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AN ESSAY ON SOME CRITICAL ASPECTS OF THE INTERNATIONAL CORPORATION

by

J. N. Behrman

Background Study to the
INTERIM REPORT ON COMPETITION POLICY

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INTRODUCTION

During the past decade, the growth of the large international corporation has altered the basis on which economic policies (foreign and domestic) must be examined. Not only have the activities of these companies altered the structure and basis for trade, but they have also significantly affected financial elements in the balance of payments and put pressures on domestic financial situations of "host" countries (those in which foreign-owned affiliates are established). In addition, they raise new questions concerning the use of industrial property rights, the ability of governments to control some economic factors in the economy, and the future industrial structure of the free world.

This brief examination attempts to put the development of this new entity into perspective economically, to show why it is significantly different from domestic corporate activity, to describe the aspects of the international economy that are critical to the continued growth and influence of the large corporation, to assess the problems raised for public policies, and to indicate future possible patterns of growth of the corporation. This essay is both cursory and speculative, making no attempt to cite sources or provide detailed empirical support for the observations made. No attempt has been made to be inclusive in covering all aspects of the international corporation; for example, its effects on international unionism are not treated at all. Rather, the essay is a distillation of some 15 years of research on problems surrounding foreign investment, foreign licensing, patents, antitrust, taxation, and balance-of-payments impacts. It is principally an effort to suggest the areas of interest for further research and the significance of problems being raised by the growth of the large international corporation.

NATURE AND SIGNIFICANCE OF THE "MULTINATIONAL" CORPORATION

Definition

There is no accepted definition of an "international corporation", and the concept is likely to remain confused because of the

different meanings of the term "international". It is not clarified by the substitution of the word "multinational". Thus one company claims to be "multinational" because it operates among many countries as a single unit, with the objective of harmonizing varied interests of its affiliates and host governments while not being subservient to any one set of interests. Another says precisely the opposite -- that it is "multinational" because it attempts to serve the specific interests of each host government or economy and to treat its various affiliates as separate entities. But, in fact, neither of these attempted characterizations works out in practice, for conflicting interests must be reconciled, and the interests of various parties do at times conflict. There are no truly international companies. Attempts in business journals to define an international or multinational corporation (the terms are usually used interchangeably) as a company that makes no national distinctions in coming to business decisions -- balancing all alternatives on a cost/return basis from all over the world -- simply do not reflect parent company policy at present.

Even so, there is such a thing as an international company -- if characterized simply as a large (domestic) corporation which has a substantial overseas investment in operating subsidiaries or affiliates -- sometimes including licensees. A sizable export volume out of total sales would not indicate that a company was "international". Nor does size make a company "international". Rather, it is here defined by the ways in which it pursues its overseas activities. Thus U.S. Steel is not an international company, nor is Bethlehem Steel, nor many of the lumber companies; however, many paper companies are international, as are many auto, electronic, and chemical companies.

Nature

The number of companies over the world engaged "internationally" under the above definition would undoubtedly run into the thousands, but we have no statistical information by which to pin the number down. In any event, it is the large international company that focuses our attention in this piece. Among the 500 largest companies in the Free World, only about half would be considered significantly "international" in the above sense. But there are over 900 in the United States considered significant enough by the U.S. Government to be asked to co-operate in its program of constraint on direct capital outflows.

The large international corporation is a significant economic and public policy phenomenon of only recent vintage. Although these companies did not spring up overnight as full-blown international corporations, this major growth overseas has been within the past decade. There are companies (International Telephone and Telegraph (I.T.&T.), Singer, National Cash Register, and U.S. Rubber) that have had affiliates overseas for more than 50 years, but the rate of growth abroad has accelerated in the past decade. And few of these gave host governments serious pause to consider the influx prior to 1960, unless they were in the fields of public utilities or extraction.

The activities pursued make a considerable difference to governments. Those in public utilities and extraction are seen differently from those in manufacturing. Even the parent (capital-exporting) country sees significant differences among each of the three classifications. (I exclude trade and finance, when separated from manufacturing, completely from the discussion: "trade" investments are simply an extension of exports, though they are obviously important in promotion; "finance" investments serve a different purpose and involve a different set of regulations within the host government.) Thus the extractive investment is "resource-bound" -- that is, it must be made where the resources are. And the public utility investment is "market-bound" -- that is, it must locate where the market is (or close by). The motives for investment by the company, the acceptance of the investment by the governments concerned and by the public, are different not only between these two categories but also as compared with manufacturing investment. This paper is much more concerned with the last than the former two types of investment, though much of the analysis may be applied to all three.

