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Zenon S. Zannetos

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THE ECONOMIC IMPACT OF THE MULTINATIONAL ENTERPRISE ON THE HOST COUNTRY

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Since I am the first speaker I wish to take the opportunity and add my congratulations to the Boston University Law School on reaching the young age of 100 and also thank Professor Frankel for making the arrangements which bring all of us here today.

I have decided to concentrate my attention on the general aspects of the economic impact of the "multinational enterprise" on the host country, and only through implication deal with the U.S. domestic problems. This will help reduce the overlap between the talks of the various people on this panel.

First of all let me address myself briefly to the use of the term "multinational firm". As you undoubtedly know there has been recently a considerable discussion as to what constitutes a multinational firm. The most critical dimensions used for the definition usually include the number of countries within which a firm operates, the ownership patterns, the degree of independence of affiliates from each other and the parent organization, the national character of top management both of the parent and of the affiliated organizations, and the sources of its capital (whether it is raised purely from domestic sources and exported or whether part of it or all is obtained from the local capital markets of the host countries).

Although definitions are useful for purposes of general taxonomy, they often become sterile and stultifying. The reason for this is that in such cases the definitions do not enable the user to derive operationally
meaningful inferences for the specific objectives that he has in mind. In an attempt to provide a lot of content in definitions, one sacrifices in the process the meaning.

The term "multinational" as used in this presentation will refer to any firm which has production and marketing facilities in more than one national entity.

I will be dealing, as the title indicates, with the economic impact of such a firm on the host country, i.e., in the jargon of the economist I will be mainly using arguments supported by "partial" rather than "general" equilibrium analysis. If the firm operates in more than one host country the arguments will still be valid, affected only by the degree of complexity and not by the substance of the analysis.

A Brief Review of the Relevant Economic Thought

As an economist, I am very conscious of the limitations of economic reasoning. Economics is not an exact science but more exact, I must add, in the sense of having been subjected to more quantification - than law, for example. The general equilibrium theory of production and exchange\(^1\) can indeed lead us to deterministic solutions. But the perfect assumptions underlying this intellectually powerful model cannot all be satisfied in reality. For this reason its greatest value lies in its use as a framework to infer the qualitative (and less confidently the quantitative) consequences of changes in the critical assumptions in a partial equilibrium sense. So the exactness of deterministic models is not within our reach for day to day operating problems especially at the macroeconomic level. Some economic notions, such as marginality and the theory of value, which have been used very successfully in the micro sense, cannot help as much in the macro area either. And this is mainly because partial solutions are made possible by

the simplifying assumptions which constrain the problem and reduce its complexity. The more we learn about complex systems even in their simplest manifestations, the more we realize how little we know about their structure.

In economics we are always trying to reach an acceptable balance between meaning and content, and reconcile theory and empirical observations. At one extreme we find people who spend their life time trying to make practice fit their theory and telling managers how "things ought to be", and at the other end people who try to develop theories out of what they see. The former approach is more appealing in that it normally provides criteria for assessing efficiency, but it harbors restrictive assumptions regarding market structures, technology, flow of information, and motivation of those operating in the various markets.

In an attempt to develop theories which better describe reality many professionals have embarked on research which is aimed at providing a theoretical explanation of what they observe in practice. The results thus far obtained by the purely descriptive school of thought have been quite interesting and thought provoking but not very unifying. The questions which are raised by these researchers, however, have challenged both the normative theorists, as well as those who are in between, to sharpen up their analytical tools and improve the explanatory power of their models.

The contemporary theory of international trade assumes that the prices of factors of production are equalized within countries but not necessarily between countries. The factors of production are traditionally limited to

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2 These approaches are respectively termed normative (or prescriptive) and positive (or descriptive).

3 The most "authoritative" model is known in the economic literature as the Heckscher-Ohlin-Samuelson model.
capital, labor and land which are assumed to be homogeneous within any one country. These factors are not traded, only their output is. Trade, therefore, tends to reflect in terms of factor intensity the comparative advantage that the various countries have in their endowments.

