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MULTINATIONAL ENTERPRISES IN THE DEVELOPING SOUTH PACIFIC REGION

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EAST-WEST CENTER

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Preface

The purpose of this study is to provide an overview of multinational corporations—their operation and impact in the context of the Pacific island countries—as a part of a broader research project on multinationals that the Pacific Islands Development Program is currently conducting. The overall project was mandated by the Standing Committee of the Pacific Islands Conference at its inaugural meeting in Pago Pago in 1981. The Standing Committee saw the need for a ". . . better understanding of the role of multinational enterprises in the Pacific islands in terms of their objectives, organization, and know-how as well as their role in development."

This study highlights both the benefits and costs of multinational operations within the South Pacific region, alternative arrangements, and major issues and problems needing further clarification and investigation. It also makes a number of specific recommendations on measures that the Pacific island countries can take to protect themselves against possible abuse and exploitation by these companies. Such recommendations are envisaged, in the final analysis, as a possible means of developing more mutually beneficial relationships between multinationals and host nations.

The task of collecting firsthand information was carried out by the authors during short visits to Fiji, Papua New Guinea, and Western Samoa. In each case, detailed discussions were held with political leaders and representatives of government, statutory authorities, the private sector, and international aid agencies. The authors gratefully acknowledge the generous assistance received from these sources.

Acronyms

ADAB	Australian Development Assistance Bureau
ADB	Asian Development Bank
AMP	Australian Mutual Provident Co.
BCL	Bougainville Copper Ltd.
BHP	Broken Hill Propriety Ltd.
BP	British Petroleum
CDC	Commonwealth Development Corporation
CRA	Cozinc Rio Tinto of Australia Ltd.
CSR	Colonial Sugar Refinery
DMC	Developing Member Countries
EDB	Economic Development Board
FFA	Forum Fisheries Agency
NICs	Newly Industrializing Countries
NIDA	National Investment Development Authority
NLTB	Native Land Trust Board
Ok Tedi	Ok Tedi Mining Co. Ltd.
PAFCO	Pacific Fishing Company
PIIDS	Pacific Islands Industrial Development Scheme
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement
UNCTC	United Nations Centre on Transnational Corporations
WMC	Western Mining Corporation

Executive Summary

Purpose of the Study

This overview of multinational operations in the South Pacific region stems from a request by the Pacific Islands Conference Standing Committee at a meeting in Pago Pago in 1981. The Standing Committee called for a study of multinational enterprises (MNEs) and their role in the socioeconomic life of the Pacific islands, with an emphasis on how multinationals succeed, why they succeed, and in what areas. The Standing Committee also requested that the project focus on alternative approaches capable of reducing the island nations' dependence on multinationals and on ways of fostering mutually beneficial relationships between these companies and host countries.

The report was prepared by Dr. Te'o I. J. Fairbairn, research associate and team leader for the multinationals project, Pacific Islands Development Program, East-West Center, and Dr. T. G. Parry, visiting fellow, Australian National University, Canberra. The two researchers visited Fiji, Papua New Guinea, and Western Samoa in February 1985 to collect data and information.

The Background

The economic life of Pacific island countries is powerfully influenced by the activities of MNEs. MNE involvement is significant in terms of their overall role in the economies and the way in which they dominate certain key economic sectors. Key economic aggregates such as employment, exports, the balance of payments, and government revenues are determined in large part by the activities of MNEs.

An MNE can be defined as a firm or enterprise that operates in two or more countries and makes major decisions on the basis of global alternatives available to the firm. Organizationally, MNEs may operate along geographic lines with control exercised across functions by areas; alternatively, they may operate according to a product line or by area groupings on a multidivisional structure. In the South Pacific region the latter arrangement is the most common.

The strength of MNEs is embodied in their foreign direct investment package of potential benefits for the host country: a package consisting of products, technology, management, skills, capital, and market access. The very elements of this package play an important role in determining whether Pacific island nations can develop domestic industries, increase employment, and access technology and markets—all of which are desired by the Pacific island nations.

Inflows of direct foreign investment to the South Pacific region have recently been small in absolute terms and have been heavily dominated by Papua New Guinea's mining sector (especially Ok Tedi). However, over time, investments by MNEs have caused them to dominate the key sectors of many island countries, especially trading, mining, telecommunications, banking, insurance, and the "up-market" hotels. Only in the fields of agriculture and small-scale business is significant local participation apparent.

The dominant role of Australia-based MNEs is notable, especially in Papua New Guinea and Fiji, although recent investments from the United States, Japan, and Southeast Asia have caused greater diversification. (Australia's position may be exaggerated because many MNEs that claim to be Australian are, in reality, U.K. branches or U.S. parents.) A notable trend has been the increase in management contract arrangements and joint ventures, with the latter often involving central government or one of its agencies.

Contributions and Costs

MNEs can make a number of important actual and potential contributions to the Pacific island countries, but, at the same time, situations can arise in which the development contributions of MNEs are not fully realized because of the offsetting negative impacts on the host country. An assessment of the net benefits of MNE activities calls for balancing the benefits against the negative influences.

MNE operations can significantly affect the balance of payments. The capital funds brought into a country can not only strengthen the balance of payments but also augment the supply of local capital. A further contribution can take place via export or import replacement activities. On exports, MNEs have succeeded in establishing sizable operations, for example, minerals, forestry, and agroprocessing.* However, weighed against MNE contributions to the balance of payments are the inevitable outflows of funds, particularly in the form of dividend payments, licenses, management fees, and savings by expatriate personnel.

MNEs have been a key vehicle for developing Pacific island resources through their exploration and development of raw materials and creation of skills and employment. In the larger and more diversified countries, MNEs have been instrumental in developing large-scale industries, which have a large impact on employment and, ultimately, on economic growth. Invariably, these two results have been accompanied by significant skills training. MNEs cannot fully develop local human resources unless their inputs are contingent upon local staffing requirements, which, in turn, are dependent upon training.

MNEs can play a crucial role—in the development process—as agents for technology transfer. New products, management skills, and technological know-how are brought into a host country, possibly resulting in dramatic improvement in productivity, particularly in the development of natural resources. These benefits, however, can be negated in whole or in part by unfavorable conditions attached to the technology transfer. For example, the technology may be inappropriate to the factor endowment of a particular country; management fees and related charges may be exorbitant; and products may be unsuitable to the country's demand pattern.

In principle, by fostering competition MNEs can play a key part in promoting efficiency in the allocation of resources and the distribution of economic well-being. The resulting benefits can manifest themselves as lower product prices, reduced monopoly profit, and improved working conditions, including higher wages. On the other hand, MNEs have the potential to stifle competition by virtue of their corporate structures combined with their access to the resources of the central organization. Specific examples of monopoly power are "tie-in" clauses and transfer pricing.

Many of the larger MNEs operating in the Pacific region have developed new lines of activity, which have served to further diversify local economic structures. In addition, by virtue of their network of offices in the South Pacific, MNEs have promoted a degree of regional integration.

However, certain noneconomic aspects of MNEs have been a source of concern: their size and dominance in the local economy, their sociocultural effects, and their potential for political interference.

Alternative Approaches

Over time the nature of MNE involvement has changed, and nontraditional or alternative forms of involvement have evolved. In large part, this development has been prompted by new host government attitudes and policies toward MNEs, for example, insistence on local equity participation. These alternative forms most commonly include joint venture and management and licensing arrangements—all of which involve participation by government or statutory authority. Technical aid and independent consulting agreements are also emerging as alternative means by which certain types of resource transfers take place. Joint venture arrangements allow a degree of local participation but, depending on the extent of local ownership, may have little impact on controlling the enterprise or securing maximum local benefits.

Problems and Issues

Pacific island nations need to address and resolve a number of problem areas if they are to maximize the benefits from MNE operations. These areas include (1) high-cost import substitution manufacturing, (2) rigid and inflexible land systems, (3) a failure to fully exploit the skills training potential of MNEs, and (4) pricing policies that reduce the benefits of MNE activity to the host nation.

Generally, a closer assessment needs to be made of policies within individual nations as well as the overall approach to reflect consistency across the region as a whole. Areas meriting attention include a clear identification of resource areas for indigenous investment and for priority areas for MNE involvement, a specification of local equity requirements in general and in particular sectors, appropriate screening and approval mechanisms, formulation of regulations covering the activities of MNEs, and appropriate incentive systems. Scope also exists for improving administrative systems and establishing "fast-track" negotiations and implementation mechanisms.

Recommendations

Recommendations for specific action for further research are as follows:

1. An assessment of the extent of transfer pricing and related activities associated with MNE operations.
2. A study of the possibilities for and benefits from coordination of incentives among Pacific island nations.
3. An assessment of current policies relating to foreign investment in terms of whether they are consistent with development goals and contribute toward a stable economic and political climate favorable to MNE involvement.
4. A study of special policies designed to take advantage of MNE potential for employment and skills formation.
5. Additional research on monitoring MNE activities, where appropriate, and developing skills in negotiations with MNEs.
6. A comprehensive collection of data and basic information on various apsects of MNE involvement including pricing practices and contributions to the local economy.

Introduction

Multinational enterprises (MNEs) play a major role in the international economy. The importance of MNEs to the developing nations of the South Pacific region has been increasing, though limited in absolute values when compared with the activities of MNEs in other developing and developed economies. In certain areas the activities and importance of MNEs have been rapidly growing and will continue to increase. These areas include minerals and petroleum exploration and development and petroleum distribution; raw materials exploitation and processing including copra, timber, and fisheries resources; and service-sector activities such as telecommunications, tourism, banking, and finance.

Foreign direct investment inflows to the South Pacific region, partly reflecting the activities of MNEs, vary considerably with regard to individual host nations. As shown in Table 1, net private financial inflows, which include private direct investment, have been significant in Papua New Guinea, to a much lesser extent, in Fiji, and, even less important, in Vanuatu. In Papua New Guinea, most inflows have been associated with minerals and petroleum exploration and development; in Fiji, the bulk of private direct investment has been directed into the tourist sector. Even for those nations that have received significant amounts of private capital, these flows have been much less important than the total net flows of all financial resources. Aid flows and unilateral transfers (such as from citizens working abroad) have been much more important as a source of capital flows for all of the South Pacific nations. Indeed, net private flows have been insignificant or even negative up to 1983 for the Cook Islands, Kiribati, Solomon Islands, Tonga, and Western Samoa.

Two points about the role of MNEs in the South Pacific require clarification: First, with the exception of Papua New Guinea and, to a lesser extent, Fiji and Vanuatu, MNE involvement in the economies of the island countries has not been very large

TABLE 1. Financial flows into selected Pacific island countries *(US$million)*

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
A. Total net flow of financial resources from all sources											
Cook Islands	6.4	4.3	5.8	5.6	6.9	8.5	6.7	7.8	11.4	11.7	12.1
Fiji	18.0	23.6	36.1	17.5	38.7	43.6	43.6	60.7	80.6	85.9	75.6
Kiribati	4.2	6.0	5.7	5.7	4.1	6.3	10.7	9.1	19.2	23.1	15.2
Papua New Guinea	328.5	335.6	338.6	291.3	284.5	263.1	336.0	327.4	394.3	323.8	600.5
Solomon Islands	12.6	12.3	12.5	25.6	19.0	17.0	28.1	26.4	44.6	30.1	28.0
Tonga	1.2	1.4	30.0	3.4	4.7	6.9	9.9	24.2	16.1	18.0	16.9
Vanuatu	6.2	10.3	19.5	16.5	41.1	16.5	23.7	43.1	42.4	29.5	32.1
Western Samoa	4.8	3.6	5.7	13.4	11.6	24.4	23.3	33.5	25.1	24.6	21.7
B. Net official flow from all sources											
Cook Islands	6.4	7.1	5.8	5.6	6.9	8.5	7.0	7.8	11.5	11.7	11.6
Fiji	8.5	20.1	23.9	26.0	31.8	28.9	28.4	49.2	60.9	82.1	67.5
Kiribati	4.2	6.0	5.7	5.7	4.1	6.3	10.7	9.1	19.2	23.3	15.1
Papua New Guinea	206.5	207.9	274.6	318.2	234.3	243.6	300.5	309.8	347.6	368.7	450.0
Solomon Islands	12.6	11.6	12.0	22.3	19.9	16.9	26.6	26.0	44.0	31.1	27.9
Tonga	1.2	1.4	3.0	3.4	4.7	6.8	9.6	23.9	16.4	18.0	16.9
Vanuatu	6.2	7.5	16.3	12.7	31.7	14.8	18.7	38.2	44.0	30.5	26.0

Western Samoa	3.2	3.6	5.6	13.4	11.7	20.0	22.2	34.0	25.7	24.9	21.9
C. Net private flow from DAC (Development Assistance Committee) Countries											
Cook Islands	-	-	-	-	-	-	-	-	-	-	0.6
Fiji	9.5	3.5	12.1	7.8	7.4	14.7	15.2	11.5	16.7	3.8	8.1
Kiribati	-	-	-	-	-	-	−0.1	-	-	−0.2	0.1
Papua New Guinea	122.0	127.0	63.9	20.8	50.3	19.5	35.5	17.6	46.8	44.9	150.5
Solomon Islands	-	0.7	0.5	3.3	−0.9	0.2	1.5	−0.2	0.1	−1.0	-
Tonga	-	-	-	-	-	-	0.4	0.3	−0.3	-	-
Vanuatu	-	2.8	3.2	3.8	9.5	1.7	5.0	4.9	−1.6	1.1	6.2
Western Samoa	1.6	-	0.2	−0.1	−.01	2.9	1.1	−0.5	−.05	−.03	0.1

Source: ADB 1984.

in *absolute* dollar terms. This is especially striking when one looks at the magnitudes of overall MNE involvement in the international economy. Some idea of the size and scope of MNE involvement in the world economy can be had from data included in the latest United Nations Centre on Transnational Corporations' report (UNCTC 1984). The leading 380 MNEs in 1980 had among them 25,000 affiliate firms, total sales of US$2,635 million, and total global employment of 25 million persons. These figures show the relative size of MNEs compared with all but the largest individual nation-states in the world. If the individual largest industrial MNEs are considered, it is clear that many of them operating in the region—especially in petroleum distribution and resource development—have sales and assets that are many times larger than the economies of the Pacific island nations.

On a global basis MNEs in total have been increasing in importance as economic agents in the international economy. For example, the total value of sales of the top 100 MNEs increased by some 17 percent per annum during the 1970s—a period of international downturn in which most nations achieved relatively low GNP growth. When account is also taken of non-industrial MNEs in areas such as banking and finance and the service sector, it is clear that the MNEs that operate within the developing nations of the South Pacific region are very much larger than the economies in which they interact.

Second, if the size and range of activities of those MNEs involved in the region are compared with the size of the island nations that play host to them, MNEs clearly have had a significant impact on some of the nations and certain sectors in the region. This impact is likely to increase in certain sectors and for certain nations as development-related activities accelerate. The purpose of this report is to identify the nature of the impact of MNEs on developing nations of the South Pacific region, the nature of costs and benefits, and the policy issues and options including alternative forms of involvement, so that the host nations may be better able to maximize the net contributions from the activities of MNEs in the region.

What is the Multinational Enterprise?