Growth and Significance

The spread of U.S. private foreign investment in manufacturing rose significantly after 1956, with the prospect of the European Common Market. There were already substantial amounts of investment outstanding in Canada and in Latin America -- by both North Americans and Europeans. But here also, the pace of growth accelerated after the early post-Second-World-War period. It is noteworthy that by far the largest portion of such direct investments is in the industrialized areas of the world. While much of the petroleum and extractive investment is in the developing countries --

where the resources have not yet been explored fully -- the manufacturing investment is in North America and Europe, by and large. This reflects the fact that investors seek, first, a stable political and economic environment and, second, a location with as little unfamiliarity (in a business sense) as possible, and third, a sizable internal market. These factors merely explain the direction of the investment and not the fact of investment. The fact is largely explained by the restraints placed on expansion of trade internationally and the self-imposed (as well as government-imposed) constraints on growth of the company in the domestic market. These and other factors have tended to make the larger companies look outward and be willing to promote their growth through overseas investment -- as will be discussed later.

To indicate the economic significance of these movements, we would need to catalogue the contributions made by the assets transferred and their impacts on major factors of the economy. To understand the weight of these, however, it is well to get a cursory picture of the statistical magnitudes. Unfortunately, these are anything but precise. There are few data covering in detail the direct foreign investments by European countries in specific countries of the world, and even aggregate data are hard to come by. Equally imprecise are data on sales abroad. What is available is useless for comparisons with host country activities, for many such economies do not have adequate breakdowns of sales by industry (separating foreign- and domestically-owned enterprises). Thus our statistical calculations must remain guesses, even when extreme care is taken to produce all available data.

Attempting a comparison in a very broad sense, however, we can extrapolate, from the fact that the United States had some $65 billion of direct foreign investment in 1968, that sales by companies overseas attributable to the U.S. portion of ownership amount to roughly $150 billion. This is derivable from the broad guide that sales amount to between 2 and 2 1/2 times the book value in manufacturing (though the multiple varies considerably from industry to industry and company to company); the estimate is considered rather conservative in any event. On top of this, some $10 billion in sales derivable from licensing agreements occurs yearly over the world, based on U.S. licences. (One could add the production supported by portfolio investment, but

we are abstracting from this capital outflow in this paper.) There is $9 billion of foreign direct investment in the United States and undoubtedly an equal amount (at least) in Canada and Latin America besides U.S. investment there; and direct investment in other parts of the world by Europeans and Japanese add up to another $65 to $70 billion apart from U.S. holdings. Sales attributable to all direct investment would probably aggregate over $300 billion; this is not the net contribution, for "value added" would probably be only about half this amount, or $150 billion.

This contribution arises from the transfer of capital, the addition of management skills, the transfer of know-how, the use of proprietary rights (patents, trademarks, and copyrights), and the tie-in with a worldwide marketing arrangement. By far the more important in my own view are the nonfinancial contributions, especially those of management, and marketing skills and know-how. The latter, of course, stem from large research and development activities by the parent, and the former from cadres of management capable of shifting their attention to problems overseas. And, in the marketing area, there is a substantial advantage in the affiliate's having access to marketing arrangements established worldwide by the parent organization.

These contributions are not without their impacts on various elements of the economy. Thus the international corporation will place demands on the local financial system, requiring not only working capital but asking also for fixed capital contributions (either debt or equity). And it may have a favoured position in line for such resources because of its strength and stability. Impacts are also felt in the labour market, the housing and construction markets, and in the price structures. These may or may not be considered beneficial, but the decision depends as much on general economic conditions as on the behaviour of the company itself. Finally, the major impact in foreign economic activities is felt in the balance of payments, mostly through the return of earnings as the operation becomes successful. In the aggregate, after-tax earnings by direct investors are not exhorbitant -- running currently under 15 per cent, and the return of earnings is normally under 75 per cent of earnings; thus about 10 per cent of book value will be paid out through the balance of payments annually. (U.S. data show about $6-8 billion of earnings returned to the United States on $55-65 billion of book

value, or about 11 per cent.) Of course, the inflow of capital may itself be disturbing at times, but this has not seemed to be a major cause of concern by governments.