Challenging the assumptions regarding the factors of production Williams in the late 1920's pointed out that technology creates trade disequilibria and non-competing countries. Then came the celebrated Leontief paradox which cast serious doubts on the validity of the factor intensity conclusions of trade theory.

The above mentioned challenges had their beneficial impact as one might expect. As a result, efforts were initiated to expand the simple models to include more factors of production (such as skilled labor, quality of capital and technology) and to emphasize the original resource content of trade rather than the final factors into which it has been incorporated. In this sense professional salaries and the wages of skilled labor may appear as capital. I must stress, however, that these efforts toward extension of the traditional

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theory of trade are still in their formative stage. Furthermore, we need to devote a considerable amount of research to gain a better understanding of the causes of market imperfections (such as economies of scale, inception and exploitation of technology, transferability of inventions and innovations, information flows and mobility of factors of production) before we can articulate on the process by means of which the flow of goods and services is rationalized on an international scale and an equilibrium, albeit imperfect, is reached.

The short and simplistic review of the theory of international trade presented here explains why economists need many hands to deal with all the alternative arguments, surrounding economic events. No wonder the public often feels that by the time economists finish expounding on their subject they have only succeeded in confusing the issue. To a certain extent you may find these characteristics in my comments, although I come closer to advocating positions than most of my professional colleagues.

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7 In addition to the standard excellent textbooks on International Trade the interested reader may wish to review: Vernon, Raymond (Editor) The Technology Factor in International Trade, N.B.E.R., Conference Series No. 22, Columbia University Press, New York 1970.
The Impact of the Multinationals

In any pragmatic economic problem there are two major classes of issues involved.

(1) Those concerned with the efficient allocation of resources and
(2) The equity issues of the economic solution (that is to say the impact of a solution on the distribution of wealth).

Let me now amplify on how the activities of the multinational enterprise affect these two issues. In my efforts to simplify the arguments I will take these two classes of issues separately, although in many practical situations the two are inseparable, especially in policy considerations.

1. Impact on the Efficient Allocation of Resources

If we look at the activities of the multinational enterprise we will find, in my opinion, that it scores quite high as regards the efficiency of allocation of the economic resources. The modern multinational firm does not normally establish manufacturing and marketing operations in a host country unless it sees the opportunity of utilizing local resources to produce its products at a cost which is locally competitive and also lower than its domestic cost plus the necessary transportation and tariffs associated with the foreign markets. In this sense the problems at hand for the host country are not very different from those faced by regional industrial development boards and regional governments within a country.

I am conscious of the fact that miscalculations can occur and aware of instances where economic logic has not prevailed. Also because of local protectionist legislation a firm may establish manufacturing facilities to protect its share of the local market, although in the absence of such legislation it would have been more efficient to have only marketing facilities in the host country. Even these instances, however, are a testimony to the potency of the market mechanism for the efficient allocation of economic resources.
There are, however, various dimensions to this issue of economic allocation of resources of which dimensions I would like to take a few and elaborate further.

a. **Utilization of Surplus Resources.** We often find that the host country has relative abundance of a basic resource. The multinational enterprise, on the other hand, normally has relative abundance of capital or easier access to such, and/or a comparative advantage in technology both of the scientific/engineering type and the managerial type. When these surpluses are utilized both sides normally benefit, especially if countries have no opportunity to "store" and later exploit these resources. I am referring here to both degenerating (mutable) resources and resources which if left unexploited represent lost opportunities.