A useful working definition of the MNE is a firm or enterprise with a structure "where operations are in two or more countries on such a scale that [its] growth and success depend on more than one nation, and where major decisions are made on the basis of [its] global alternatives" (Parry 1973). This definition has two important elements: The first element of the definition entails an MNE involvement in more than one market with a significant proportion of the total operations located in several nations. Most MNEs have a large proportion of total sales, assets, earnings, and employment in countries outside their home country. For those MNEs operating within the South Pacific, their involvement in this region is small in comparison to their total global operations. This situation may have implications for the ways in which these firms operate within the region and make decisions regarding price, output, and investment.

The second element of the definition involves an organizational commitment by the firm to make decisions based on the global resources and opportunities available to them. MNEs have reasonably well-developed corporate organizations, which control and monitor the various parts of the worldwide enterprise and make sales, output, investment, trade, financial, and other decisions on the basis of global options and alternatives. Obviously, each individual MNE varies in the degree to which, and the success with which, it undertakes these functions.

Well over 9,000 firms were estimated to have one or more foreign affiliates in the mid-1970s (UNCTC 1978). Since that time this number most likely has increased significantly. While not all of these would be classed as MNEs under the structural and organizational criteria noted above, a significant proportion of them would be: MNEs are very large and they are large in number!

Organization and Control

The various production, investment, and financial activities of the MNEs require that they globally organize, monitor, and control a large number of operations. The organizational structure of MNEs has been studied by several scholars (for example, Stopford and Wells 1972; Brooke and Remmers 1970; Davis 1976; Frank 1976), and some consensus occurs regarding the main forms of existing organizational structures. Broadly speaking, the operations of modern MNEs are structured in two ways: First, MNEs may operate along geographic lines with control exercised across functions by areas, and, second, MNEs can operate according to a product line or by groupings on a multidivisional structure.

The functional structure divides the organization of the MNEs globally according to their different responsibilities. For example, purchasing, marketing, production, transportation, accounting, and finance are thus separated from one another and each is coordinated for the firm's overall global operations. This form of organization involves transmission of data and coordination of units along individual functional lines. An MNE international division often emerges with special responsibility for a number of functions.

The multidivisional structure, which is the more common form of the MNEs operating in the South Pacific, involves the organization of all corporate functions within the one product or area line. Thus, a common form of MNE structure involves a regional head office, which coordinates all the activities of affiliates within its region. MNEs in the finance and banking and the petroleum distribution sectors appear to favor this multidivisional structure. For example, Fiji is commonly the location of the regional head offices for MNEs operating in the South-West Pacific.

The organizational structure of the individual MNE reflects the particular circumstances surrounding the firm and its need for coordinating and controlling activities in its different markets. The organizational requirements of MNEs, in general, involve various categories of information flows: reporting, monitoring, appraising, coordinating, and controlling. The organizational structure of MNEs reflects the "quest for efficient organization," given their markets, strategic outlook and preferences, and "national cultural factors" (Caves 1982). In addition, the organizational structure of MNEs is dependent upon the existing "organizational technology": Advances in communications and information systems have meant that MNEs potentially are able to exercise a significant degree of control over the regional activities of their various affiliates. Clearly, the evolution of MNEs across national boundaries has required evolution in the technology of communications, as well as in internal modern organizational structures.

Each individual MNE differs significantly in the way in which it is organized. In addition, MNEs based in different home countries appear to vary in broad organizational and control patterns. Thus, U.S.-based MNEs, in general, are characterized by tight and detailed organization with formal control mechanisms (Davis 1976). Japan-based MNEs tend to have control structures that are based on extensive personal communications (Yoshino 1976). Europe-based MNEs, particularly from the United Kingdom, tend to have a relatively unstructured "mother-daughter" structure of control, with a greater degree of "subsidiary-independent" behavior patterns (Franko 1976).

Obviously, all MNEs operating in the South Pacific cannot be categorized according to the general characteristics noted above. Nevertheless, from a preliminary examination of MNEs operating in the region, these generalizations based on the home country seem valid. The nature of organization and control structure is particularly relevant when potential conflicts arise between MNEs and host nations. An MNE with decentralized control structures and with indigenous senior management may well be characterized by less conflict with the host nation.

MNEs and Conflict

Many commentators perceive that conflict is inevitable between the MNE and the host countries in which it operates. In the limited research on the MNE in the Pacific (for example, Winkler 1984), the conflict side has been stressed without adequate empirical justification, and a balanced discussion has been neglected of the benefits arising from interaction. Conflict is certainly possible in the interaction between MNEs and both home and host nations—particularly the small developing host nations such as those of the South Pacific.

Potential conflict arising between the MNE and those nations in which it operates (both home and host) is due to the global orientation of the enterprise. This global perspective of the enterprise's decision making inevitably causes some of the decision-making powers to be focused outside the host country. Thus the MNE's orientation to global opportunities may lead the individual components of the firm operating within different nations to make decisions on output, price, and investment that are seen not to be in the best interests of the host nation.

For example, transfer-pricing activities (which will be examined below) may arise in response to taxation differentials or foreign exchange opportunities, which discriminate among countries. The MNE that underprices exports from or overprices imports into a particular country in response to such opportunities may be maximizing its global profits while disadvantaging the country or countries involved. Similarly, investment and employment decisions by integrated MNEs may be seen by one country as favoring other locations in which the firm operates to the detriment of that particular host (or home) country. Numerous examples (encompassing price, output, investment, and financial decisions) of the MNE's global orientation in decision making can be seen (rightly or wrongly) as being in conflict with the legitimate sovereign interests of the very nations in which it operates.

Conflicts of interest are not limited to economic areas. Social, cultural, and political interaction between the MNE and the sovereign nations also can lead to a conflict of interest. Numerous examples exist of cultural and political pressures associated with MNE activities that are viewed as compromising the political and cultural sovereignty of the host nation. Some of these problems, both real and perceived, will be examined later in this report.

In the final analysis, of course, the main issue concerning the nature of interaction between the MNEs and the nations in which they operate involves the nature of costs and benefits and the distribution of net benefits among the parties involved—the home nations, the host nations, and the enterprises themselves. The major concern of policy must rest with this issue.

Strengths and Weaknesses

The potential MNE advantages and disadvantages derive from the underlying strengths of this particular form of business enterprise. MNEs possess certain advantages relative to smaller, nationally based enterprises. In particular, MNEs have advantages in their technology base, access to personnel and to markets, diversity of operations, financial resources, and size and scope of operations extending across national boundaries.

The strengths of MNEs are embodied in the foreign direct investment package of potential benefits for the host country: a package of product, technology, management, skills, capital, and market access. These elements have important roles in the growth and development of domestic industries, increased employment, and access to technology and markets, which many developing nations view as crucial to their viability. Indeed, as one result of the international downturn of the 1970s, many developing countries are increasingly seeking the involvement of MNEs in their economies via foreign direct investment to stimulate economic growth, development, and employment opportunities.

The developing nations of the South Pacific region are actively seeking this involvement and consequently are tailoring or revising policies to encourage increased activities by foreign investors, including the MNEs. One issue, which needs to be satisfactorily resolved, is the identification of appropriate policies that maximize the net contributions of MNEs to the economies of the developing nations of the region. Even though the MNEs and the foreign direct investment package can have potentially significant development impacts for developing host nations, their associated activities can have adverse impacts on host countries—impacts that can detract from, if not negate, these benefits.

The competitive strengths of the MNEs associated with the positive contributions of the foreign investment package may also lead to a dominant position in the home country or host country or both. The power base of the MNE in its global operations, together with the specific advantages that vary among firms, may lead to the exercise of monopoly power vis-à-vis the smaller indigenous firms as well as the nation-state. The small developing host nations may be in relatively weak positions to monitor and exercise control over the activities of MNEs. To the extent that an MNE can and does exercise such power, any benefits to the nation may be eroded or redistributed in favor of the MNE. MNEs have engaged in many economic, cultural, and political practices that clearly disadvantage the host (and home) nation, such as transfer pricing, political intervention, financial practices, and employment and training policies, which often have involved adverse effects. However, these practices generally have become less frequent as countries become aware of the problems and monitor and control MNE activities and as MNEs, in turn, have become more aware of the benefits of good relations with their host countries.

The developing nations of the South Pacific region, where experience with MNEs is relatively limited, need to have a proper understanding of the nature of MNEs and both the costs and benefits associated with their operations. Of critical importance are appropriate policies designed to maximize the net benefits flowing to the developing host nation and, at the same time, to secure satisfactory long-run returns to the enterprise.

The Development Role of MNEs: Benefits and Costs

The nature of the benefits and costs of MNEs will be outlined in subsequent sections of this report. Briefly, and by way of an overview of these issues, the major benefits of the MNE are tied up with the foreign direct investment package. That is, MNEs provide new products, factors of production, and resource inputs that are either scarce or not available in the developing country. A result of these activities is the creation of employment opportunities within the developing host country—an objective of considerable policy importance in most developing nations. At the most basic level, MNEs may provide some capital to the developing host nation, though this depends on actual financing arrangements (Fiji, for example, has restrictions on local borrowing by foreign subsidiaries to maximize the inflow of foreign capital associated with MNE operations). At least as important for developing host nations as capital, MNEs can provide management and production skills, product and process technology, and access to international markets for imports and exports. Given the small size of the markets in the Pacific, MNE activities are primarily directed toward export markets. The development inputs associated with MNE operations are thus primarily directed to the utilization of local labor (employment generation) and resources for international markets.

The key issue for individual host nations, of course, is the extent to which the development contributions are in fact realized, as well as the costs and conditions associated with the provision of these development inputs by MNEs. During the 1960s in particular, a number of developing host nations questioned the costs and conditions associated with MNE involvement and examined the options for alternative means of access to the elements of the traditional foreign direct investment package. To some extent, the mood of the 1980s has changed, and some of these countries are realizing that the most effective means of access to the overall development inputs associated with MNE activities may still require some involvement by way of traditional direct investment by MNEs. Nevertheless, options may exist for alternative forms of MNE involvement, including joint ventures and licensing and management agreements. Because of their limited domestic resources, the smaller developing host nations are less able to enter into alternative arrangements with MNEs. They do, however, need to be aware of the nature of MNE interaction with the economy and society and thus to pursue policies that maximize the beneficial contributions of MNE activities to their countries.

MNEs have been active in the developing countries, predominantly in Latin America and increasingly in the NICs of South and East Asia in a number of ways. Of historical significance, they have been active in the extraction and export of natural resources, primarily unprocessed. While the form of MNE involvement in these activities in many developing nations has changed since the late 1960s—with an increase in indigenous ownership and in joint venture forms of involvement—MNEs still play an important part in the natural resource sector, especially in the international distribution (transportation and marketing) of these products. The most active MNE involvement in the South Pacific has been in the extraction and export of copra, coffee, timber, sugar, minerals, and fish resources.

Worldwide MNE involvement in "traditional" and more advanced manufactured exports has been less important in the South Pacific, with the exception of food products. In the case of traditional exports such as clothing, textiles, footwear, leather goods, and processed foodstuffs, the role of MNEs has primarily been to buy, market, and distribute in developed country markets. For the more technologically advanced manufactured goods, some MNEs have located production and assembly facilities in the NICs and near-NICs of Southeast Asia and Latin America.

Thus the direct role of MNEs in the manufacturing exports of developing countries appears to be very important (UNCTAD 1978).

Of particular significance for the South Pacific region, MNEs also have been involved in the service sector and have provided importing, wholesaling, and retailing activities, as well as banking, financing, and other services. These traditional activities have been heavily oriented toward trade activities—both importing and exporting. The small size and fragmentation of markets have meant minimal MNE involvement in import-replacing manufacturing. More recent changes in the protection policy indicate some movement in this direction by traditional MNEs in countries such as Papua New Guinea and Fiji. The economic rationality of heavily protected manufacturing activities (whether undertaken by foreign or domestic enterprises) in small, fragmented markets needs more careful consideration than appears to have occurred to date. Even where employment creation has a high policy priority, the use of high protection barriers creates major distortions that erode any benefits from MNE investment within the host nation and that generate high-cost employment.

The role of MNEs in development extends beyond trade-related activities. The development process requires the mobilization and organization of indigenous and external resources. Capital inflows, know-how, and other factor inputs provided by MNEs are an important part of this process. In addition, direct and indirect linkages and leakages through labor markets and fiscal effects associated with MNE activities potentially can play an important part in the development process. To a large extent, the overall development impact of these linkages and leakages depends on the ability of the developing host nation to share in the benefits. There is reason to believe that those South Pacific nations that have to date experienced involvement by MNEs have failed to benefit *fully* from this interaction because of limitations in the absorptive capacity of their countries.

While MNEs have a potentially significant role in the development process, they may pose potential (and actual) problems for developing host countries. In addition to adverse economic effects, several social and political issues are relevant. One major problem area involves the claim that MNEs rely excessively on imported goods and services, which adversely affects the development of domestic sources of supply for a range of goods and services in the developing host country. The major consequence of such behavior is the discouragement of the development of local industries and skills. Related to this claim is the charge that MNEs engage in "transfer pricing" of imported goods and services, which has a number of serious consequences for the distribution of benefits. Another charge against MNEs is that they tend to discriminate against indigenous employment at all levels in favor of expatriates. This charge also has adverse consequences for the development of indigenous skills in production and management and other areas of trade and commerce.

Access to the know-how (including technology) generally provided by MNEs raises a number of important issues. While access to know-how is an important part of the development process, the costs of that access may discriminate against the host nation. The small developing nations, in particular, may be in a relatively poor position when monitoring and bargaining over appropriate prices for the know-how and know-how-based services provided by MNEs. One example of relevance to some South Pacific nations involves the question of appropriate pricing of management and other know-how fees charged by MNEs operating in the hotel and tourist sector. The question of appropriate charges for know-how and technology extends to a number of sectors including mining, manufacturing, agriculture, forestry, and fisheries, as well as services.

In addition to potential problems related to economic interaction, other areas of concern relate to cultural and political impacts. Large foreign entities may impinge on the culture of small developing nations in ways that are unacceptable to the host nation. In addition, the risk of political interference by MNEs is often inevitable, given the importance that some MNEs have for economic activity—notably, investment, exports, and employment—in the small developing nations. The range of benefits and costs (both economic and sociopolitical), with particular relevance to the developing nations of the South Pacific region, will be explored more fully in later sections of this report.

Pacific MNEs: Foreign Direct Investment Flows and the Role of MNEs

Private flows of financial resources in and out of the South Pacific are not well documented, but Table 1 gives some indication of these flows for the eight Pacific island members of ADB—the so-called DMCs (Developing Member Countries). Unfortunately, the figures of net private flows are not broken down to show the foreign direct investment component as distinct from borrowings and other elements. Be that as it may, Table 1 clearly shows the dominance of net official flows, which in 1982 totaled US$636 million versus $165 million for net private flows. Also apparent is Papua New Guinea's preeminence as a recipient of private capital, especially in 1982 when it accounted for $150 million or 91 percent of total net private flow. (Papua New Guinea's overriding importance is also clear during 1972-73.) Net flows to Fiji have been modest and relatively steady. The small island countries, notably the Cook Islands, Kiribati, and Tonga, stand in sharp contrast to both Papua New Guinea and Fiji with net private inflows having been either negligible or negative in recent years.