A final comment on the statistical significance of the growth of the large corporation may be emphasized by a simple projection of growth rates of international companies as compared with "domestic" companies. Taking the guesstimates of the previous paragraph, that there are (at least) $130 billion of direct investments outstanding overseas in the Free World today, and the resultant figure of $300 billion of sales controlled by these companies, we arrive at some rather startling comparisons for the next 20 years. The comparisons of "internationally owned" sales with "domestically owned" sales show a rapid catching-up of the former.

Thus we know from the past decade (which may be wholly atypical, but I doubt it for the near future anyway) that the international companies have been growing at a rate of from 12 per cent to 17 per cent per annum, based on outlays for plant and equipment. We do not have data for sales by year, but company responses indicate growth rates well over 10 per cent; thus a conservative growth projection figure would be 10 per cent. But economies as a whole have been growing at current prices by only about 4 per cent on the average in the Free World. We can anticipate that the "internationally owned" sector will grow at a substantially higher pace, therefore, and soon become quite significant. A very rough picture is shown in the following:

	1969	1980	1990
		($ billion)	
Total Free World GNP	$ 2,000	$ 3,300	$5,000
U.S. GNP (including foreign-owned sales)	950	1,600	2,500
Rest of Free World (including foreign-owned sales)	1,050	1,700	2,500
Of which:			
"Foreign-owned" sales	300	900	2,500
by U.S.-owned affiliates abroad	150	500	1,500
by affiliates owned by Rest of World	150	400	1,000

Thus, in 20 years, the internationally owned sector could easily equal the size of the U.S. Gross National Product or that of the Rest of the Free World, accounting for half of Free World GNP compared with about 15 per cent currently.

There are many reasons why this trend is likely to continue -- if no obstructions are placed in its way. They include the fact that the international companies are in the more dynamic sectors of industry, that they generate capital funds more readily, that they develop highly efficient cadres of management, that they devote more to research and development, and that they attract aggressive young management.[1/] But, of course, governments may slow down or reverse the trend. Several problems will arise that might cause governments to reassess the pattern of growth of the international corporation.

1/ J. N. Behrman, Some Patterns in the Rise of the Multinational Enterprise, Chapel Hill, N.C., University of North Carolina, School of Business, Research Paper 18, 1969, Chapters 2 and 3.

DIFFERENCE BETWEEN DOMESTIC AND INTERNATIONAL CORPORATION

Many of the impacts of the international corporation are the same as those of domestic corporations -- pricing, antitrust problems, employment, location within the economy, tapping the financial market, etc. But when it comes to implementation of the government's policies -- even in these areas -- the international corporation takes on a different colouration, simply because the international company is different. Its critical difference lies in its power. This power is not against governments or over them, but lies in the ability to avoid (not evade) government edicts. It may also lie in an ability to persuade governments not to issue certain edicts. Contrarily, domestic companies have some capabilities derived from political influence, while the international company generally has little direct political influence but substantial economic pressures. These powers may not have been used significantly as yet, but the potential growth of the enterprise raises the question of when such pressures might be successfully applied.

Essentially the power of the international corporation derives from its flexibility and mobility. These characteristics result from its orientation to the world economy. And this orientation reduces the control of any one government over the international company.

Flexibility and Mobility

The flexibility and mobility of the international corporation are reflected in its ability to shift resources and alter operations both geographically and through time. Having several sources of supply, it is capable of shifting its purchases among affiliates to meet the demands of the international situation, including governmental pressures. Having a variety of production facilities, the cost of shifting the locus of production geographically is minimized as compared with a domestic company, which would have to create alternative facilities from scratch. In addition, it will likely have the funds necessary to make these shifts effective. It is also capable of transferring manpower and managerial personnel from one location to another to make its decisions effective. The highest degree of freedom and mobility exists at the time when

the international company is making a decision to begin a given type of operation in a foreign locality. At this juncture, it is capable of assessing alternative pressures or incentives of governments, and of making its decision on the basis of the greatest assistance or least interference. It can, therefore, avoid situations of high governmental interference. And, of course, the opening of trade channels through the reduction of tariffs reduces the cost of making a decision to accept a "second-best" alternative, since selling into the "best" market is still possible. (This ability varies according to types of products and of national markets.)