In the case of resources which can be stored, the analysis becomes more complicated in that one must first establish "trade-off" relationships between present and future utilization of resources before surpluses can be determined. If there are discrepancies in the value structure, the preferences or the relevant planning horizons, as viewed by the owners or users of these storeable resources and the national entity, conflicts may arise between the multinational firm and the host country. Issues of exploitation and equity may be raised especially if the resources utilized cannot be restored to their prior state. Examples of such arguments we find in the use of oil, ore, air, water, and timber.  

b. **Utilization of Complementary Resources Which May Not Be In Surplus.**

And even if resources are not in surplus quantities, the operations of the multinational firm often encourage complementary resources to gravitate toward uses which have greater net marginal value product. In the process
we usually find that the price of these resources is bid up which indicates that the market mechanism for the efficient allocation of resources works.

But there is another aspect of the utilization of complementary resources with which we must deal and that involves the use of exhausting natural resources especially ecological. We have noticed all along that when something is public the tendency is for it to be abused. This is consistent with good economics. If the "short-run marginal cost" of a resource is zero then it is used up to the point where there is no "incremental value" left in its use. Compounding this economic tendency is the relative notion of "well-offness", which encourages some people to use the public resources even beyond the point of zero marginal direct value. These people feel that they are worse off if someone else benefits more than they do.

There are several efforts in progress now to measure the societal cost of the use of ecological resources such as air and water and tax the firm for the negative externalities. Unfortunately, as of this moment we have not made much progress in applying some of the suggested schemes. The point which needs stressing, however, is that all the proposals of which I am aware are attempting to apply the economic calculus in the efficient allocation of these resources. Ignoring the issues of equity between local versus extra-territorial interests and present versus future generations, one is confronted with some thorny issues of definition of the appropriate time horizon, cost and value functions and discount rates for the calculation of marginal costs and marginal benefits. To overcome these problems, the most promising proposals use auctioning procedures to establish a market value of allotments on the assumption that the buyers in their preferences will reflect correctly the objective data which are necessary to allocate these resources efficiently. Unfortunately, however, and even if this
approach works satisfactorily nothing similar can be provided on the supply side so some rather arbitrary decisions by central authorities must be made regarding acceptable pollution levels, planning horizons and trade-offs between the present and the future. But again these issues are not caused by multinationalism.

c. **Economies of Scale.** In areas where either the capital cost for entry into the industry or the research and development costs required for staying in are excessive, the multinational enterprise is likely to benefit both the host country and the domestic operation. The reason is that the host country is likely to bear less than the long-run full cost of product development and manufacture, while at the same time the domestic operations of the multinational enterprise may benefit from a partial spreading of these costs.

Scale also appears to have transferable benefits, or positive externalities of its own. It is very likely that an affiliate of a large firm will reach the various optima (administrative, organizational, financial, production, research and development and distributive) earlier than an independent firm because of such transferability.

Incidentally this issue has not escaped the Third World economists in Latin America who insist that multinational corporations cause market fragmentation because they force the local firms either to be a miniature replica of the parent of their competitors (i.e., produce a little of everything inefficiently) or to overspecialize and be of much larger size than the multinational subsidiary in order to compete effectively. What in effect they are saying is that elements which create the domestic industrial concentration and grant a firm its monopoly power influence

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adversely the industrial organization in the host country. Implicitly, this is admission of the economic benefits of overhead costs and of the complementarity of operations and organizational activities.

d. Spread of Technology. The post-war examples of the industrial growth of West Germany and Japan made us appreciate more than ever the respective roles of imitation of technology versus full-scale support for developing new technology. Through its host country operations the multinational firm invariably hastens the transfer of technology and creates the competition which in most cases results in the efficient allocation of economic resources. 11

There are several points with regard to the spread of technology which must be mentioned.

(i) Technology is a multidimensional notion. It can be manifested in one or more often interdependent ways.

(ii) It can be of the research and development type, engineering (process, development, production, product, cost reduction) managerial (organization, finance, marketing, planning and control, etc.).

(iii) It can be embodied in capital investment, or be present in ways which are not classified by the accounting system as capital. For example, skilled and semi-skilled labor reflects the technology of the firm and so do the infinite number of alternative approaches to the "way of doing things".