A 1982 surge in private flows is evident for Papua New Guinea, Solomon Islands, and Fiji, which seems to have been sustained in 1983. For Papua New Guinea, private capital flows, including borrowings, totaled US$298 million in 1983 as compared with $323 million in 1982 and amounted to $70 million in each of the first two quarters of 1984 (Bank of Papua New Guinea 1984). As in 1982, borrowings and equity inflows in connection with Ok Tedi developments dominated this flow (this company accounting for $328 million in 1983), but inflows connected with oil and mineral exploration (totaling over $22 million) also have been significant.

The net inflow for Solomon Islands increased sharply in 1983 and amounted to US$5.8 million (and is forecast at $3.1 million in 1984), resulting from gross flows of $7.3 million in and $1.5 million out (Central Bank of Solomon Islands 1984). A major factor in this case is the equity and loan finance for a timber operation on Guadalcanal and the short-term intercompany borrowings by the fishing industry.

Fiji's private capital flows in 1982 show a credit of US$60.7 million and a debit of $19.2 million, giving a net inflow of $41.5 million. Of the latter, net equity capital totaled $4.8 million, and retained earnings were $11.1 million, totaling $15.9 million. For Western Samoa, which recorded net capital outflows in each year during 1979-82, a reversal is evident, and for 1984 a net inflow of $2.2 million is forecast.

The Role of MNEs

Historically, MNEs have played a leading role in promoting the growth of the modern trade economy in the Pacific island countries through the establishment of trade, distribution, and transportation facilities, as well as production and service enterprises (in particular, plantation, mining, tourist, and finance sectors). Their activities in establishing a network of trade and purchasing facilities in regional centers and advertising and related services have also hastened the growth of the modern commercial economy. Few aspects of the economic and social life of Pacific islanders remain untouched by MNEs.

A basic motive for MNE involvement in the South Pacific region has been the opportunity to engage in profitable investment among the low-income, developing Pacific island countries, which stand to gain from what MNEs have to offer: capital, technology, management, and market linkages—either as individual components or as a combined package. By tapping these resources, island countries can utilize their own resources more productively and thereby achieve their economic goals.

Of course, these countries differ in their economic potentials, as measured by resource endowment, market size, and growth prospects—hence, in their respective attractiveness for MNEs. It is not surprising, therefore, that MNEs have made the biggest impact on the economies of Papua New Guinea, Solomon Islands, and Fiji, all of which have more diversified economic bases. MNEs are heavily dominant in key resource areas such as mining, forestry, palm oil, and fisheries. By contrast, few MNEs are found in the mini-economies of Kiribati, Niue, and Tuvalu.

Primary Resources

MNE participation in the development of Pacific island resources, especially those for export, is substantial in the larger island countries with many large projects. MNEs and other forms of foreign-affiliated investment have been most dominant in Papua New Guinea and Solomon Islands in the field of *commerical agriculture* (historically among the first areas of MNE investment in the region).

In Papua New Guinea, foreign-affiliated investment has dominated the large-holder agricultural sector of the economy responsible for a large share of export production. These holdings, which number approximately 1,000 units, account for the bulk of tea and rubber, about one-half of total copra production, and about one-third of cocoa, coffee, and palm oil (ESCAP/UNCTC 1984). In the case of palm oil, three large plantations are dominant under joint venture arrangements between government and a number of foreign partners. MNEs also play an active role in sugar production; the ownership of the major company concerned (Ramu Sugar Holdings Ltd.) is largely held by the government and the Commonwealth Development Corporation (CDC), but its management resides with a U.K. company under contract.

In Solomon Islands, MNEs are involved mainly in copra and palm oil (through CDC participation) and in the past in rice cultivation. Several foreign companies are active in copra, which is often combined with other cash crops or cattle, but the largest company is a joint venture (Lever Solomons Ltd.) between the government and a subsidiary of a U.K. multinational (Unilever).

At least two foreign-affiliated companies operate copra plantations in Vanuatu, but foreign interest in agriculture in other countries is either minimal or nonexistent. Of course, in Fiji the sugar industry (Fiji's most important export earner) was formerly an Australian monopoly (Colonial Sugar Refinery or CSR), but in 1973 the ownership was transferred to the Fiji government.

MNE involvement in *fisheries* has been predominantly in tuna and confined chiefly to operations in American Samoa, Solomon Islands, Fiji, and Papua New Guinea. Tuna processing in American Samoa has been long-standing and spearheaded by U.S.-based companies (currently Van Camp and Star-Kist). These operations dominate the American Samoan economy and account for almost the entire export earnings and a significant share (at least 30 percent) of the total employment. Tuna fishing in Solomon Islands is dominated by two companies, both of which are joint ventures between government and a Japanese MNE or its affiliate (Taiyo Gyogo K.K., on behalf of Solomons Taiyo Ltd. [STL], and the National Fisheries Development Co. [NFD]). Through the activities of these companies, catches have risen spectacularly, to the point where fishing is now Solomon Islands' largest foreign exchange earner and accounts for US$24.0 million or 42 percent of total export earnings of $57 million in 1983 (Central Bank of Solomon Islands 1984).

Tuna canning and exporting in Fiji have been spearheaded by the Pacific Fishing Company (PAFCO), a joint venture among a Japanese MNE, (C. Itoh Co.), which holds majority ownership, the government, and a small group of local residents. (However, within two years the Japanese are expected to withdraw from the venture.) The Japanese interests also own a can-making company that services PAFCO. Vanuatu's involvement with an MNE is limited and confined largely to purchasing fish from foreign boats for export. The company concerned (the South Pacific Fishing Company) is owned by a Japanese MNE, except for a small share held by government.

MNE participation in tuna fishing in Papua New Guinea has been extensive in the past. Plans for a tuna-canning operation have been shelved. Foreign companies continue to show interest, but depressed world prices for tuna have tended to discourage firm commitments. Apart from tuna fishing, MNEs are active in prawn fishing, and at least four Japanese MNEs are involved.

Considerable MNE interest in *timber* has been shown in Papua New Guinea and Solomon Islands, both of which have extensive forest areas. An analysis of major forestry projects in Papua New Guinea shows that all involve foreign investment in varying degrees. Out of twelve such projects cited by ESCAP/UNCTC (1984), Japanese companies held majority ownership in five and Australian companies in two. Investments from Korea, Taiwan, and New Zealand were also evident, though relatively small in amount and confined to a few cases. The combined impact of these companies on the local economy is considerable, with sales of over US$57 million and employment of 4,500 people (including 190 expatriates). In Solomon Islands, timber operations (mainly logs) are dominated by MNEs. MNEs from Australia and the United Kingdom were the earliest arrivals, but among recent entrants have been investors from the United States, Fiji, and Australia.

The timber industry in Fiji is presently monopolized by two companies, each with Australian majority ownership. Foreign-affiliated investment is also active in a number of other countries such as Vanuatu and Western Samoa but on a smaller scale than in Papua New Guinea and Solomon Islands. A major project in Fiji, however, is a joint venture among the Pine Commission (a statutory body), British Petroleum, and a number of other partners to develop the pine industry. A US$40 million investment project, its aim is to produce sawn timber, woodchips, and plywood and to build up an export market for these products. British Petroleum provides management under a six-year contract.

Mining

MNEs have been crucial in developing the region's mineral resources at both the exploration and production stages. By far the biggest MNEs are the two copper-gold mines in Papua New Guinea—Bougainville Copper Ltd. (BCL), located on Bougainville Island northeast of the main island, and Ok Tedi Mining Co. Ltd. (Ok Tedi), situated in the Western Province.

BCL, which started operations in 1972, is a joint venture among Conzinc Rio Tinto of Australia Ltd. (CRA Ltd.), a subsidiary of the U.K. parent, which owns 53 percent of BCL, the government and its nominee, the Investment Corporation of Papua New Guinea (20 percent), and the public. As one of the largest mines in the world, BCL's impact on the local economy has been extensive. In 1983 it employed nearly 4,000 persons (including about 800 expatriates), accounted for over one-half of total export earnings of US$780 million, and since its inception has contributed over $600 million to government revenue.

Ok Tedi comprises a large copper deposit overlain with a rich cap of gold whose potential was recognized through the exploratory efforts of a U.S. multinational (Kennecott). The development of the mine, however, has taken place under the auspices of an international consortium in partnership with the government.

BHP, an Australian company (represented by Dampier Mining Co.) holds 30 percent ownership; AMOCO Minerals, a subsidiary of Standard Oil of Indiana, 30 percent; Kupferexplorationsgesellschaft, a German group (itself a mini-consortium of three predominantly German-owned companies), 20 percent; and the government, 20 percent. Development costs are expected to be in the order of US$1.6 billion (1981 prices), but when fully operational the mine will have much the same impact on the economy as BCL. The first stage of the mine opened in 1984 with gold mining; further stages of development (to be implemented during the 1980s, subject to current renegotiations) will see the company producing only copper because gold deposits will be exhausted.

MNEs continue to maintain active exploration in Papua New Guinea for both minerals and energy resources and have uncovered several promising possibilities. Notable among these are explorations by a Japanese MNE for copper (for example, Frieda deposits) and U.S. and Australian companies for gold. Regarding gold, at least three major mining possibilities have been identified. Significant oil discoveries are also expected to be commercially viable.

Other major mining operations involving MNEs are nickel in New Caledonia and gold in Fiji. (Phosphate mining in Nauru is a government enterprise, but up to the 1960s it was controlled by Australia, New Zealand, and the United Kingdom through a commission.) French capital is involved in nickel operations in New Caledonia, and this industry is by far the country's leading foreign exchange earner. Australian interests (via Emperor Gold Mining Ltd. and Western Mining Corporation [WMC]) monopolize the gold production in Fiji while foreign investment is overridingly dominant in other areas of the mining sector, including quarrying and exploration.

In recognition of mining possibilities in Solomon Islands and Vanuatu, several MNEs, principally Japanese, U.S., and Australian, have been active in exploration work. Tonga has also attracted MNE interest in oil exploration.

Manufacturing

Manufacturing development varies widely, with Fiji, Papua New Guinea, and, to a lesser extent, Western Samoa leading the way even though manufacturing contributes no more than 10 percent of the gross domestic product in each country. Nonetheless, MNEs and other forms of direct investment have played a notable part in manufacturing development in the region.

In Fiji manufacturing activity has been spearheaded by foreign investment, particularly Australian. Several industrial ventures have been established in recent years, mostly in the area of import substitution, which includes the manufacture of copra oil, canned fish, beer, cigarettes, biscuits, paint, plastic products, light engineering products, and wood products. In the case of copra oil extraction, paint, and various food items, the traditional trading companies, W.A. Carpenter and Burns Philp, have become major influences.

The inflow of foreign direct investment in Fiji's manufacturing has declined in recent years and appears to be connected with the exit of CSR and the growth of local manufacturers (ESCAP/UNCTC 1984). However, foreign-affiliated companies in manufacturing remain a major element. Of the approximately 220 manufacturing companies in operation, 72 have some foreign investment and account for nearly 25 percent of the total production (estimated at US$80 million in 1983).

In Papua New Guinea MNEs are active in various resource-based processing activities, such as palm oil and saw mills, but import-substitution industries have had the main impact on manufacturing. Major import-substitution ventures include two breweries, industrial gases, paint, matches, cigarettes, rolled steel, glass, plastics, cement, and packaging. As in Fiji, manufacturing investment is dominated by Australia although investment from the United Kingdom, Hong Kong, and several other countries has increased.

Foreign participation in manufacturing in other Pacific island nations is limited and is virtually absent in the very small countries. Participation in Western Samoa and Tonga has been the most extensive where foreign investment has been involved in a few resource-based areas (for example, coconut oil extraction and honey), with the main thrust also in import substitution. These products typically include food items, beverages, cigarettes, paint, toilet tissue, cement products, and light engineering products, some of which are produced on a relatively large scale (for example, beer in Western Samoa). Joint-venture arrangements are common, and some of their products involve minor transformation of imported inputs.

MNE activity in manufacturing for export could rise, given the possibility of greater MNE involvement in agroprocessing and export-oriented manufacturing. In the latter area, the development of Tonga's Small Industry Centre, concerned with fabrication and assembling for export, has been notable. Also, the advent of SPARTECA in 1982 has opened up new export opportunities in Australia and New Zealand in manufacturing, which are likely to be of interest to MNEs. Foreign investors are also encouraged to invest in export-oriented projects via various aid schemes such as New Zealand's Pacific Islands Industrial Development Scheme (PIIDS) and, to a lesser extent, the Australian Joint Venture Scheme.

Trade

The MNE dominance is striking in the trade sector, encompassing mainly the importation of goods for retail and wholesale distribution combined with some produce marketing. The names of leading MNE trading houses are household words, and through fairly aggressive promotional advertising they continue to exert a disproportionate influence on the behavior of Pacific island consumers. Established during the colonial period, many MNEs have developed a wide range of activities, in some cases far removed from their traditional roles.

In the past, MNE trading houses have been highly active in produce marketing, especially copra. However, MNE involvement in this area is now limited, largely because almost all Pacific island nations have set up produce-marketing boards or similar bodies, some of which have been given exclusive marketing rights over one or more products (for example, Western Samoa's Produce Marketing Board has marketing rights for bananas and taro). MNEs, however, remain active in Solomon Islands, where they are free to engage in the marketing of primary produce, except for copra. This situation also applies to Vanuatu although plans are to incorporate coffee into the marketing activities of the Vanuatu Commodities Board.

The dependence on MNEs for the distribution of imported fuel, including aviation fuel, is virtually complete. The three dominant MNEs are Shell, Mobil, and British Petroleum. Each of these companies has branches in several countries (for example, Papua New Guinea and Fiji), and only one or two are involved in the smaller countries (for example, two are in the Cook Islands and one serves as sole importer in Western Samoa). A U.S.-based company (Pacific Resources Inc.) has recently won the right to supply a number of countries in the Pacific, including American Samoa and the Cook Islands.

Three Australia-affiliated trading companies dominate Papua New Guinea's wholesale and retail trade: Burns Philp (Papua New Guinea) Ltd., a subsidiary of Burns Philp and Co. Ltd., Australia; W.R. Carpenter (Papua New Guinea) Ltd.; and Steamship Trading Co. Ltd. Local equity is involved in the first two companies: 32 percent of Burns Philp (Papua New Guinea) Ltd. (of which 26 percent is held by the Investment Corporation of Papua New Guinea) and 50 percent of Steamship Trading Co. Ltd. Together these companies heavily dominate Papua New Guinea's trading sector with wide ranging and diversified activities.

Apart from its traditional role as merchant, Burns Philp (Papua New Guinea) Ltd., through 16 separate divisions, engages in automobile sales and repairs, hotel services, industrial production of items like soft drinks, and packaging of products. The parent company itself operates 20 cocoa and copra plantations. W.R. Carpenter operates 22 subsidiaries, 3 tea estates, and 27 cocoa and copra plantations in Papua New Guinea while also engaged in coconut oil processing, building, financing, and paint manufacturing. Steamship Trading Co. Ltd. displays a similar diversity in its range of activities. All in all, these three trading companies combined accounted for "not more than half" of the country's total retail sales in 1981 (including industrial and export sales) (ESCAP/UNCTC 1984, p. 378). The company also employed an estimated 11,800 persons.