On the occasion of negotiating with governments for the privilege of investment -- and especially when the investment takes the form of an acquisition -- the company is probably in its best bargaining position. At this point, governmental conditions of entry are imposed (or negotiated) and the strongest weapon of the company is a good alternative investment in another country.

Such an alternative is not open to a domestic company -- for the government may (at the extreme) prevent an outflow of funds for direct investment. Even if this prohibition is not imposed, the domestic company has a large hostage within the country already which tends to give rise to "good behaviour". The domestic company is further circumscribed as to alternatives within the country. Thus, if the government wishes more industrial activity within a given (depressed) area, the international (foreign) corporation is capable of responding more readily. The domestic company has economies of scale, management, transport, etc., which appear to make expansion of its activity at the existing source more attractive than dispersion. The international company may come in with an entirely new operation, which it can locate in any of several areas. Therefore, inducements may be offered to new industry which, in fact, tend to favour the foreign investor, not by intent but because of the structure of domestic industry.

Once the international company has committed itself and its funds and equipment to an operation within a country, the situation is different. Once in, the affiliate of the international company takes on many of the characteristics of a domestic

company, and the government's ability to control rises. Even so, the situations are not completely identical. Marginal units of the international corporation can be shifted; price and supply shifts are possible; marketing areas can be shifted; and even production divisions can be consolidated among affiliates without "closing down" or "moving out", thereby incurring the wrath of the government.

World Orientation

These elements of the international company are part and parcel of its orientation to the world economy (or at least sizable segments of it -- North America, Europe and Japan account for four-fifths of the Free World GNP). The company is becoming equally "at home" in each of the advanced economies, and it will increasingly balance one operation in a country against a similar or even different one in another economy.

The ability to shift its attention among different proposals or projects extends also through time. Thus the corporation can adjust its investment scheduling to meet the pressures of governments and evade interference. For example, if the present government of a country is attempting to impose unbearable conditions on an international company, it may hold off on its project there (moving into another in a different country), and wait for the government or its attitude to change. Or it may cut its proposal to one that is "just bearable", getting a foot in the door, and expanding it when the government's attitude changes. This capability is a result of the company having worthwhile alternatives elsewhere in the world.

Government Control

The fact of having alternatives reduces the host government's power over the international company. Rather than being in a "command" position, the host government is in a "negotiating" position with the international company. The position of the two negotiators varies according to the circumstances, but the essential nature of the relationship is negotiation -- unless the government wishes to exercise its ultimate power of expropriation. Further, the international company has positive inducements not to yield much to host governments; it is exposed to pressures

from each, and acceding to one tends to set a precedent for others to ask for the same action or response in their turn. This would increase the cost of accession to requests severalfold. There will likely be an increasing tendency, therefore, for the international company to plead its "international status" and the too-high cost of yielding to governmental request. However, this approach will probably be used carefully so as not to fan the flame of antipathy to the "foreigner".

The fires are already fanned by the fear of foreign control, and it is essentially a desire for "national control of our own destiny" that causes most host governments to regard the international corporation differently from the domestic one. It is, of course, impossible for the international company to claim more than one "parent" government. But it is trying and will attempt to "identify" with each host government. Some have gone so far as to avoid the use of the parent company name in each foreign country, attempting to acquire a "national image". Others are now attempting to acquire an "international" image, i.e. not identified with any country -- for example, the switch of U.S. Rubber to "Uniroyal" as a company name and trademark. Essentially, however, unless there is a withering of nationalism itself, the international company is not likely to be able to reduce the pressure against "foreign control", which leads to repeated efforts to distinguish in policy between the foreign and domestic companies. It is fairly remarkable that, to date, so few policies or regulations do in fact overtly discriminate against the foreign-owned company -- though, of course, we find some such situations in Japan and the developing countries, and even in some of the North Atlantic countries on a covert basis.

CRITICAL CHARACTERISTICS OF THE INTERNATIONAL CORPORATION AND ITS OPERATIONS

The means available to governments of handling the international company are influenced by some of its critical characteristics and the conditions prerequisite to its continued operation.

Types of International Companies

The international corporation could have taken one of several forms: an international holding company, a minority participant in "domestic" companies, a joint-venture partner with other "domestic" companies, or an integrated worldwide company having its own affiliates or facilities over the world. It has been moving strongly towards the last type, for reasons that reflect the structure and regulation of the international economy, as well as the nature of the markets of the world.