11 There are of course cases where cut-throat competition may lead to short-run wastage of resources and long-run monopoly exploitation. Such cases, however, are not very likely to be encouraged today although history can document some. On the contrary today there is some concern that imitation of technology may be occurring too fast, to the point where price competition and fast erosion of profits may be discouraging innovation in the long run.
One of the most significant repositories of the technology of the firm is its accumulation of "drawings" which drawings nonetheless are useless to anyone else unless one can interpret them and can develop the capability to tool oneself for production. I have observed cost reductions of enormous proportions because of slight changes in the approach toward tooling and in the design of fixtures. This technology does not register in the accounts of the firm.

(iv) In many cases technology is modularized and stored into parts which are contracted out to vendors locally, if possible. This reduces short-run uncertainty and creates overall efficiency for the firm but increases the probability that it can be imitated. Forward looking firms carefully evaluate the alternatives before them.

(v) To imitate successfully a firm must have enough "overall maturity" to put the pieces of the puzzle together and efficiently interface the parts of a complex system. The greater the number of parts (or modules) and the greater the number of alternative ways of interface the more difficult the imitation efforts become.\(^\text{12}\)

(vi) Successful imitation does not necessarily imply an identical copy of the technology of someone else. In fact the most efficient combination of factors of production for one firm may be inefficient for another, given differences in the factor endowments and the degree of maturity described under (v).\(^\text{13}\) Obtaining ideas is one of the most critical factors encouraging change and innovation.

\(^{12}\) As can be readily seen a random approach to the solution of modularized complex problems leads to a combinatorial problem of immense proportions.

\(^{13}\) See also the relevant discussion of Jones, Ronald W., "The Role of Technology in the Theory of International Trade", especially pages 89-91 in Vernon (Ed.) op. cit. Also in the same volume, Chipman, John S., "Induced Technical Change and Patterns of International Trade", pp. 95-123.
The arguments that I presented here regarding the spread of technology and its contribution toward the efficient allocation of resources, do not negate Williams' assertion that technology creates trade disequilibria and non-competing countries. In the short run it does. What is argued is that these disequilibrating tendencies of technology are not by themselves sufficient to perpetuate the comparative advantage of technologically advanced countries so that their factors of production (including technology) are permanently protected. We are dealing here with phenomena of imperfect competition so well described by Chamberlin and Joan Robinson back in the thirties. Unfortunately, existing theory does not permit us to talk authoritatively and in deterministic terms on the long-run equilibrium tendencies of technology. All evidence points out, however, that overall technology is beneficial and efforts are made at the national level all over the world for exploiting its transferable aspects.

e. Managerial Technology. Although several aspects of managerial technology have been already mentioned under (d) above this is an important subclass of technology which merits further elaboration.

Several studies carried out in the recent past indicate what some of us observed through exposure, that U.S. managerial practices and styles are different from those exhibited in other countries. These practices affect the organization structure of the enterprise, the approach to risk taking, the planning and control systems, the capital-output ratios and the blue-collar to white-collar employee ratios. While some economists - myself included, I must confess - feel that the United States' firms are possibly

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14 See Williams, J.H., *op. cit.*

"top heavy", their non-U.S. counterpart err extremely in the opposite direction. Relative decentralization, delegation, risk proneness and impetuous action which are usually associated with U.S. managerial practices are today unmistakably infiltrating European managerial styles. And this is in no small degree because of the multinational operations of United States firms. The relative success of the subsidiaries of most multinational enterprises (measured in terms of profits and growth of sales) is a testimonial of sorts to their organizational efficiency, in spite of the nationalistic constraints which often impinge on them. Studies both friendly and unfriendly indicate that the subsidiaries of multinational firms are growing on the average much faster than their local competitors.  

f. Toward Creation of an International Capital Market. The final comment that I wish to make regarding the impact of the multinational enterprise on the efficiency of resource allocation, relates to the capital markets. During the last few years we have witnessed in my estimation the potential power of the market mechanism in the allocation of capital on a universal scale. Although we are nowhere near the day when the barriers to the efficient operation of such a market for capital rationing are removed, and all the necessary details are worked out, the process has started. The Eurodollar market was sustained mainly by the operations of multinational enterprises. And even though many would no doubt associate this market with the malaise of the international monetary system which more recently led to the realignment of the value of the dollar vis à vis other currencies, it also taught us a valuable lesson. It showed us in my

16 Recent wholesale dismissals of "staff" personnel by large firms in the U.S.A. to a certain extent support this belief.