In Fiji, Australia-affiliated MNEs—Burns Philp (South Seas) Ltd., W. R. Carpenter (South Pacific) Ltd., and Morris Hedstrom Ltd. (which Carpenter bought in 1956)—have also played a leading role in the trade sector. As in Papua New Guinea, these companies have branched out from the traditional trading functions to become highly diversified organizations. Among some areas of diversification are copra oil extraction, food processing, light engineering, and paint and primary production. On the merchandising side, however, these MNEs have come under severe pressure from local competition, and Burns Philp has, in fact, been forced to withdraw from merchandising. (It is said that local competitors, principally Asian merchants, profited from the use of low-paid non-union labor.)

Branches of Burns Philp and Morris Hedstrom also operate in Western Samoa (both MNEs); Tonga (both MNEs); Vanuatu (Burns Philp of Australia), and Niue (Burns Philp). Other MNEs are also in Fiji, some as sizable as the local branches of Burns Philp and Morris Hedstrom though generally less diversified. Ballande Vanuatu, with headquarters in Noumea, is active in both produce marketing and merchandising and together with Burns Philp accounts for up to 30 percent of national imports. In Solomon Islands, the importation of consumer goods is dominated by two Australia-affiliated companies, Sullivan-Solomon Islands Ltd. and Trading Co. Ltd. (Solomon Islands). In Tonga and Western Samoa at least one other foreign-affiliated trading company (E.M. Jones Co. in Tonga and MacKenzie S.V. Co. Ltd. in Western Samoa) operates on a scale similar to the Burns Philp and Morris Hedstrom branches.

Other Services

Not surprisingly, the commercial banking sector shows a heavy dependence on MNEs though local participation through joint ventures is not insignificant. Leading MNEs active in this area are Australia-affiliated banks such as Westpac Bank and the Australian and New Zealand Group Ltd., with the former maintaining an extensive network of branches throughout the region. However, affiliates of major banks from the United States, New Zealand, and several other countries are also found in the region, especially in Papua New Guinea and Fiji.

Of Papua New Guinea's five commercial banks, four are Australia-based and one—the Bank of Papua New Guinea—is wholly owned by the government. The latter has grown to the point where it accounts for about one-half of the commercial banking business. All of Fiji's commercial banks are MNEs except the National Bank of Fiji, which is relatively small. For Solomon Islands, the government owns a large share (49 percent) of one of the three MNE commercial banks. Government shareholding is also significant in Western Samoa, which has two commercial banks (and an international offshore bank), and in Tonga with one, although MNE interests still predominate in each case. Joint ventures between government and MNEs are found in Kiribati and Tuvalu, but a single bank operating in the Cook Islands is wholly an MNE.

The general insurance and life insurance fields and brokerage activities are very much the domain of MNEs although increasing government involvement is evident. Papua New Guinea and Fiji have numerous MNEs with some represented by local agencies like the major trading houses. Australian and U.K. multinationals predominate with such companies as Queensland Insurance and AMP, both Australian, operating extensively in the region. Fewer MNEs are found in other Pacific island nations, but they still wield considerable importance. Western Samoa succeeded in breaking MNE monopoly; one local company is wholly locally owned while another contains a large government shareholding. The one wholly foreign-owned operation is in insurance brokerage. In Fiji the insurance sector is closely controlled through a commissioner. In Kiribati insurance is largely handled by a government corporation under overseas (New Zealand) management.

The heavy involvement of MNEs in the hotel sector, both ownership and management, is evident in Fiji but less apparent in Papua New Guinea. In both countries, Australian interests are clearly dominant, but participation by U.S., Southeast Asian, and Middle Eastern MNEs is significant. Foreign-affiliated hotel and guesthouse ownership is widespread in the Cook Islands, Western Samoa, and Tonga, many in the form of participation by individual entrepreneurs with a local partner. No major MNE is found in Solomon Islands, and foreign investment in hotels is confined to a number of small operations.

Finally, other significant areas of MNE participation in the region are shipping, air transportation, telecommunications, accountancy, car rentals, philatelic services, and, in some cases, public utility items (for example, electricity, which in Vanuatu is provided by a French MNE for Port Vila and Luganville).

In a number of cases, the dependence on MNE-owned telecommunication services is complete. In Fiji, however, a joint venture is in operation between government and Cable and Wireless on a 50:50 basis. A regional line (the Pacific Forum Line), coupled with a few locally registered companies, has made some inroads into international shipping, but the extensive foreign dominance remains. A similar dominance applies in air transportation; recent events involving the tie-up of national carriers with overseas airline companies in Fiji (a joint venture with Ansett) have further strengthened this dependence.

Some key features of MNE operations in the South Pacific region are as follows: First, MNEs are clearly dominant in many key sectors of Pacific island economies, particularly the larger countries with a potential in resource exploitation, the development of which demands large amounts of capital and relatively sophisticated technology and management. Only in agriculture and small-scale business activities is there significant local participation. Second, recent inflows of foreign direct investment to the region overall, which are small in absolute terms, are heavily dominated by the mining sector of Papua New Guinea. Furthermore, the dominant role of Australia-based MNEs is notable although recently diversification has been increasing due to flows from the United States, Japan, and Southeast Asia. Admittedly, Australia's position may be exaggerated because many MNEs that claim to be Australia-based are, in fact, U.K. or U.S. branches. The same caveat applies equally to New Zealand-based MNEs. Third, this analysis has shown that MNE participation through joint ventures and management contracts is common, with the former arrangement often involving government or one of its agencies. Based on present indications, such departures from traditional patterns of MNE involvement seem likely to continue.

Existing Policy on Foreign Investment

Not all Pacific island countries have succeeded in formulating a set of coherent and clear-cut foreign investment policies. Nonetheless, it is apparent that these countries have adopted highly favorable positions toward foreign investment and, at the same time, have chosen to exercise a degree of control over the developments associated with such investments. In welcoming foreign investment, the Pacific island nations have come to recognize the potentially valuable contributions that this investment can make toward the realization of national development objectives. These contributions include employment expansion, natural resource exploitation, and balance of payments reinforcement.

The purpose of foreign investment, as widely perceived in the region, is to promote the development of key areas of the economy. These areas differ significantly from one country to the next, but there are also many common areas (for example, manufacturing). The pattern for any one country depends on resource endowment and related economic circumstances. Thus, in Papua New Guinea, a large and resource-rich country, priority areas for foreign investment (as stated in the National Investment Priority Schedule) are minerals and petroleum, agriculture and livestock, forestry and forest products, fisheries and fish products, shipbuilding and repairs, tourism, and wildlife. Natural resource development is also a priority in other relatively large island countries, such as Fiji and Solomon Islands, and in the middle-order countries, such as Western Samoa. In these countries, agriculture, animal husbandry, manufacturing and agro-processing, and, of course, tourism also figure prominently. Among the small economies, as represented by Kiribati, Tuvalu, and Niue, smallness and limited resources restrict the range of key investment areas chiefly to fisheries and selected small manufacturers.

A number of countries (for example, Western Samoa) do not openly encourage foreign investment in agriculture. In large part, this policy is dictated by complications over existing land tenure systems, which inhibit access to large land areas for large-scale commercial development. In part, it is also due to existing development policies that tend to treat agriculture as a preserve of indigenous farmers. Where foreign investment is emphasized in agriculture, as in Fiji and Solomon Islands, it is largely in connection with the development of large-scale projects with high capital, technological, and managerial requirements.

Policies to achieve greater localization in the agricultural sector have been pursued in several instances. Papua New Guinea has been notable in instituting a Plantation Redistribution Scheme designed to transfer the ownership of plantations to nationals. The scheme, however, appears to have discouraged foreign investment in agriculture.

Certain countries, notably Papua New Guinea and Solomon Islands, specify reserve areas for investment by local citizens. This policy reflects preferences for maximizing indigenous participation in the commercial life of the country. The activities normally falling within the ambit of reserve areas are normally those that are amenable to small-scale development and that do not require large inputs of capital and managerial expertise. In Papua New Guinea, areas designated as reserve activities include cultivation and processing of coffee, production of copra and groundnuts, poultry farming, inland fishing, trucking, retail trading, and the provision of small-scale services. Similar reserve areas are specified in Solomon Islands but are observed less formally in a number of other countries.

The formation of joint ventures in major economic sectors between foreign and local investors (including government or its agent) appears as a prominent element in the foreign investment policies of many countries. Although formal and specific requirements regarding local equity are found in only a few instances, the local equity content is usually an important factor in the assessment of eligibility for tax and related concessions. In practice, governments have tended to be pragmatic and flexible in this area and have been prepared to reduce the proportion of local equity required or even to withdraw it altogether. In some cases (for example, Fiji) provision is made to effect the required local equity participation over an agreed time period. In general, flexibility on local equity requirements is most evident where highly desired investment projects are involved.

Insistence on a large local equity share has been most evident in Papua New Guinea in connection with the two mining giants: BCL and Ok Tedi. Government equity participation in each project is 20 percent with the balance owned by overseas-based multinational groups. As a result of recent policy review, however, significant modification of this approach is likely to occur. In contrast to a major equity participation, taxation may be emphasized as a means of securing financial benefits for the country from major foreign investment projects.

Other elements of policy attempt to promote localization and related goals. Thus, MNEs are expected to conduct staff training, and in Fiji a payroll tax is levied to contribute toward this objective. Also widely encouraged is a high degree of staff localization at the professional and executive level. To do this countries often exert pressure on companies through their work permit systems whereby attempts to recruit overseas personnel must be justified in detail.

Several countries have established incentive systems to encourage investment in selected areas. Usually applicable to both local and foreign investors, these incentives commonly take the form of financial concessions such as income tax holidays, relief from the payment of import duty on capital equipment and raw material, and assistance including the provision of serviced factory sites and training. In some cases, separate incentive measures are available on the basis of individual sectors or industries.

The range of incentives for which potential investors are eligible is usually set out in formal legislation. Criteria for awarding benefits under such acts are normally specified; these include high value added, favorable impact on employment and foreign exchange earnings or savings, and the capacity to bring in both capital and technological know-how. The provision of a separate set of incentives, which may be associated with a particularly important "commanding heights" type of project, is frequently determined directly at the ministerial level.

It is a matter for debate whether tax and related concessions actually do stimulate investment although some evidence suggests they do not (see, for example, Fairbairn 1985 and UNIDO

1983). This question aside, many countries regard such incentives as an essential part of their armory for inducing productive investment and have used them as leverage to channel investment into desired areas of the economy.

Notable differences exist in the range of incentives offered. Widely available are income tax holidays ranging from two to five years in duration. These are provided in differing combinations with a variety of other concessions including relief from customs duty, accelerated depreciation, carry-over of losses, protective tariffs, relief from withholding taxes or dividends, and the granting of quantitative restrictions on imported goods that compete directly with local production. Less frequently found incentives are investment allowances, relief from export tax, and extreme forms of restrictions on imports (for example, outright banning of a product). Only Papua New Guinea and Fiji grant export incentives while they, plus one or two other countries, provide investment allowances in certain defined areas.

Aside from the special cases of Vanuatu and Nauru, both of which do not levy income or profit taxes, the most generous tax incentives are found among the middle-order countries, such as the Cook Islands, Tonga, and Western Samoa. Thus, in Tonga approved industrial enterprises—either new or old ones wishing to expand—are entitled to an initial tax holiday of five years, which can be extended for an additional five years or even longer. Other possible benefits in Tonga include customs duty exemption for two years on capital equipment and materials, accelerated depreciation, carry-over of losses without a time limit, and exemption of shareholders from a 14 percent withholding tax. In Western Samoa for new enterprises whose subscribed share capital is not less than one million tala, relief for an "extended period" (apparently as long as 10 years) can be obtained on income tax, customs, and excise taxes.

In Papua New Guinea financial concessions are used far less, as evidenced by the absence of relief from income tax and import duty. An extensive range of assistance measures is still available, including accelerated depreciation, export incentives, tax deductions for staff training, and a willingness to use tariffs and outright banning of imported goods as a means of boosting local enterprises. However, a tax rebate is being considered for new manufactured products based on a percentage of the minimum wage per employee.

A cornerstone of Papua New Guinea's policy, especially in minerals, is the application of the so-called resource rental taxes, which involve the levy of taxes on additional profit on returns beyond the agreed rate of return applicable to a particular venture. Individual projects are subject to negotiations over the project's agreed rate of return beyond which additional profit taxes are levied. In the case of BCL, for example, profits in excess of the agreed rate of return of 15 percent are taxed at the rate of 70 percent.

Policies toward local borrowing by foreign companies are not always well defined, but from the available evidence such borrowings are generally permitted on a limited scale and subject to close control. Fiji is the most specific; it pursues a fairly flexible policy where local borrowing is permitted—once Reserve Bank approval is obtained. Favored areas are activities that confer benefits in employment, export earnings or import savings, and the realization of other tangible economic benefits. Borrowing for working capital is normally permitted. Guidelines are less specific in other cases, but, in practice, there appears to be a degree of flexibility. The deciding factors often are the degree of local equity and the importance attached to the activity in question.

Some countries provide direct forms of assistance in certain key areas, which can include assistance in acquiring land sites for factories. Tonga has established a Small Industries Centre where fully serviced land and factory shells are available. In Fiji, Solomon Islands, and Western Samoa, industrial estates make factory sites available for renting. In other cases, government assistance can usually be obtained in negotiations with local groups over land for factory sites. In Papua New Guinea public land is available for industrial leasing.

Other forms of direct assistance tend to be distinctive to a particular country. For example, in priority projects, Papua New Guinea will pay up to one-half of the cost of feasibility studies and also will provide the necessary infrastructure, including buildings, normally on a user-charge basis. Fiji provides a small subsidy (7 percent of approved capital expenditure) for hotel construction and extension (as an alternative to accelerated depreciation) and makes a cash grant (via the National Training Council) for approved training activities.

Different institutional mechanisms have been developed to deal with foreign investment, specifically to assist in providing basic information and developing projects through the various stages including registration. The responsibility for this work is often entrusted to a single statutory body. In Papua New Guinea the National Investment Development Authority (NIDA) is responsible for screening and approving all foreign applications and for negotiating the terms and conditions of foreign entry. In Fiji the Economic Development Board (EDB) scrutinizes and processes all foreign investment applications and makes recommendations on the proposal for the cabinet's consideration. (The EDB also undertakes investment and trade promotion work.) In most other cases, the responsibility for servicing foreign investment falls on a government department or a division thereof—a division of the National Planning Office in Solomon Islands, the Department of Economic Development in Western Samoa, and the Ministry of Labor, Commerce and Industry in Tonga.

In some cases, serious deficiencies remain in the servicing of foreign investment, which in Papua New Guinea have prompted a review of the existing system. Despite the existence of servicing and coordinating agencies, major bureaucratic delays and inconvenience frequently occur. On the whole, procedures need to be further streamlined if efficiency is to be improved.

Contributions and Benefits

As noted earlier, MNEs have played a major part in developing the economies of the South Pacific region. They have been in the forefront in promoting trade, transportation, and service industries and in developing key resources in the areas of minerals, forestry, and fisheries. MNEs have been a powerful agent in the transfer of capital and technology from the advanced industrial countries to the developing Pacific island nations and, in general, in the promotion of the modern monetary economy.

MNEs will continue to play a major role in the region for two reasons: First, they enjoy a comparative advantage in their access to capital and technological resources on a scale unavailable within the region. This factor is particularly important in cases where substantial inputs of capital and technology are required. The second reason is the countries' clear indication that they want continued and increasing MNE participation in their economic development, given their lack of the basic ingredients for development. The provision of often generous tax concessions in a number of the Pacific island nations underscores this attitude.