The international holding company would, in essence, be a company holding (up to) 100 per cent of the shares of each affiliate over the world. It would involve itself in none of the operational or policy aspects of the affiliates, save decisions on the transmission of dividends to the holding company. In effect, this arrangement would constitute a minimum of interference by the parent in the affairs of affiliates, and probably would satisfy host governments to a high degree.

The second form was represented by the practices of General Electric prior to the Second World War in which it attempted to obtain a 10 per cent to 25 per cent interest in every major electrical manufacturer of the world and thus combine and co-ordinate their interests. By its participation in all activities over the world. it would be able to assist in the international allocation of business and in maintaining a "proper" price level, as well as obtaining part of the profits of worldwide sales. There would, under this arrangement, exist no real international competition among giants of the industry -- except that necessary to satisfy governments of "arm's length" dealing, and of course governments could not always know. There are no such worldwide arrangements today, largely because of the antitrust policy of the U.S. Government.

The third type is, in a sense, a combination of the previous two. It joins a "domestic" company with a foreign partner in a joint venture -- each usually participating to the extent of 25 per cent and 75 per cent. The international corporation may have minority and majority interests in different affiliates, holding control in some and not in others. But the essence is that "domestic" interests are represented, pushing the determination

of policy more towards that of the international holding company, as compared with type four below. In all of the first three types, local nationals can hold shares in the "domestic" affiliates of the international corporation. And it is this possibility that intrigues governments, who consider that such ownership will prevent actions against the national interest. There are a few international corporations that have been developed on the principle of combining a series of joint-venture partners -- usually controlled (i.e. over 50%-owned) by the international (parent) corporation. In the main, however, joint ventures exist where there are no other viable alternatives, for they impose a cost on the international corporation which it would rather avoid.

The integrated, centralized, international corporation -- the fourth type -- has developed for quite specific reasons. The clearest justification is a "desire for full authority" on the part of the parent company. The control system of all business is hierarchical and more authoritarian than democratic; consequently, the management wants to minimize interference from affiliates. Although it normally desires a "feed-back" of information, it would rather not face "talk-back" from others of equal authority. Still, there are advantages -- especially to assuage governments -- in having joint ventures, and they would probably be more readily accepted were it not for other factors.

Other factors include the U.S. antitrust regulations. These regulations are usually interpreted as requiring that U.S. companies not "team up" with competitors in ways that would tend to reduce competition affecting the trade or business of the United States. The fear of U.S. antitrust action is so great that it is simply easier to own the affiliate and thus "become one" with him -- making it impossible to conspire with oneself. The same ownership pattern is encouraged on the part of foreign investors holding an affiliate in the United States -- that is, it appears best to hold it 100 per cent (e.g. the Bayer-Monsanto case)[1/] -- but the management result is different, for many European companies are reluctant to dictate decisions of even a 100%-owned affiliate for fear of contravening U.S. antitrust law.

1/ Commerce Clearing House, 1967 Trade Cases, #72001.

An economic pressure towards control by the parent arises from the necessity to reduce costs to meet international competition. Competition among the international giants is, in their own view, so intense that it is necessary to make every effort to reduce costs. This can be done only if the entire resources of the corporation are integrated into the best possible arrangement for least-cost production and distribution. In turn, this may require the supply of elements from one affiliate to another and an interlocking of production and distribution. The quarrels and dissatisfaction among joint-venture partners with their particular roles makes that type of ownership less than desirable to the international corporation.

Thus part of the desire for control over the foreign subsidiary is to be able to make the "economic" decisions, i.e. to use worldwide resources in a manner which produces the best products at the least costs for the particular markets served. This may require a shifting of production levels at times and even a shift in the location of production of some items. It may require an allocation of markets among the affiliates so as to reduce overlapping of effort and thus be more capable of meeting the competition. Production may be structured so that each affiliate produces certain items and then ships to other affiliates either for further processing or for final sale as part of the full line of the company. The parent company, by this method, is able to reserve activities and geographic areas for itself according to its production and sales capabilities, though it still faces competition from both local and other foreign companies in the field. Joint ventures would reduce the parent's ability to make such decisions readily.