17 Of all the European countries France more than the rest of them saw the value of learning about U.S. managerial practices, and set out to selectively emulate the American approaches to management. U.S. style business schools have been encouraged and France today is in the forefront of modern business education in Europe. One wonders to what extent this may have contributed to its national economic health.
estimation that in the long-run it is much more safe to depend on the economics of "free" markets rather than follow faithfully the expediency of political solutions of central authorities.

Underlying the Bretton Woods agreement was the belief that free trade and free capital movements lead to a higher standard of living for trading nations. Since then we have witnessed a series of efforts on the part of the leading industrial nations to bargain the removal of trade barriers imposed mainly for political reasons. The assumptions which influenced the thinking of the architects of the world monetary system 28 years ago appear to be also valid today. The multinational enterprise is a key factor in this arena. Through its operations in the capital markets of the host country it will be exerting continuous pressure toward the creation of truly international markets for capital. The political pressures will no doubt continue, but the net result will be less political control and more economic rationalization of the process of allocating capital. Funds will be moving more freely toward uses which promise higher returns.

Everything considered, from the overall efficiency point of view, therefore, the multinational enterprises serve both the host and the domestic markets rather well. Markets are by nature international because of the uneven geographic distribution of economic resources both specialized and unspecialized. But like in any other situation of imbalance, unevenness in the possession of resources and competitive comparative advantages raise questions of equity. So let me now say a very few words regarding equity and the role multinational enterprises play in the distribution of wealth.
2. **Equity in the Distribution of Wealth**

The art and science of economics does not unfortunately tell us very much about equity. Only in the case of a perfectly competitive equilibrium with exclusively private goods do we get a solution which guarantees both an efficient allocation of resources, across all uses, and an objective method of distribution of wealth to the various factors of production on the basis of their contribution to the total value generated. This is economic efficiency although not necessarily moral or ethical equity because there is nothing to guarantee that each and every person will be able (i.e., allowed by the market mechanism) to earn enough to cover his needs.

The perfectly competitive equilibrium satisfies the conditions of Pareto optimality in that no redistribution of wealth (movement away from the equilibrium position) can make one or more people better off without making anyone worse off. But if we had to live continuously under perfectly competitive equilibrium conditions we could not possibly be where we are today. We would be in a state of stagnation with many buyers and sellers in each and every market, selling and buying identical items and earning the minimum return necessary to encourage them to stay in these markets. Once someone finds a way to differentiate himself from the rest and succeeds, the competitive processes encourage the elimination of the inefficient, imperfect market conditions ensue and arguments of equity arise. Political pressures then mount for protectionist legislation, for restriction of competition, for aid measures and in general for redistribution of economic power. All of you are aware, no doubt, that all these arguments are motivated by some type of notions of equity. But as in the case of welfare economics which is only in

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18 Often these equity arguments are motivated by subjectively unpalatable variances around the mean value of wealth. As such these notions of equity are relative. To my knowledge, no economist has as yet shown that the variance is under all conditions detrimental to the share of wealth going to the low income groups.
small part economics and for the greatest part philosophy, ethics and morality, the protectionistic arguments cannot be justified on purely economic grounds.