Balance of Payments Effects

The capacity to mobilize capital funds at a scale required for development is severely restricted among Pacific island nations, which has led to extensive dependence on external capital, both official and private. Low savings levels and propensities reflect deep-seated social and economic factors, including low income levels, undeveloped entrepreneurship, and institutional deficiencies in local capital markets. MNEs have a significant capacity to bring in capital funds and often draw upon the resources of the central organization. Moreover, through this nexus they are in a position to more easily raise funds in international financial markets, possibly at favorable terms.

The capital funds that MNEs bring into a host country for investment purposes augment the supply of local capital and ultimately lead to expanded production. Such funds also directly contribute to filling the foreign exchange gap commonly experienced by Pacific nations. The enlarged productive capacity induced by MNEs can have significant effects on the balance of payments, particularly through increased export earnings (netted out for the import requirement of such exports and other foreign exchange outflows connected with the enterprise). This result is often facilitated by an affiliate's capacity to export to overseas branches or by its access to established markets. Also potentially significant are the net foreign exchange savings achieved through import substitution.

Other than the initial injection of capital and foreign exchange, which occurs during the establishment period, host countries can also benefit from the reinvestment of profit, once the project is a going concern. Transfers to host governments in the form of taxation and related charges can also build up productive capacity through, for example, improvements in infrastructure. Against these potential benefits must be weighed the ensuing outflow of funds in the form of dividend payments and license and management fees, which impact the balance of payments. Such transfers could be substantial depending on the level of profitability, the tax system (including tax concession schemes), and the availability of opportunities to deploy funds locally.

In seeking to attract MNEs, Pacific island nations usually pay close attention to a project's export potential and related effects. In this regard, two aspects are worth emphasizing. The first is the desire to establish major export-oriented ventures capable of serving as growth leaders. The second is the development of productive activities that either earn or save foreign exchange. These considerations are generally embedded in current policies toward foreign investment and usually carry considerable weight in the awarding of tax and related incentives.

However, as will be discussed in the next section, the full value of MNE contributions to the balance of payments has to be judged against the foreign exchange outflows associated with the enterprise over time. Such outflows can be substantial as in the case of certain import substitution activities involving large amounts of imported raw materials. Where restrictive trade arrangements and transfer pricing apply, the potential for net export earnings can be further substantially undermined.

The MNE contributions to export earnings are overriding in several countries, particularly the large island nations that are well endowed with commercially valuable natural resources. The most dramatic single case is that of BCL in Papua New Guinea, one of the biggest copper and gold complexes in the world. This company came into operation in the early 1970s as a joint venture between the government with 20 percent of the equity, CRA, and several other major partners. In 1983 BCL's exports consisted of copper at US$180 million, gold at approximately $206 million, and silver at $14 million, giving a total of $400 million. Because Papua New Guinea's export earnings totaled $780 million, BCL accounted for 51 percent of the country's total export earnings (Bank of Papua New Guinea 1984b). The share of export earnings accounted for by foreign-owned ventures is overriding when exports originating from the forestry and plantation sectors are taken into account.

In Solomon Islands, exports are dominated by three resource-based activities with heavy MNE involvement (fish, logs, and palm oil). For the fiscal year ending in June 1984, these products accounted for US$50 million out of total export earnings of $78 million, or 64 percent. MNE participation in exports in Fiji is mainly in fishing, forestry, and light manufacturing although overall these products account for only a modest share of exports. However, it should be noted that Fiji's leading export—sugar—was established and run by an Australian company (Colonial Sugar Refinery [CSR]) until it was taken over by the Fiji government. Sugar usually accounts for one-half of the country's total export receipts. The extent of MNE contribution to exports in other Pacific island countries is not clear due to lack of data. The experience of Vanuatu, Tonga, and the Cook Islands, in particular, suggests, however, that it is increasing.

MNE influence in the development of import substitution, especially light manufacturing, is extensive in Fiji, Papua New Guinea, and Western Samoa. But the extent to which such ventures actually succeed in achieving foreign exchange savings is difficult to judge. Many countries are heavily dependent on imported inputs (and high-cost expatriate management), which use up foreign exchange so that the actual benefits to the balance of payments may be negligible or even negative. Many also operate under heavy tariff protection and enjoy tax holidays, which involve other costs to the host country.

Employment and Resource Development

MNEs have been a valuable vehicle for developing the region's resources through the utilization of raw materials, employment, and skills training. Pacific island countries have differing resource endowments varying from the large and resource-rich Papua New Guinea to the small and resource-poor Tuvalu, though all nations have a marine potential. Because resource-based projects generally must be approached on a large scale, MNEs have new opportunities to bring into play the resources and skills at their command in combination with local labor and natural resources. The result can mean a substantial boost in productive capacity having a major impact on employment, the balance of payments, and the GNP.

The examples of major resource projects developed by MNEs are numerous: BCL and Ok Tedi in Papua New Guinea, Van Camp and Star-Kist in American Samoa, PAFCO in Fiji (and CSR in the past), and Taiyo in Solomon Islands. Usually, the MNE involvement dates directly back to the exploration and identification of resource potential. Without the MNE contribution, many such ventures either would not have been established or would have suffered considerable delay.

The significance of employment creation and skills training connected with MNE operations is obvious. Employment creation is everywhere a leading objective in development policy because of the needs to alleviate severe unemployment and to provide meaningful alternatives to emigration. Faced with rapidly growing populations, the Pacific island nations are threatened with growing unemployment and, at the same time, a widespread shortage of basic skills. This shortage of all levels of skills—professional, technical, managerial, administrative, and supervisory—has led to a heavy dependence on expatriates. In this context MNEs thus have an integral part to play in developing skills and in promoting government policies designed to achieve significant localization. While significant achievements have been made to date, much remains to be done in fully benefiting from the skills-generating potential of MNE involvement.

During field visits to Fiji and Western Samoa the authors sought to obtain data on direct employment by MNEs. As expected, the numbers of people employed by the 13 companies surveyed from which information was secured varied widely. The largest employers are the traditional, trade-based companies such as Burns Philp (South Seas) Co. Ltd. in Fiji with 1,117 employees and a Burns Philp affiliate in Western Samoa with 173. Also important were PAFCO in Fiji with 413, a bank in Fiji (Westpac) with 454, an airline company in Samoa (Polynesian group) with 180, and a fuel distributor in Fiji (British Petroleum) with 118. Among the smaller companies were Price Waterhouse in Apia employing 23, Shell in Western Samoa with 7, and Hellaby Samoa Co. Ltd. in Western Samoa with 16. Among the 13 companies, the number directly employed ranged from 1,117 to only 4, with a total of 2,871 people and an average of 212.

The strongest employment impacts were found in the mineral sector of Papua New Guinea. The number of people directly employed by BCL is estimated at 3,800 while for the first stage of Ok Tedi the corresponding figure is 3,000 (including approximately 1,500 construction workers). However, because many MNEs in the region are part of a broader network, the total "regional" employment should be considered. Westpac, for example, has a regional office in Suva but maintains affiliates or joint-venture arrangements in Vanuatu, Tonga, and Western Samoa and is initiating operations in Solomon Islands and Kiribati. While Westpac's employment totals 450 in Fiji, the total regional employment is probably over twice this level. The Fiji branch of Burns Philp employs 1,300 people, but when account is taken of the Apia office and other affiliates, the total employment is probably well over 2,000.

Expatriates associated with the 13 companies numbered 110, equal to 3.8 percent of the total employment of 2,871 people. These figures, however, include an unusually large number of expatriates in an airline company (Polynesian), which at the time was being restructured in partnership with an Australian company. If this company is excluded, the number of expatriates is reduced to 60, or 2 percent of the total, with an average of 5 people. Only in a few cases do expatriate numbers seem too high—for example, Burns Philp in Fiji with 17 expatriates out of 1,117, PAFCO with 13 out of 43, and Westpac with 14 out of 154 (but the last is a regional head office). In one case, no expatriates were present, and, in at least four cases, though expatriates were present, the top management positions were held by locals. Overall the impression is one of significant localization.

That MNEs engage actively in staff training is clear from the records of the 12 companies surveyed. Eight companies confirmed that they conducted on-the-job or inhouse training as a matter of course; in a number of cases this MNE training was combined with other local training schemes, such as Westpac's training center, which in Fiji can handle approximately 24 trainees. Seven companies indicated that they provide some overseas training, often through regional or head office facilities. Usually such training was of limited duration, sometimes lasting as little as two weeks, and directed at upgrading the skills of local staff in specialized technical and professional areas. At the time, the most intense training was being undertaken by Polynesian Airlines in Western Samoa and involved training in a wide range of skills including computers, booking procedures, and flying. Training efforts were considered less than satisfactory in only two cases, one related to PAFCO, where training by Japanese technical staff appears to have been minimal.

Technology

It is widely acknowledged that technology—whether embodied in a production process, product, or management—is a powerful determinant of economic growth. Its application to the development of a hitherto underexploited resource can result in major new industries or in expanded production capacities of existing industries. New techniques, when applied to existing operations, allow output to rise without necessarily changing other factor inputs, such as labor. (Technology can, of course, reduce the labor requirement.) The resultant improvement in labor productivity provides the basis for realizing higher levels of real wages with possible benefits to local living conditions.

MNEs can play a vital role in the development process as agents for technology transfer. New products, management skills, and technical know-how are applied, and goods and services are often vigorously promoted through product differentiation and advertising. These inputs and activities can lead to radical change in the economic and social life of the Pacific island countries. As compared to local competitors, if they exist, MNE affiliates have a considerable advantage: they not only have direct access to the research facilities and expertise of the central overseas organization but also operate in an environment where involvement in any major R and D work is not feasible in and of itself.

The potential role of MNEs as carriers of technology is readily apparent in natural resource development projects with substantial capital and technology requirements. Prime examples are the two copper-gold mines in Papua New Guinea, in which technology, management, marketing (and 80 percent of the capital in each case), and related skills were provided by MNEs. These mines would never have materialized without MNE participation, and it is doubtful whether such technology could have been secured in any way (for example, management agreements and foreign aid) other than through the involvement of large overseas companies with proven skills and expertise in mining.

However, the value of imported technology in practice has to be related to the terms and conditions attached to its acquisition, which may impose heavy burdens on the host country and can effectively remove many of the potential and realizable benefits. Major technology costs will be discussed in the next section, but suffice it to say that the technology introduced by MNEs is often inappropriate to the economic circumstances of the small island nations. High capital intensity technology is, for example, inconsistent with the factor proportions prevailing in most of these countries, at the consequent expense of increased labor absorption.

Little information is available on whether MNEs attempt significant technology adaptations in the South Pacific, but the subject merits close study. In principle, however, major technology adaptation is unlikely to occur in large resource projects in which efficiency considerations dictate the use of the latest technologies. Such projects are naturally capital and technology intensive. (High technology is frequently abetted by "tie-in" clauses and other arrangements that benefit the technology-supplying MNEs.) But as Hood and Young point out (1979), technology adaptation may be limited for other reasons, such as small markets, scarcity of skilled labor, and serious distortions in the price of goods and other factors.

A form of process adaptation, which is common in the manufacturing sector of Pacific island nations, concerns the use of second-hand machines (see Fairbairn 1985). Thus Rothmans Tobacco Co. Ltd. in Western Samoa, a subsidiary of a New Zealand parent, was manufacturing cigarettes with reconditioned machinery, which originally had been bought from the parent company as surplus. Rothmans made a deliberate attempt to make parts of the machines more labor intensive and decided not to use machines for bundling operations in favor of providing employment to 10 women. Also in Western Samoa, second-hand machines bought from Japan and Thailand were reconditioned and modified by Hellaby Samoa Ltd.—a meat canning company with its head office in New Zealand—as a means of maximizing manual operations, including the hand-filling of cans. In both these cases the underlying motives appear to have been to maximize the use of local labor and to achieve a degree of capital savings.

Local MNE operations can diffuse technology in the local economy. Demonstration effects may have a strong influence on local firms by encouraging the use of up-to-date techniques in production, management, marketing, and related fields. Management skills learned on-the-job at an MNE can stimulate the growth of local entrepreneurship. Product promotion may awaken new desires that when translated into productive effort can help to promote economic growth. The cumulative effects of such MNE-induced spin-offs or externalities can be a powerful force in development.

Competition

In the major areas of development in the Pacific island nations, the issue of competition with local firms does not normally arise. These areas are major mineral projects, telecommunications, banking, and fisheries—areas where local entrepreneurship and capital do not exist at the required scale. In a sense, these constitute the natural domain of MNE operations.

In the Pacific, however, many other major areas, including trading, manufacturing, local transportation, and construction, exist where MNE involvement can confer considerable benefits through increased competition. These benefits can take the form of lower prices for consumer goods, reduced monopoly profits, improved working conditions, and higher wage levels. In the particular case of trading, increased competition can result in a widening of consumer choices, an improved quality of products, and a greater reliability of supply. In principle, by engendering greater competition in such sectors, MNEs can promote efficiency in resource allocation and the distribution of economic welfare.

The most obvious potential benefit is where an MNE entry results in the breaking up of a "cozy" oligopolistic market situation (Hood and Young 1979). The resultant competition generally leads to lower product prices and other benefits that enhance consumer welfare. The benefits are also apparent where an MNE acquires an inefficient firm operating in a noncompetitive situation.

While having the potential to foster competition, MNEs also can reduce competition by virtue of their corporate structure combined with certain advantages over local firms. One such advantage arises from access to the financial and other resources of the central organization located overseas. The local affiliate is thus in a position of strength vis-à-vis local firms and capable of capturing an increasing share of the local market. Local entrepreneurship suffers as a result.

Being the first to set up operations can also place an MNE in a powerful and advantageous position. Where the domestic market is small and local entrepreneurship poorly developed, as is common in the region, MNEs can quickly develop into large monopolies exercising significant power throughout the economy. Such a monopoly can be difficult to break up by local competition. (However, Burns Philp in Fiji has recently been forced out of merchandising due to increasing pressure from local competition, mostly local Indian traders; see Taylor 1982.)

Several policy approaches have been used by Pacific island governments in part to curb the exercise of excessive monopoly power in the region. One such approach is price control whereby maximum prices are set for certain classes of "priority" goods, often including those manufactured locally (for example, beer and cigarettes in Western Samoa). Another is the specification of certain reserve activities for indigenous business development and the provision of concessionary development finance.

Other Features

Many MNEs have succeeded in developing new lines of activity in host countries, often entering a seemingly unfamiliar territory (though not necessarily so for the group as a whole). By so doing, MNEs have contributed toward strengthening the national economy and alleviating the balance of payments pressure by reinvesting profits. Particularly noteworthy are instances of MNEs becoming active in traditional sectors (such as merchandising and fuel distribution) and becoming involved in primary sector development. Such involvement is often prompted by government encouragement.

Several instances are well known. One is Burns Philp, Fiji—a long-established company traditionally concerned with merchandising, shipping, insurance, and automobile distribution. Recently this company has branched out into two new areas under joint-venture agreements: food processing including the canning of tomato products, which is being undertaken with the National Marketing Authority, and bus-body building, in cooperation with P. P. Lal. Burns Philp is also engaged in the major redevelopment of a copra plantation on a 4,500-acre estate owned by the company on Taveuni Island.