Further, the parent company contributes much more than capital to the operations of the affiliate: management, proprietary rights, know-how, and a continuing flow of results of research and development. It is virtually impossible to capitalize such a future stream of assets, and most governments place a limit on the capitalized value of non-capital contributions. In addition, negotiations with a joint-venture partner over the valuation are difficult; he may appeal to the government, both during initial negotiations and later, to prevent high charges. These charges are running now at the rate of approximately $1 billion on the part of U.S. parents: about $360 million returns

of royalties (excluding motion pictures) and $640 million as management fees and service charges. Of course, a 100%-owned affiliate may or may not be charged for such services; whether it is or not depends on the tax situation and the general policy of the parent company towards all affiliates. In any event, the parent does not really see why it should share the benefits of its own outlays on research and development with a joint-venture partner who, in the main, contributes only capital.

Still less does the owner of proprietary information see reason to license it to an independent company if he can keep control. Although most governments prefer licensing to investment, most corporations prefer licensing cum investment. And transfers of technology are still more readily extended to controlled foreign affiliates. The disadvantages of licensing are, therefore, reasons for the preference for controlled foreign subsidiaries.

The monetary returns are frequently quite low (being restricted or taxed abroad), particularly in view of the costs of providing continuing technical training and advice to nascent industries abroad.

Some of the developing countries consider that the payments required for know-how and other proprietary rights are too high. They feel that such assets, when contributed in a joint venture, are capitalized too high. Some (such as India) have taxed royalty payments at 50-60 per cent, leaving returns at levels hardly covering legitimate costs. And the uncertainty of their ability to guide market-development efforts makes many potential licensors feel that total sales will be small, making returns still smaller.

Other disadvantages to licensing exist. Principally they involve the loss of control by the licensor over certain aspects of the rights and the products made by their use. For example, a licensee can adversely affect a trademark if he does not maintain quality of the product and protect against its infringements or dilution. A patent must also be maintained and protected, and this responsibility is passed, on occasion, to the licensee; this risk is avoided if the licensee is an affiliate. The least protection is afforded to the licensor who extends solely

know-how. But, in each instance, the licensor is building up competition for himself in the future, in the event he wishes to enter the market himself. Also, even at the termination of the licence, he cannot possibly recover all that has been transferred.

Additional difficulties lie in the attitude of governments towards licensing. Some of the governments have restricted provisions of the contract, such as requiring export rights, weakening the position of the licensor. The licensor, therefore, is usually quite cautious to circumscribe the rights of the licensee in several directions. But some of these constraints raise questions of possible antitrust violation -- which do not arise with a 100%-owned affiliate.

For example, the licensee frequently feels that he should have exclusive rights to a patent in the national market, and the government may wish to obtain rights to associated markets overseas. The licensor himself may consider that the local market is so small that some guarantees against spoiling the market by others are warranted, for the costs of developing a market are high and the competition from substitutes is sometimes intense. In addition, the licensor is frequently interested in imposing certain protective conditions on the licensee -- such as quality control, protection against know-how leaking outside the company maintenance of the patents, pricing of the product, use of specified materials, minimum annual royalties, etc., some of which should be to the licensee's advantage but are also to the benefit of the licensor. If the licensor is to obtain these desirable provisions, he may have to give in on another, such as exclusivity; alternatively, of course, he may be able to "buy" non-exclusivity by forgoing other desirable provisions.

Another provision which has given rise to difficulties, particularly in the antitrust area, is that related to use of components or materials supplied by the licensor. This requirement has some justification in control of quality, but it is equally well justified by the fact that exports of the finished product may have been terminated by factors such as governmental interference or restrictions; a tying clause to save some of the export earnings would appear justifiable. It certainly would accord with the U.S. objective of maintaining

and expanding U.S. exports. Yet this provision is reportedly in violation of the "tied sales" principle in antitrust regulations.

The protection of the U.S. market against a licensee is also an aim of the licensor; yet he may feel stopped from making such an exclusion in the agreement. If the U.S. market is significant enough, and can be entered by the licensee, the potential licensor's approach is simply not to license. But he forgoes returns from foreign licensing in order to prevent competition from arising from a potential licensee. Licensors in other countries, such as Europe, are not under similar constraints and therefore have taken opportunities which otherwise would have been open to U.S. companies. Ownership and control of the foreign affiliate (licensee) reduces each of the above problems.