The initial activities of the multinational firm will very rarely fail to benefit the host country in the aggregate, although they may cause inequities by affecting the fortunes of some local inefficient firms. What will happen after that depends on how fast the local firms imitate and adapt to conditions of dynamic growth. It is the response of the host country and of the local firms which will determine whether the particular country has deficits in its balance of payments because of lack of direct investment (capital inflow) or because of capital outflow above the "fair" rate of return on foreign capital. If these problems are looked at by the governments involved in isolation and not as part of an overall international system of fund flows they will appear to be only incidentally problems of economics and management. For the most part they will wind up as problems of national pride (economic independence) and political sovereignty and equity, problems which escape a rigorous definition, as you may well appreciate. The emotionalism created by the latter issues (national pride, sovereignty and equity)

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19 As we have already pointed out, the degree of organizational maturity of the economy is the key to successful imitation.

20 Contributing toward this tendency are the troublesome problems of identification. Often we cannot get a clear idea of the real economic impact of managerial decisions because we tend to confuse symptoms with causes and total impacts with surface phenomena. For example, the total impact of the decisions of multinational firms cannot be seen in the yearly balance of payments. One must also assess the long-run effects of these decisions on the raw material inputs and on the total economic climate of the host country.
is often so strong as to completely becloud the economic issues involved. Many politicians have perpetuated themselves in office and condemned their countries to low standards of living by vowing that they "will not trade their national dignity and honor for a piece of bread". In such cases the "scoundrels" will no doubt be the multinational firms and the countries of their national origin, and no economic arguments, however sound, may dissuade those in power.

A vivid example of the conflict between economic efficiency and equity one finds in the actions of our neighbors the Canadians. Kari Levitt \(^{21}\) presents an impassioned picture of how Canada was luring U.S. capital only to realize later that in the process the country "lost its economic independence". Her arguments although couched in economic terms are definitely more political than economic. She is more than anything else decrying the fact that the government lost its flexibility to use the economic resource allocation process as part of the political process. \(^{22}\) But we know that any specialization creates inflexibilities, so we cannot "have our cake and eat it too". The case Levitt builds is not unlike that of some of our present day "cop-outs" who blame society for thrusting them into a world the complexity of which they cannot handle, but yet they are all too willing to demand the fruits of such complexity and interdependence.

Another issue which is often raised regarding the operations of the multinationals refers to the very survival of the national entity. Many

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\(^{22}\) Using for example, the power of the monetary and fiscal tools plus ancillary instruments for controlling unemployment, inflation, and redistribution of wealth in an "equitable" manner. Incidentally, these inflexibilities are not peculiar to host countries. Similar constraints limit the options of governments in developed countries (with or without multinationalism) because of the complex interdependencies created by and necessary for economic development.
people argue that the multinational firm is becoming a supra-national entity (more often than not because of its economic success, I may add) and therefore threatens the host country. It appears to me that the opposite result is more plausible. As the firm gains economic power the local governments may be tempted to seize it and use its resources for political power. As such the firm is a potential political threat not so much because of what it is, but because of what it may become in the hands of someone else. The recent history of expropriations and the present maneuvering by the petroleum producing countries in Middle East are cases in point.

I hope that my discussion of the issues of equity (and of the political and psychological aspects of national policies) do not give the impression that I underestimate their power. On the contrary, I believe that the multinational enterprise should be very well aware of these and other national sensitivities and attend to them if it wishes to coexist in foreign countries. What I wanted to stress is that the science of economics does not resolve the issue of equity. It is only concerned with the efficient allocation of resources.

In order that I do not overtax your attention, and also do not trespass in the areas of the speakers who follow me, let me close with the following thought which shows, I believe, why economics per se is concerned with efficiency and not with equity. It is rather ironic that we are here examining the equity issues involved in the operations of the multinational enterprise when we realize that the multinational firm was mainly nurtured by the tariff walls which were ostensibly created for reasons of assuring domestic equity. So problems of equity we will always have as a result of the operations of multinational enterprises. And this not because these firms will fail to have a beneficial economic impact on the host country but because they will succeed in doing so admirably well.
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