Morris Hedstrom Samoa Ltd., another leading merchant, has had a similar experience. It had taken up shares in a biscuit manufacturing company and a meat company and was in the process of replanting a 413-acre plantation under hybrid cocoa and coconuts. A ten-year development project was envisaged to cost just under US$1 million. Plantation development was said to be consistent with traditional group activities in Papua New Guinea and Fiji, both of whose expertise could be drawn upon.

Also notable is British Petroleum's involvement in the pine industry with the Pine Commission of Fiji and two other parties. This US$40 million project is designed to come on stream in 1987 with the production of sawn timber, plywood, and chips largely for export markets. Under a six-year agreement BP is to provide management. Such a move was consistent with the group's regional policy but was further motivated by government encouragement and pressure to diversify out of traditional lines due to a growing competition from hydropower. BP was also considering serving as a distribution agent for solar-heating equipment supplied by an Australian company.

As already noted, many MNE affiliates in the region are part of an extensive regional network. Examples are Westpac, Burns Philp, British Petroleum, and Queensland Insurance. The many advantages of being part of such a network are exchange of information, use of expertise and training facilities, and group buying in volume. Other potential benefits have wider regional implications, such as the promotion of closer economic integration among host countries. This can be illustrated by the Westpac network, which will serve at least seven island countries and will facilitate financial and trade transactions among these countries.

Another positive feature that emanated from the authors' field visits deserves mention: MNEs are often perceived as a stabilizing element in the local economy. They are looked upon as being more dependable when compared to smaller groups of foreign investors (many of which were said to be fly-by-night operations). MNEs have the financial resources to survive during times of adversity, for example, as when commodity prices are low. In the case of the tourist industry of Fiji (personal conversation with J. Samy), the "up-market" MNE-owned hotels were best able to withstand the recent recession and thereby served as a stabilizing factor in the industry and in the economy as a whole.

Multinational Enterprises: Costs and Problems

MNEs can make a number of important actual and potential contributions to the Pacific island nations. At the same time, however, situations can arise in which the development contributions of the MNEs are not fully evident because of offsetting negative impacts on the host country. The costs and problems that may be associated with the activities of MNEs arise partly as a result of the global orientation of the MNEs in their decisions about investment, output, pricing, and other operations, which bear on their global long-run profit and market position. Some of the problems associated with the activities of the MNEs, however, are partly the outcome of their responses to inappropriate host government policies.

The range of issues relevant to a consideration of costs and problems associated with the activities of MNEs in host countries differs markedly among different groups of host countries. Compared to the developing nations, the large developed host countries have different economic priorities and different expectations about and perceptions of the role of MNEs. The relatively small developing host nations, such as the Pacific island countries, are different from the large developing nations of Asia, Latin America, and Africa. For example, the nature of MNE activities in and interaction with the developing host economies of Singapore or Mexico is different from the situation in Papua New Guinea or Tonga. There is little point in discussing the issues (costs and problems) associated with technology transfer by MNEs for large-scale manufacturing industries because they have little relevance in the foreseeable future for the Pacific island countries.

Thus this discussion of the costs and problems associated with MNE involvement in developing host nations focuses on the main areas of actual and potential interest to the Pacific region. These areas are balance of payments effects, employment and resource use, provision of technology and know-how by MNEs, monopoly practices (including pricing issues), and social and cultural issues.

Balance of Payments Issues

As discussed in the section above, the capital inflows and export earnings associated with the operations of MNEs in the Pacific island nations have been important in varying degrees. The extent to which MNEs finance their activities by local borrowing, however, does minimize their contribution of capital inflows to the balance of payments. As noted earlier, Fiji and, to a lesser extent, Papua New Guinea have rules regarding local borrowing activities by those MNEs operating within their economies.

The counterpart of capital inflows is, of course, the outflow of payments by earnings (and interest) accruing to the MNE venture in the host nation. Such payments constitute an outflow in the balance of payments. While disaggregated data are not available, the data in Table 1 suggest that net outflows associated with private direct investment, including that of some MNEs, are likely to have been important at different times in several Pacific island countries. Not all of the earnings by an MNE take the form of direct payments of dividends on profits and interest on loans; indirect payments for a range of indirect "proprietary services" can be important. Indeed, these indirect payments, particularly management and service fees and royalty payments, are likely to be especially important for several of the countries of the region in sectors such as tourism (hotels and airlines), fisheries, and forestry, as well as other plantation operations.

Although data on such indirect payments are not readily available, this issue clearly requires further consideration by the host-country governments. Any judgment about the cost and balance of payments implications of payments for services provided by the MNEs, however, requires that these payments be compared with those that would arise in market transactions with unrelated parties. While it is true that MNEs may charge excessively for these services, it is also true that some MNEs provide know-how to subsidiaries at less than market (arms-length) prices. The pricing issue obviously has implications for the question of transfer pricing, as well as for the magnitude of balance of payments flows on the current account.

Also on the current account, the activities of MNEs can have adverse effects relevant to both imports and exports. In the case of imports of goods and services, some critics argue that MNEs have a greater propensity to import than do indigenous firms (for citations, see UNCTC 1983). Any greater import propensity of the MNEs clearly reflects the global orientation of the MNEs in their production and sourcing decisions: The firm may source from its own operations or from third parties from which it enjoys the benefits of ongoing relationships and economies of scale in purchasing. However, any scale economies may not be passed on by way of lower prices for all individual subsidiaries. Indeed, related to the transfer pricing issue, the subsidiary may pay higher prices for imports than local firms buying at arms length in the market.

Data suggest that generally there are high gross profit margins and low retained values in the service sector, especially trade and tourism, for developing countries (ESCAP/UNCTC 1984). In the tourism sector the imported component of goods and services is usually high. Figures for Fiji suggest that there is a 60 percent leakage from every tourist dollar of expenditure flowing to imports of goods and services, as well as other payments. The key issue is whether this figure would be any different—higher or lower—in the case of greater indigenous ownership and control of the tourist industry. Given the composition of tourist flows and the nature of tourist consumption patterns, the leakage figure in the case of indigenous ownership and control is unlikely to be very different with respect to the *level* of imports of goods. Still at issue, however, is the nature of *prices* paid for imported goods and services: Does the obvious buying power of the large hotel and transportation MNE flow to lower prices for imports of goods and services?

Because of the importance of "intra-firm" trade (approximately 24-30 percent of world trade occurs within the MNEs), MNEs are linked with high levels of imports, and their prices are higher than those that do (or would otherwise) exist in an arms-length, market situation in the absence of MNE involvement. The other part of the question is, Why are quantities and prices different?

Another example involves the pricing of petroleum products by MNEs in the Pacific region. In several nations, lower contract prices have been secured from "independent" suppliers of these products, compared with traditional MNE suppliers. The issue of whether these lower prices will mean a fall in quality and service (in maintenance of facilities and equipment and in security of supply) remains to be determined. Perhaps the higher prices for products supplied by MNEs compared with "market prices" reflect a range of quality and service characteristics that is provided by the MNE suppliers but is absent in the lower-price market alternative.

In the case of exports the argument is sometimes made that the MNE subsidiary is prevented from exporting as a result of a restrictive export franchise. One example of this general type of problem apparently existed in the PAFCO fisheries venture in Fiji, in which the range of fish products for export seemed to be limited by the Japanese MNE's joint venture partner (and the associated MNE's cannery). The Fijian partner was eager to diversify the types of tuna caught and canned, but the MNE partner restricted products to the traditional line, which apparently was compatible with its global marketing and distribution practices. In this situation an apparent conflict of interest takes the form of an export restriction imposed by the MNE partner in a joint venture. Further investigation is required of the extent to which this form of export restriction associated with MNE operations is prevalent in the fisheries and, indeed, in other exporting sectors of the region.

The Pacific island nations may have reason to believe that some part of the balance of payments has been adversely affected to some extent, at least in the past, by transfer-pricing activities in which exports have been underpriced. This problem appears to have occurred in the fisheries and timber sectors, though less so at present for reasons noted below. The effect of overpricing (relative to arms length) of services in various sectors—notably, royalties, management, and service fees—by MNEs also may be significant. No evidence, however, exists as to whether such activities in fact take place and, if so, to what extent they affect the balance of payments. Further research in this area is needed.

Employment and Resource Development

Also related to the balance of payments effects of excessive reliance on imports of goods and services is the alleged adverse effect by MNEs on the development of domestic sources of supply for a range of goods and services. In addition, MNEs are frequently blamed for not fully developing local skills and employment opportunities. It is argued that if indigenous firms would source a greater proportion of their requirements domestically, they could better encourage the development of local industries. Local firms, in turn, could be expected to make fuller use of local labor. Of course, this argument assumes that an indigenous enterprise would be in a position to generate the same production opportunities as an MNE in using local resources and generating employment. In the small developing nations in particular, an indigenous enterprise may not have the capital, technology, skills, or marketing opportunities that are prerequisites for resource-using and employment-creating activities.

Even though MNEs are clearly generating activities that would not otherwise exist, some evidence exists that resource use and skills formation have not always been maximized. In the case of resource use by MNEs in Fiji, one example involved the activities of a food-processing MNE in the chicken-processing industry. The MNE had a major share of the local market, was vertically integrated backward into chicken breeding, and took an increasing proportion of its raw materials from its own sources—all of these factors had the effect of forcing indigenous breeders out of existence. The response of government was two-fold: first, the MNE was pressured to sell some equity to the Fiji Development Bank, and, second, the firm was required to take a proportion of its input supplies from local growers. The government policies effectively changed the MNE's resource-using practices. Whether the change in input purchasing resulted in a change in the cost of the final product is not known. Nevertheless, government policy toward indigenous employment and indigenous enterprise activity appears to have had priority over any possible economies of input supply.

In the case of employment and skills generation, the evidence is mixed. MNEs clearly have a strong incentive to utilize as much local labor as rapidly as possible. The high cost of expatriate employees used by MNEs is a major reason why MNEs attempt to train and employ indigenous people at all levels within the firm as soon as possible.

Nevertheless, the training of indigenous employees has been limited in certain instances. For example, in some ventures in Fiji, such as the PAFCO joint venture, only limited training of indigenous personnel occurred in technical, engineering, and quality control activities. To a large degree, however, this limited training seems to have been the result of the host country's limited ability to take advantage of training and skills development opportunities; in other words, the absorptive capacity of the developing host country can be a major constraint on the development of skills.

The overall training and skills development in Papua New Guinea appears to have been more generally limited. While some MNEs, particularly in the banking sector, appear to have been active in training local employees, the government's localization policies have not caused a significant degree of indigenous skills development to date, in either the public or private sector. While only ten years have elapsed since independence, some of the MNEs in Papua New Guinea have had a presence in that country for a longer period of time.

The relatively low degree of indigenization of employment in senior technical and managerial positions indicates a serious shortcoming that reflects not only on MNE activities but also on failures of government policies to create an appropriate environment for such skills development to take place. Given the obvious incentives for MNEs to replace high-cost expatriates with indigenous employees, governments should critically assess their policies relating to education, training, and wages.

Technology

One of the major potential contributions associated with MNEs is the provision of technical and managerial know-how and skills. The issue is whether access to technology and know-how generates actual net benefits that are greater than those via alternative mechanisms, such as licensing and management agreements. Many aspects are related to technology flows via the MNE, though only some are relevant to the small host nations such as the Pacific island nations. (A more detailed discussion of the technology-related issues directly relevant to large developing host nations can be found in Parry 1981.)

One major problem associated with the use of MNE technology involves its suitability. The issue of appropriate technology has several dimensions. Of fundamental importance is that technology may be inappropriate because the actual product or process is unsuitable to the developing country's demand patterns, that is, unsuitable to real needs or wants. A well-known example of products, which may be inappropriate in this sense in developing nations, is baby food. The criticism largely has concerned the marketing practices of certain MNEs in promoting baby foods, which may be inappropriate for widespread use as an alternative to traditional methods such as breast feeding. A range of other goods and services, particularly for consumers, may also fall into this category of being inappropriate.

In addition to inappropriate technology (in the sense of an inappropriate product embodying that technology), technology may be inappropriate for developing nations because of the factor proportions associated with the technology. Particularly for developing countries with abundant labor, the capital-intensive technology used by MNEs may be inappropriate. The suitability of MNE technology in terms of factor proportions is especially relevant to the question of employment creation by MNEs. The evidence about factor use associated with MNEs is mixed (see, for example, Parry 1980), though MNEs often seem to respond to host country wages and exchange-rate policies that discriminate in favor of more capital-intensive techniques and thus against fuller use of local labor. This type of inappropriate technology does not appear to have been a major issue to date in the Pacific, however, given the limited involvement of MNEs in the manufacturing sector, an involvement confined to small-scale manufacturing.

Another issue relevant to the technology and know-how provided by MNEs to small developing nations—compared with technology and know-how provided via other channels of access—is the pricing of that technology and know-how. This issue is considered below as part of the transfer-pricing problem.

Monopoly Practices

The competitive strengths (or monopoly advantages) of the MNEs represent a paradox. The assets and advantages of MNEs often lead to the exercise of monopoly power within individual host nations. Given the size and assets of most MNEs, especially when compared with those of the small developing host nations, these firms obviously have major impacts on the structure of the industries within which they operate. The fact that the MNEs tend to operate in highly concentrated industries with few competitors is especially significant in small host nations.

The major manifestation of monopoly power occurs through monopoly pricing, including the use of transfer prices. The MNE having a monopoly position within a host market may attempt to set prices that extract above-normal returns. One example of the exercise of monopoly power is the use of "tie-in" clauses for intermediate goods and services; that is, the MNE uses imported goods and services at prices that are above market or at arms-length and then passes these prices on via higher final product prices within the host market. Well-known examples of such practices have involved the activities of pharmaceutical MNEs operating in the developing nations (see, for example, the classic study by Vaitsos 1974). Because the MNE enjoys a monopoly position within the market, only limited, if any, market pressures prevent the MNE from engaging in this form of monopoly practice.

Several sectors in some of the Pacific island countries are open to this form of monopoly practice. The tie-in of goods and services by MNEs operating in tourism, transportation, and communications, for example, may discriminate against the developing host nation. In particular, the pricing of inputs of both goods and services by the MNE via these tie-in arrangements is likely to be passed on in the form of final product prices that are above normal within the host market.

The MNE may also exercise monopoly power via the transfer pricing of exports from the host nation. Some evidence exists that MNEs operating in the fisheries and timber industries in the past have engaged in transfer pricing of exports from the host country (ESCAP/UNCTC 1984). In the case of fisheries, the setting up of the Fish Marketing Authority in Papua New Guinea, the operations of the Fijian authorities since 1981, and, in particular, the activities of the Forum Fisheries Agency (FFA) have all meant a significant change in the practices of those MNEs operating in the fisheries sector in the region. Undoubtedly associated with these developments is the apparent change in the attitudes of the MNEs themselves; the MNEs increasingly see that good corporate behavior and relations with governments are important. A closer examination is required of whether transfer-pricing activities remain a problem in the export of timber and agricultural products. In the case of those products where the markets are more competitive and thus the market prices are readily identifiable, the problem of transfer pricing of exports appears less likely to arise.

Advances clearly have been made in limiting the monopoly power exercised by MNEs in the region through transfer pricing of certain exports. Transfer pricing involving other exports (as well as tie-in arrangements and transfer pricing involving imports of goods and services by MNEs in various sectors) is a monopoly practice that requires further investigation.

