsidiaries but by internationalizing the parent. By doing this it is suggested that we will preserve the full economic promise of the world corporations as an institutional instrument of the world economy. This would also be a solution to the MNCs' feelings that they are being increasingly hamstrung and emasculated by national restrictions. The proposed body would be created by treaty of an "International Companies Law", it would be administered by a supranational body including representatives drawn from various countries. These members would not only exercise normal domiciliary supervision but would also enforce anti monopoly laws and administer guarantees with regard to compensation in cases of expropriation. The central operating principle would be to assure the most economical and efficient use of world resources.

Service contracts, for example, solve problems of technological transfer in that the company does not have to sell the rights to the host country. Nor, in service contracts, do the companies obtain ownership of property. This latter is often the most important issue in an ex colonial country where local politicians are quite understandably loathe to allow national property into foreign hands.

The central drawback to service contracts however, is that, as in the case of Argentina, the contracting state agency, the Y.P.F., is obligated to purchase all the oil and market it, while the companies have to produce as much as possible to remain profitable.

The joint venture may prevent disagreements on labour policies, royalties, taxes and in matters relating to the rate of production and marketing which are common in collaborative agreements. More difficult, however, will be problems related to re investment policies or return of dividends; these will have to be worked out in advance. Favorable situations for the foreigner will only be likely when he has exceptional technological advantages or can provide a monopoly market.

U.N. AD HOC GROUP: AN APPROACH TO TAX TREATIES

In terms of the search for commercial and economic constructs which might provide a base for MNC - LDC diplomacy, taxation on an international scale is also very important. Because the MNC is such an important influence upon the economies of its host country, because of its ability to shift capital, dividends and prifits under various forms, the Multinational Corporation might reasonably be subjected to some form of international taxation. This concept is being studied at present by the Public Finance and Financial Institutions Division of the U.N. Secretariat. The intent of such taxes would be more than just restrictive or punitive, they would help to shape the growth of international commerce which falls within the MNC context.

The Economic and Social Council resolution of August 4, 1967 expressed the belief "Tax treaties between developed and developing countries can serve to promote the flow of investment useful to the economic development of the latter, especially if the treaties provide for favourable tax treatment to such investments on the part of the countries of origin, both by outright tax relief and by measures which would assure them the full benefit of any tax incentives allowed by the country of investment."

From this resolution the Council requested that a working group be set up to investigate the possible tax treaties and structures. A group was set up and proceeded to examine the situation within the context of its statement that "Although the flow of private investment to the LDCs is affected by many factors besides taxation the climate for investment is influenced to a considerable extent by the international tax situation". The group of experts stated further that as progress had been slow in the area of tax treaties between the Developed Countires and the LDCs special emphasis was to be placed there.

The OECD draft model of tax treaties, while conceded to be less suited to the LDC - DC situation, was chosen as a framework for the discussions. The model was elaborated upon by various experts from the developing countries.

There are special economic relations between the developing and developed countries. In tax relations between the two it is desired to facilitate trade and to promote foreign investment. In the OECD model the principle is to allow the country of source the primary right of taxation. The host country has only a secondary right.

The developing country members of the working group felt that this forced the host country to give up its tax on investment income in too many cases. It was felt that the developing countries required more leeway in choosing tax policy, their tax incentives are necessary to bypass the protective tariffs in order to put foreign investors on the same footing as local investors.

In the OECD model only profits from permanently established businesses are to be taxed. The developing countries wanted to modify this to cover more businesses. Modern construction methods for example allow buildings to be put up quickly and for the firm not to have to be on location long enough to be considered as permanently established. Any developing country having capital goods installed in factories or having some sort of foreign services such as consultants might have, other wise ,to forgo taxing a profitable business.

Another problematical issue considered was that concerning the taxation of interest. While taxation of loan interest might be quite easily resolved in much the same way as within and between developed countries, that on machinery necessary for development was felt to be in a different category. It was seen by the members from the LDCs to be interest on deferred payment of the purchase price and not as a straight loan, really a difference in philosophical concept. In the discussions on the taxation of interest the questions were which country or countries should have the right to tax, whether the taxation in the source country should be on a net or gross basis and to what extent the country of the lender's residence should relieve double raxation.

In the discussion of the issue of royalties the LDC view was generally that, as the use of patents and technology was essential to them,a mitigation of tax on royalties in the source country would be appropriate. They pointed out that research and development was usually tax free in the developed countries and that the prices were unfairly high in the LDCs for the same products. The developed country representatives on the other hand felt that patents were for the benefit of all and that the costs should be shared by all who benefited. It was finally agreed that taxation on net profits was most rational but that the other mentioned aspects needed more research.