Social and Cultural Problems and Related Issues

The activities of MNEs can present problems in other areas for the host nation, particularly the small developing host country. One area entails the sociocultural effects of MNE activities, which some commentators perceive to be incompatible with local culture and values (see, for example, Winkler 1984). It is not always easy, however, to distinguish between the effects of the MNEs and those associated with the development process *per se*. Thus, for example, MNE activity in the natural resources and tourism sectors may be seen as having an adverse impact on the natural environment and on the traditional culture. The question is whether such effects, if indeed real, arise from MNE activities or from economic development—not whether MNEs or indigenous firms are involved.

The sociocultural conflict also involves the MNE impact on consumption patterns in developing host countries. The major problem seems to be the creation of consumption patterns that are regarded as inappropriate. One example noted earlier is the marketing of baby foods in competition with traditional and more appropriate feeding practices. Other instances of MNE activities promoting inappropriate consumption extend to other consumer products such as foodstuffs, consumer durables, vitamins, and pharmaceuticals (UNCTC 1983). Related to the promotion of inappropriate products is that some MNEs may also be involved in the production or marketing of unsafe products. Examples include the marketing of cigarettes, which have nicotine and tar levels in excess of "acceptable" levels, and of other products that have exceeded safe shelf-storage lives. To the extent that MNEs (and indeed other enterprises) engage in such practices, tighter consumer protection and health policies are required in the relevant host countries.

Still another problem with MNE operations in developing host countries involves political interference by MNEs. While no direct evidence exists that MNEs have directly interfered in the political processes of the region, their size and importance accord them a powerful position. In some of the small host nations, the risks exist that a few large MNEs can become dominant within the country and that the economic progress of the country can become heavily dependent on the activities of one or two large MNEs. Some of the traditional trading MNEs have diversified into other activities, which has increased their overall importance within the host economy. To some extent, the small developing host country becomes locked-in to one or two large MNEs. Indeed, the firms themselves become locked-in to the country; the firm has difficulty in disposing of assets built up in these small economies. This mutual interdependence may lead to a risk of political intervention greater than would exist with a more diversified involvement. Still another issue is of even more immediate relevance than direct political intervention by MNEs. These small developing host nations may take undue account of the stated (and perceived) interests of these firms in their own political decision making because they attribute critical importance to MNE investment and employment decisions.

Alternative Forms of MNE Involvement

MNEs have been changing the ways in which they operate within host countries, to some extent as a response to changes in host government policies and attitudes toward MNEs. Local equity requirements have been one major policy initiative taken by a number of host countries. In addition, some MNEs have evolved their corporate strategies in ways that favor nontraditional or alternative forms of involvement. These alternative forms of involvement differ from traditional foreign direct investment in their departure from reliance on the wholly owned foreign direct investment subsidiary.

The major feature of alternative forms of involvement is some "unbundling" of the assets and resources provided via the MNE. The most common examples include joint ventures, licensing and turnkey operations, and management agreements. Also emerging are technical aid agreements and independent consulting activities as alternative means by which certain types of resource transfers take place. These forms of involvement, particularly joint ventures and licensing and management agreements, are not mutually exclusive. Indeed, joint venture activities by MNEs are commonly associated with the use of formal licensing or management agreements. In the Pacific island nations the most common examples of these alternative forms of MNE involvement are joint ventures and licensing and management agreements.

The recent examination of MNEs by the United Nations Centre on Transnational Corporations (UNCTC 1983) highlights the increased importance of joint ventures and licensing agreements compared with traditional direct investment. The trend appears especially marked in the developing host nations. Three issues are associated with alternative forms of MNE involvement: (1) the extent and type of international resource transfers compared with traditional MNE involvement, (2) the costs and terms of access to resources associated with alternative forms of MNE involvement compared with traditional forms, and (3) the distribution of benefits between the host nations and the MNE. Given the importance of joint ventures and licensing and management agreements among several Pacific nations, some of the issues associated with these alternative forms of MNE involvement need to be discussed.

The use of alternative forms of involvement by MNEs is influenced by specific aspects of corporate strategy, as well as by a particular government's policies in different home and host countries. Thus a range of influences can bear on the use of alternative forms of MNE involvement.

1. Local equity rules and related government regulations are probably the major influence on the form of international involvement (UNCTC 1983; Parry 1984). Many host countries, both developed and developing, have requirements relating to local equity participation, which across the board have been particularly important in Papua New Guinea and Solomon Islands. Other countries such as Fiji, Tonga, and Western Samoa have expressed a preference for some local equity participation, but the approach has been one of accommodation in general. Most Pacific island countries have reserved specific sectors for indigenous investment. A preference for some degree of local equity participation in Papua New Guinea has caused the government to take significant equity in major mineral projects—the BCL and Ok Tedi projects—because of the inability of local investors to finance such an involvement. It is not clear, however, whether the Papua New Guinea government will continue to take significant equity in large-scale mineral projects in the future. Other countries, including Fiji, have also taken equity either directly or via statutory corporations in several MNE ventures.

2. The risk-spreading factor can also explain reduced (or non-) equity forms of MNE involvement. Thus the joint venture arrangement permits the MNE to invest while reducing the risks associated with traditional (wholly owned) direct investment. Other forms of involvement in the absence of any equity investment, such as licensing and management agreements, can be tailored to share the risks between the relevant parties. Two recent examples of management agreements are the Qantas-Air Pacific arrangements, where no equity is held by the foreign participant in the agreement, and the Ansett—Air Vanuata and Ansett—Polynesian Airlines arrangements, where equity is held by the foreign par-

ticipant in addition to a formal management agreement. As noted earlier, other instances of management and licensing agreements in the region have differing levels of MNE equity participation (including zero equity participation by the MNE). To some extent, these developments have reflected the desire of MNEs to reduce the risk as well as the influence of host nation equity participation policies.

Joint Ventures and Local Equity Requirements

In the larger joint venture forms of MNE involvement, especially the resource-based projects in fisheries, timber, and agricultural plantations, the host country government often takes an equity position, either directly or via a statutory authority. The Fiji government tends to take equity positions in joint venture projects with MNEs via statutory corporations and authorities, while the Papua New Guinea government, especially in the minerals sector, has taken a direct equity position.

An interesting example of a joint venture project between a host country government and an MNE is the Westpac Banking Corporation's joint venture with the Kiribati government in providing a banking facility extending to a "central" banking function. Such arrangements between private foreign banks and governments also exist in Tonga and Tuvalu. The Kiribati experience is particularly interesting because the government equity participation was funded under the Australian Development Assistance Bureau's (ADAB) Joint Business Venture Scheme. In this case, the MNE has 51 percent equity and a formal management agreement with the venture. One interesting aspect of this particular joint venture is the apparent improvement in performance of the operation after the Kiribati government purchased the equity.

The ADAB scheme provides funds for the purchase of equity in joint business ventures that involve an Australian direct investment participant. Funds are either provided via the local development bank for on-lending to local private companies at the development bank's normal interest rates or as a grant to the host country government or government body. In the case of the Westpac-Kiribati venture, the ADAB joint venture funds were provided as a grant to the government.

The main feature of the ADAB scheme is that, unlike the New Zealand Pacific Islands Industrial Scheme (PIIDS), it provides aid funds specifically to enable local firms and host governments to purchase equity in ventures with foreign (Australian) investors. To the extent that it has advantages in encouraging joint venture forms of involvement by MNEs in the region, this use of aid money is an important innovation. Indeed, host governments in small developing nations have difficulty in pursuing local equity and joint venture policies because of their severely constrained ability to mobilize scarce financial resources. Thus the host country government, rather than indigenous companies, is often required to take up local equity. Many of the benefits ensuing from joint venture forms of involvement by MNEs are associated with the development of skills and transfer of know-how to the local partner(s). Where the local participant is government or a government agency, such benefits may be less than fully realized in comparison with those cases where the local participant is an indigenous enterprise.

The ADAB joint venture scheme has been in existence for only a few years. To date only five or six ventures have been financed under the scheme, and one criticism made during interviews is that the scheme is overly cumbersome, takes too long to secure approvals, and essentially provides loan funds for joint ventures by indigenous firms that would normally qualify for development bank funding in any event. In the case of grants to host country governments, the scheme may permit equity involvement by the host country that might not otherwise be readily available. In the case of private sector participants, however, the ADAB scheme essentially acts to supplement development bank funds rather than to finance local equity participation that otherwise would not be funded.

The New Zealand PIIDS scheme does not normally fund equity participation by host country governments or enterprises. Rather the PIIDS scheme provides New Zealand government assistance to ventures that have at least 75 percent New Zealand equity. This assistance takes the form of various incentives such as suspensory loans for investment purposes, small venture grants, and contributions toward feasibility studies and training costs. The scheme may be used to provide financial assistance by way of grants or loans to permit local equity in a project. This form of assistance does not appear to have been significant to date.

The provision of aid funds for local equity participation with MNEs in the region is a major initiative worthy of further consideration. Should funds be available to finance local equity participation by indigenous enterprises or host country government or both? Should such support be limited to joint ventures with firms from the aid-granting country only? Should such support take the form of concessional loans and grants? How can such schemes best contribute to the overall benefits accruing to the local participant(s) in the joint venture? Additional research should examine the existing schemes and consider the range of options for aid-based local equity schemes.

The use of aid funds to supplement scarce domestic financial resources for equity participation with MNEs is one way of meeting the local equity objectives of developing host nations. Another new method of channeling local funds in this direction has emerged in Fiji. The Great Council of Chiefs has established an innovative institution—Fijian Holdings Limited—to raise funds from provincial councils and loans from development banks and to invest those funds in local companies. Such investments can be directed toward taking equity in established foreign-owned ventures or in new joint ventures with MNEs. Among the companies in which Fijian Holdings may invest are MNE operations such as Burns Philp and Carlton Breweries, and there is no reason why Fijian Holdings could not take equity positions in new joint ventures with MNEs.

This development in Fiji has important implications for other developing host countries of the region because similar arrangements based on traditional institutions may provide an important means of mobilizing financial resources to take equity and to form joint ventures with MNEs. Of course, more than just financial resources are required for joint venture operations to be successful. A local managerial and technical capability must also exist to permit the effective participation of indigenous business with MNEs in joint venture arrangements.

Local equity participation, however, need not be the most appropriate means by which the host country can share the benefits of MNE activities. As an example, the Native Land Trust

Board (NLTB) in Fiji encourages traditional landowners to take lease payments rather than outright equity participation for traditionally foreign-owned hotel and tourist development. Options for future equity participation may be taken, but the NLTB has reservations about the returns by way of dividends from local equity participation in hotel projects with their usually long payback periods.

Apart from cases where some doubt exists about whether local equity participants will receive significant dividends, other more fundamental reasons explain why local equity participation is not necessarily the most appropriate means of redistributing the benefits generated by MNE operations in the host country. In most Pacific island countries, localization policies have extended to local equity requirements for most new foreign investment projects. An individual government's interest in sharing the rents generated by resource exploitation, however, could probably be met as effectively via taxation policies as by equity participation.

Insofar as some control over ventures is concerned, it is not clear whether government equity participation has been any more effective than administrative control via agencies such as the National Investment Development Authority (NIDA) or whether such controls are indeed fully effective. The recent Ok Tedi situation suggests a major conflict between the government acting as an equity participant in major ventures and the government acting as a controller of the venture in seeking to maximize the project's *long-term* net benefits to the nation.

The philosophy of local equity participation at all costs, including government equity involvement in ventures, may not necessarily be in the best interests of the developing host nation. Local equity requirements may not necessarily maximize the net benefits from MNE operations or the distribution of these benefits in the host country. A major constraint on local equity participation—if it is to function as an efficient means of sharing the benefits of MNE operations, especially in the small developing host nations—is the lack of an indigenous managerial and technical capability to act as an effective local equity participant, whether via government or private sector participation.

The main reasons behind local equity requirements appear to be the distribution of benefits (share of rents), exercise of control over the relevant venture, and national political goals.

First, there is a legitimate concern with the share of rents generated by MNE operations, particularly in natural resource projects. Local equity requirements, whether taken by the government or local businesses, are designed to redistribute the share of rents generated by the venture.

Second, local equity is seen as a means of controlling a venture where the foreign investor may otherwise exercise control to the detriment of the host country. Host countries argue that inappropriate decisions about technology, employment, imports and exports, and transfer pricing are less likely if local equity is a factor.

Third, a degree of local ownership, particularly in key areas such as mining and agriculture, is considered to be politically compatible with nationalistic attitudes. The "public good" argument for local equity policies may be the most important reason for this approach to foreign investment. The effects of and alternatives to such a policy, however, must be clearly known.

Local equity policies have appeal as a way of dealing with some problems—real and imagined—attributed to foreign direct investment. Such rules have difficulties, however, and alternative means can be taken to pursue the objectives of this policy approach (Parry 1983). An alternative to local equity participation, particularly by government in the large projects, is a change in the taxation and royalty arrangements applying to such ventures. Participation in the share of rents generated by fisheries, forestry, tourism, or mineral ventures, for example, can be achieved via the resource-rent-tax approach adopted by the Papua New Guinea government. When a government funds equity participation, scarce resources may be diverted from other potentially worthwhile governmental activities such as investments in transportation, communication, health, and education. In such circumstances the allocation of aid funds by donor countries may be an appropriate alternative if the capability exists for effective local participation beyond financial involvement.

Licensing and Management Agreements

MNEs have technical and management agreements in several Pacific island nations. Management contracts and technical agreements may be used in a joint venture arrangement where the

MNE has some equity in the operation. Even where the MNE has 100 percent of the operation, a formal technical agreement with the subsidiary may be used to define the terms and conditions under which the MNE provides the know-how to the subsidiary venture. Some developing nations have required MNEs to enter into formal licensing agreements that specify such terms and conditions. These agreements may be subject to a formal approval procedure by the host government. In the case of joint ventures or in the absence of any equity holding by the MNE, a formal technical or management agreement is commonly used in the provision of technical and managerial skills and services by the MNE. An example of a management and technical agreement in the absence of any equity holding by the foreign firm is the recent Qantas-Air Pacific agreement. Other similar arrangements exist in the hotel industry whereby several of the large international hotel management groups have entered into management agreements without any equity involvement.

In some cases, governments and MNEs form management agreements and technical licenses. These arrangements, however, are not always without difficulties. For example, the Western Samoan government's international hotel (Tusitala Hotel) was the subject of management agreements with foreign groups, but for various reasons these arrangements have encountered many difficulties. Another example is the PAFCO joint venture in Fiji, in which the MNE had equity participation and also provided management and technical inputs to the venture. For various reasons the parties have been less than happy with these arrangements. To some extent, as mentioned above, the limited capacity of the local partner to take advantage of the venture's training aspects restricted the gains that might have arisen from the arrangement.

The other major problem inherent in licensing and management agreements is the structure of charges made by the MNE under the agreement. The potential for transfer pricing in the services sector is a major problem area in which technical and management agreements are used. The structure of charges in the airline and hotel industries requires careful scrutiny. The pricing of material inputs, as well as of services, in these industries provides some scope for potential transfer pricing. Airline management agreements and equipment lease charges (as well as hotel management agreements and materials supply), particularly in Fiji, Western Samoa, and Vanuatu, should be carefully examined to determine whether transfer pricing or overpricing is occurring. Government authorities may not have the necessary expertise to ensure that such agreements contain arms-length equivalent terms and conditions.

Other avenues exist by which some of the resources that may be provided by MNEs can be secured by developing host countries. The options are limited to a large degree by the capacity of the host country to utilize different forms of resource flows. Financial flows alone may not be fully utilized unless the structure exists within the developing host country to channel those funds into productive activities. Management and licensing agreements may provide a needed resource—know-how—that is not readily available to the host country. The question is whether access to such know-how without MNE investment can provide the most efficient and least-cost access to that know-how. In the small developing host countries such as the Pacific island countries, real constraints exist in their absorptive capacity. In other words, capital alone or even technical assistance alone is not sufficient to meet full productive potential. This is not to say that there is no role for technical and training activities either via aid activities or via the MNE (or indeed both). Rather what is required is an effective utilization of a range of appropriate resource inputs—capital, management, know-how, and market access—which involves both an external access to appropriate resource inputs and a domestic capacity to effectively utilize these inputs. The MNE does have a role to play in these processes: The issue that remains is how to maximize the net contributions that arise from this involvement and its various alternative forms. In other words, policies need to be implemented that facilitate mutual cooperation and generate benefits for the MNE and the host country.

Policy Issues and Options

This section elaborates on the important policy issues in relation to the problem areas discussed above. The underlying objective, which must dictate the direction and content of policy relating to MNEs, is the need for policies to maximize the net contributions and benefits of MNE activities for the nations of the region. Appropriate policies must be concerned with influencing the size, type, and quality of MNE involvement within the host nation. Inappropriate policies that lead to adverse responses by MNEs must be avoided.

Many policies cause the MNE to respond in ways that can detract from the overall contribution to the developing host nation. For example, and of particular relevance for the small developing host nations, tariff and other protection policies that induce the entry of foreign-investment plants, which can operate only behind high protective barriers, lead to major distortions and adverse impacts on the MNE contributions to the host nation (Parry 1980). Similarly, foreign exchange policies and local equity requirements may lead the MNE to engage in transfer pricing and related practices to bypass such controls and requirements. This response not only will circumvent the policy itself but also will lead to serious distortions elsewhere in the host economy.

If the need is to implement mutually beneficial policies that maximize the net benefits of MNE involvement with the host nations, then several issues must be kept in mind.

Problem Areas

The first overriding issue in the region arises from the small size and fragmentation of markets and the consequent problems of distance and transportation. Among the implications, of paramount importance are the constraints placed on any MNE activities that are directed toward import replacement.

Within the manufacturing sector, in particular, a trend is emerging in the region to encourage high-cost manufacturing activities as a means of protection against imports. A major example has been the construction of meat canneries in some countries that in some cases will utilize imported tin plate and meat, with an accompanying ban on imports of substitute canned food products. This type of policy proposal involves high-cost import replacement, with adverse consequences both for economic efficiency and for income distribution. Such policies have doubtful overall net benefits for the developing host nation. Whereas MNEs have significant employment-creating activities, policies associated with import substitution of this type should be avoided. Small-scale manufacturing for domestic markets, as well as processing of primary products for export markets, represents the type of activities in which efficient MNE involvement is feasible. Governments should pursue policies designed to encourage this form of MNE investment rather than import replacement, which is better suited to larger, less fragmented markets.

A second area that requires careful consideration in the context of the future of MNE involvement in the Pacific island nations is landownership. Landownership problems in the Pacific represent a major obstacle to investment activities, including MNE activities. These problems occur in mineral exploration and development in Papua New Guinea, forestry development in Solomon Islands, and tourist development in Fiji. Even in Fiji, with its long-standing registration of customary land title and existence of the Native Land Trust Board (NLTB), substantial difficulties still occur in landownership and usage problems—the efficient resolution of which is imperative for all general investment decisions.

The traditional ownership of land does not necessarily have to be compromised in securing its productive use such as by MNE investment. Secure long-term land-use rights for minerals development, plantation agriculture, and tourism, for example, are imperative if new MNE investment, as well as reinvestment in these sectors, is to be efficiently encouraged. In some of the nations of the region the land question undoubtedly represents a major obstacle and requires careful consideration and action across the region.

Another area, which is especially relevant to the question of maximizing the overall benefits from MNE operations, involves labor policies. The experience of the large Pacific island nations, such as Fiji and Papua New Guinea, suggests that the creation of training and skills, especially in technical areas usually associated with MNE activities, has not been fully realized. The development of technical and management skills by MNEs has taken place in certain countries (especially in Fiji) and sectors (especially in banking and other service sector activities). The benefits to the developing host nations, however, do not appear to have been fully realized largely because of the limited absorptive capacity of the host nations themselves. The development of skills within the work force employed by MNEs, and other firms with which the MNEs are involved, requires the existence of a capacity to take advantage of those linkages. Domestic education and training policies within the host nation are critical, quite apart from the actual training practices of the MNEs themselves. In the last analysis, however, the development of technical and management skills represents one of the most important development contributions that MNEs can make to the region.

Another obvious issue concerns the level and pricing of inputs provided by MNEs, which range from imported raw materials to services. The extent of "leakages" associated with MNE activities, including the problem of transfer pricing, raises major issues for developing host nations. The degree of benefit that does accrue to the host nation will be affected by such leakages. The pricing of inputs and services by MNEs is not fully scrutinized by the host countries of the region, which reflects the difficulty faced by small countries in monitoring the activities of foreign firms. Because monitoring requires taxation and exchange control, this function may well lie outside the personnel and resource constraints of the Pacific island nations.

Regional groups such as the Forum Fisheries Agency (FFA) have played an important role in monitoring and controlling transfer-pricing activities. Individual nations have operated in concert with one another and with the FFA itself. An improvement in the bargaining position, as well as in the monitoring capabilities, of the nations in the region will realize benefits in negotiations with MNEs. In sectors such as forestry, finance and banking, transportation, communications, and tourism, an assessment should be made of the nature of leakages associated with the level and pricing of imported goods and services associated with MNE operations. Further appropriate action in this area is likely to improve the share of benefits accruing to the nations of the region.

Policy Areas

Several policy options, both general and specific, are available to the host nation in dealing with MNE activities. While the Pacific island nations have been actively encouraging an increase in MNE involvement, all countries exercise some control over MNE activities. Although the specific nature of policies in the region has been examined in this paper, scope exists for a more detailed assessment of policies within individual nations, as well as for an overall approach that reflects consistency across the region as a whole. Several policy options exist.

Countries can identify reserved areas from which MNEs are to be excluded, as well as priority areas in which MNE involvement is encouraged. This approach is generally adopted by all the nations of the region. Whereas reserved areas can protect the legitimate interests of indigenous enterprises (including traditional activities), especially from *unfair* competition, this approach must not unduly protect domestic firms from those effective competitive pressures that are otherwise absent in the economy.

The designation of priority areas must relate to appropriate development strategies. Sectors and specific activities must be identified that are consistent with the comparative advantage structure of the economy. Clearly, such an approach rules out import-replacing activities that are inconsistent with the small markets involved in the region. The most appropriate priority areas for the region include minerals development in some nations (Papua New Guinea, Solomon Islands, and, to a lesser extent, Fiji), forestry and fisheries exploitation (including some processing), plantation and tropical agriculture (with processing), tourism, and service sector activities, particularly those associated with the other priority areas.

Associated with the nomination of reserved and priority areas, host governments can specify the local equity requirements applying to MNE involvement. These local equity rules can be either formal requirements to apply across all sectors or guidelines to be encouraged. These requirements or guidelines can vary among specific sectors, for example, high priority areas may have flexible local equity guidelines, while low priority areas may have fixed requirements for local equity to facilitate foreign investment approval.

An extension of the nomination of reserved and priority areas is the establishment of screening and approval mechanisms and even the formulation of a set of regulations covering MNE activities. The screening and authorization function can also extend to the establishment of performance criteria and requirements governing MNE activities in the host nation.

Some countries appear to have difficulty in administering policies regarding MNE activity and foreign investment. The most serious problems appear to have been in Papua New Guinea's NIDA, though some difficulties emerge in the operations of Fiji's EDB. Layers of responsibility among different government authorities, as well as provincial agencies (notably in Papua New Guinea), have often caused foreign investment proposals to be unduly delayed by bureaucratic procedures. MNEs with interests in investment activities, which are consistent with the host countries' development priorities, should have access to "fast-track" negotiation and implementation mechanisms by which to expedite the bureaucratic procedures.

Political intervention should be avoided in these processes, other than at the broad policy level of identifying development strategies and the relevant criteria applicable to MNE involvement. The potential conflicts of interest require the absence of political involvement in the detailed approvals and in the monitoring and control activities that deal with MNEs. In addition, firms require clear rules relating to foreign investment entry criteria, as well as guidelines governing their ongoing operations within the host country. Critical to investment and other decisions by MNEs is certainty about government policies and administrative requirements and regulations.

A fundamental issue related to the operations of agencies dealing with MNEs, such as Papua New Guinea's NIDA and Fiji's EDB, is whether their objective is to promote MNE investment activities or to monitor and control MNE activities. The small host nations have a case for monitoring and controlling certain MNE activities to maximize the net benefits accruing to them. This function extends to negotiating over the terms and conditions of new entry by MNEs, as well as to monitoring ongoing activities by MNEs in areas such as training, using local resources, pricing imported goods and services, and setting royalty and management fees.

An investment promotion function is inherently incompatible with the functions of screening/approving and monitoring/controlling MNEs by the small developing host nation. While both activities may be important, they need to be undertaken by separate agencies. Certainly, the investment promotion agency must be aware of the policy guidelines applying to the activities of MNEs, but it must conduct its role in encouraging MNE entry and operations separately from the approval and control functions. The ever-present problem, of course, is the limited resources available to the small developing host nation to perform these responsibilities effectively.

The host country may set performance requirements for MNEs as a part of the initial negotiating procedures. The most common examples of performance requirements include local employment and training, export activity, and local processing. Inherent in the monitoring of actual performance is the allocation of resources and personnel by the host nation.

Finally, policies regarding MNEs may take the form of incentives to encourage MNE investment. The experience with incentives varies in the region. Papua New Guinea, for example, has tended to avoid direct grants and taxation incentives as methods of encouraging MNE investment in priority areas. Other countries have initiated a variety of incentives. The most recent example is the significant taxation concessions and other incentives that have been granted to the developers of the proposed Royal Samoan Hotel in Western Samoa.

Other incentives include investment allowances, infrastructure assistance, soft loans, and tariff concessions. MNEs generally respond as effectively to a stable business environment and favorable economic climate as to an array of specific incentives. In some cases, however, specific incentives are necessary to encourage investment. Obviously, any incentive structure must be consistent with the maximization of the net benefits accruing to the host country. Some incentive systems often cause linkages with the host country, including those associated with revenue generation via taxation and other fiscal charges, to be negated by the set of concessions and incentives made available to the MNE.

These broad policy guidelines require elaboration in terms of specific and detailed policies. Clearly, the nature of specific policies will vary among the individual nations in the region. Nevertheless, the common goal of all policies must be to maximize the potential contributions of MNE operations to the benefit of the developing host country. If detailed policies are to be set in place, several areas involving the activities of MNEs and their responses to government policies require extensive additional work.

Recommendations and Conclusions

A number of recommendations arise from this study of MNEs in the South Pacific region and relate to areas where specific action is warranted and where further research is needed. These recommendations are not exhaustive, nor are they in any order of priority.

1. The extent of transfer pricing and related activities needs to be carefully assessed and controlled. In certain sectors a variety of opportunities exists for MNEs to increase their share of rents by excessively using or overpricing imported inputs. In tourism, forestry, fisheries, and plantation agriculture, for example, the structure of royalties, management fees, and other charges for imported inputs may enable the MNE to overutilize or overprice imported goods and services. These leakages not only can be excessive but also can potentially adversely affect the host nation.

Similar to the leakages arising from dependence on imported goods and services, MNEs also may restrict the quantity and type of exports or may engage in transfer pricing of exports; both practices can have adverse consequences for the host country.

Because distortions in the structure and pricing of both imports and exports by MNEs lead to major problems, more research is needed on the pattern of payments for a range of goods and services associated with the activities of MNEs in sectors such as tourism, fisheries, forestry, and mining. Host governments need to effectively monitor and control all existing practices. The apparent success of the FFA can serve as a guide for other areas.

2. The possibilities for and benefits from coordination of incentives among the nations of the region require consideration, as well as whether or not special incentives and concessions are required to encourage MNE investment. Competition for MNE investment may have led to a range of inappropriate and even unnecessary incentives. Thus the potential for regional cooperation and coordination in this area is worthy of exploration.

3. Special incentives may be less important than a general policy environment conducive to MNE investment. In particular, policies that are consistent with development goals, that support a stable economic and political climate, and that have a high degree of visibility and certainty are highly significant in attracting appropriate MNE involvement. Policies that create layers of bureaucratic responsibility and cause delays in investment approvals clearly have had negative effects on MNE investment in the region. In addition, political interference in the detailed administration of policy has produced significant disincentive effects on MNE activities.

Policies obviously need to be directed toward maximizing the net benefits of MNE involvement. The options for fostering mutually beneficial MNE activities need to be more carefully explored. In general, policies must be consistent with the overall guidelines of speed, stability, and certainty. Beyond these general requirements, a number of specific policy options need to be carefully formulated and assessed. One high priority option is the implementation of land-use policies that are conducive to MNE (and other) productive investment.

4. One set of special policies relates to local equity requirements or guidelines. Host nations may choose to require (or prefer) local equity participation for several reasons. Where a host nation uses local equity involvement to increase its share of the rents generated by MNE activities, it should assess alternative policies, one of which is "participation via taxation" rather than equity.

Other reasons for requiring local equity may be more important, such as the encouragement of local businesses and skills development. In these cases the options for effectively channeling local resources to equity participation should be closely examined. Of potential importance are the use of traditional institutions for funds and the use of aid funds for local equity participation.

5. One of the most important reasons for encouraging local equity involvement is to maximize the flow-on of MNE activities to local training and skills formation. While employment and, in some areas, training have been important, their full potential has not been realized. The major constraint on the full realiza-

tion of the training and skills formation potential of MNE activities has been the limited capacity of the Pacific island countries to fully participate in these activities. Employment and educational policies and practices in the Pacific island nations need to be framed so that technical and management training by MNEs can be fully and effectively conducted. Employment creation and skills formation are a major potential contribution of MNE operations. Policies that permit this contribution to be realized in full should be considered and pursued.

6. In addition to bargaining and negotiation skills, effective scrutiny is required of many policies and actions designed by host countries to maximize the net benefits from MNE involvement. Resources must be devoted to monitoring MNE activities, where appropriate, and to developing negotiation skills with MNEs. Papua New Guinea, for example, has relied both on indigenous and expatriate skills in negotiating with MNEs in the major minerals ventures. Such skills are integral to the formulation of mutually beneficial policies.

7. Finally, more data are needed regarding various aspects of MNE and other forms of foreign firm involvement in the Pacific. Areas such as the nature and extent of leakages, transfer pricing, and export controls are not fully documented outside of the fisheries sector. Sectors that warrant more detailed study include tourism, finance and banking, telecommunications, timber, transportation, and agricultural processing.

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