The LDCs felt that dividends should be taxed only by the source country and that if both countries were to have rights of taxation the investors home country should give tax credit regardless of rhe amount of tax that was to be absorbed. The working group agreed that tax concessions by the LDCs only increased the taxation potential of the home government. They felt that there was a need for a tax-sparing credit or exemption by the home government. This system was, after all, recognized as a development incentive in the DCs and should be accepted as such in the LDCs.

The Multinational Corporation is a prime candidate for special tax structures. In dealing with the developing countries the MNC is in a very special situation, one which warrants its own set of rules regulations and taxes. It may well be that the solution to many of the problems encountered in MNC - LDC relations will be found in the tax structures as much as in the commercial arrangements. The problem is basically an economic one, but while it is quite reasonable to look for a purely economic solution, it is quite obvious that the commercial and diplomatic issues are still very real. The tax structures will have to be agreed upon by all the parties involved or a tough tax policy may eradicate all commercial interests of the Corporations.

Some form of agreement on tax structures or a full treaty on taxes would form a solid backbone on which commercial arrangements could be constructed. From the tax arrangements might grow joint ventures, contract arrangements or straight subsidiaries depending on the earlier mentioned factors - the size of the MNC, the nature of its business and the conditions in the particular LDC. A tax structure might well lessen the destructive and unnecessary competition between the developing countries,and provide a greater opportunity for unity in their collective actions. While a tax structure would not solve the inter regional and international political problems,it could provide a platform on which could be based a working method of agreement in MNC - LDC disputes,or for the suggested brokerage body.

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The broker will have to start on a very simple role such as that suggested earlier of information source. If, however, the broker is associated with another respected international body it could expand its role as it draws confidence from those who made use of it. Another advantage of allowing the broker role to grow rather than prividing it with rules and regulations is that it is more likely to attract users in this form. Negociations will be forced upon the MNCs regardless of what they do to avoid them and it is better that the broker start with few assumptions, as such it stands a better chance of acceptance as a neutral third party.

The factors are economic, the parameters can be defined economically and some of the solutions to problems in the MNC - LDC context will be economic. The approach to these solutions and the means of attack on these problems will have to be political and diplomatic. The maintenance of a modus vivendi, once established, will likewise be one performed by a third party. The paper has explored the various available means of economic control, or perhaps rather, the already available concepts. The methods will not themselves be fully available until some mechanism is found for settling the differences within the approach. The issue requires some common ground or neutral territory and an arbitrator which could assist in conciliation of disputes.

If a solution is found in a four party negociation structure involving host and parent governments and business interests, or just the MNC and the host government, some form of third party would be useful. The Broker with some form of established and recognized strength such as being a member of the OECD or UNCTAD would have sufficient presence to be called upon to aid in negociations. The broker should have the power and credibility of an established body lent to it in order to assure its use.

An international broker between the LDC and the MNC would be particularly useful in the area of technology transfer. It would need a technological ability and a knowledge of the markets, of shipping, of scales of production effects and some knowledge of engineering and research progress in each area involved. In the area of technology the broker will provide the intelligence infrustructure which is lacking in most LDCs, and which the MNCs are providing for themselves. The MNC is forced to provide its own services and market research to cover the gap left by the lack of this in the LDC, the very gap which gives the LDC a very definite disadvantage. A broker in conjunction with mission oriented institutions such as Rand, or the other foundation research bodies, could identify the social problems and their technological interfaces; this would be functionally similar to the way in which government agencies contract research bodies in the developed countries. The broker could effectively operate as a supra national coordinator of information. Once again this research function would serve as a growing period for the broker until diplomatic recognition accepted the body as a true negociator and mediator.

The final and critical decision regarding the broker concept is the point of insertion. Given the MNC - LDC problems, given a loose system of negociation and given the fear of both sides of losing any advantages they may have at present, the introduction of the broker will be a delicate operation. The broker concept comes already with much support from academics, researchers in development policies, government agencies and even business interests. Each, however, has his own image of the broker function and of what his own loss would be in relation to that of the other party. The broker, obviously, will be created on very delicate foundations and will only exist at the will of both parties. It's strength at any time, furthermore, will rely on the will of all parties for its continued existence. For these reasons it is suggested that the broker must gain acceptance by starting as an information source, as a supporter of research into the MNC - LDC problems and only develop its third party role as it matures. This formula should satisfy those who feel that not enough is yet known of the issues, and yet it would introduce the broker concept in a funtioning state.

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