The same problem of division of profits arises in the marketing area. As can be seen, this becomes a difficult problem when the operations of the entire corporation are highly integrated. Even when this is not the case, but where a single marketing organization channels worldwide sales of all affiliates (and joint ventures), the benefit of this organization is shared by the joint-venture partners. How to charge him for this service is difficult to determine. Because of this difficulty, when there is both a 100%-owned affiliate and a joint-venture producer of a given item, the former tends to be favoured over the latter.

From a financial standpoint, most joint-venture partners are not capable of putting up matching funds for rapid expansion. Either the parent must take over larger portions or the affiliate stagnates in comparison with other elements of the corporation. Alternative financing arrangements, such as public issues or governmental support, are sometimes used but are not desired.

There are advantages and disadvantages to a national economy of the sort of private international integration resulting from activities of the multinational company. Any economist can array these factors and the economic pluses and minuses, and a political scientist can array the costs and benefits in his area, but it is quite difficult to cast the balance. The balance depends largely on the strength of the internationalist spirit

and the ability of the international (parent) company to avoid interference by the parent government -- a topic discussed later.

Critical Elements

If it is decided that the international corporation is a "good thing" in the international arena, there are certain critical factors or elements that facilitate its operations, or without which its nature would be significantly changed. They include the free movement of capital, ease of communications, permission to control from the centre, protection of industrial proprietary rights, mobility of personnel, stockpile of efficient management, and centralization of research and development. Without these elements, the centralization and integration of the international corporation would be hampered significantly. Thus, if a government wishes to dampen the growth of this entity, it can operate on one or more of these elements.

Transfer of funds -- Historically and in economic theory, the movement of capital has been treated differently from trade. It has been considered less advantageous to national economies to permit free movement of capital than to permit freedom of trade, and there are arguments concerning outflows of capital to the effect that the capital-exporting country loses as compared with domestic investment by the amount of the foreign tax paid by the affiliate (unless, of course, foreign earnings are substantially higher than domestic earnings). Accepting this argument (which I do not, because of its abstraction from the question of alternative uses of the capital) the capital-importing country gains not only the tax but also the earnings retained by the affiliate, and has an offsetting loss only if domestic capital was displaced and employed only in a less-productive alternative activity. (It would be useful to draw up some alternative models of likely investment patterns.)

For an international corporation to operate efficiently, however, it needs ready transferability of funds -- not only for the remission of earnings but also for the switching of capital resources from one affiliate to another or for the financing of new activities. Another facility which it will tap probably more readily than domestic companies will be regional capital

markets -- if and when these are developed in Europe, Latin America, and elsewhere. Such capital markets are not essential to the international corporation but they will be quite helpful in accelerating its expansion.

Central control and communication -- The desirability of integration of company activities means that a central unit within the corporation must make the decisions necessary to effect that co-ordination. These decisions cannot wait for the mails. They are made, in the absence of effective communication, by the affiliates, but with efficient lines of communication, the less independent the foreign affiliates become. This is seen not only in business but also in the diplomatic service, where the Ambassador sometimes cannot wait for orders and simply has to use his own judgment and initiative, but now is in almost instant contact with the home office. The large international corporations will be relying to a greater extent on computerized information-gathering and on rapid communication of data affecting decisions for the corporation as a whole and for its affiliates. But it is doubtful that governments would attempt to slow down communications or limit their use by foreign entities. Thus control measures will have to rely on other elements.

Both integration and ease of communication lead to centralization of policy decisions. But these decisions must be transmitted and acted upon. If they are interdicted by a second party, the centralized control of the parent breaks down. Efforts by some governments have been directed against this centralization by requiring local nationals to sit on Boards of Directors or to be hired in top management positions. While I personally doubt the efficacy of this move, it does focus on one of the basic problems facing governments. Were the governments to find a means of interdicting control from the centre, the international corporation would have to alter its pattern of development.

Protection of property -- From the standpoint of identity and control over marketing and production processes, protection of industrial property (or proprietary) rights is critical to the international corporation. Removal of these rights would alter its nature and method of operation significantly. Thus, if the company could not register and protect its name and trademarks over the world, it would be subject to "raiding" from any

scrupulous or unscrupulous competitor. The cost of operating in a less-identified fashion, and the inability to protect the quality of products sold under a given name, would make it prohibitive to operate in some economies.

Much the same can be said for patent protection. While it is desirable for a licensor or a parent company to have a strong patent position in a given economy, the mere amassing of patents is costly; they must be filed for, obtained, and maintained. The present cost of one patent, filed in 10 or 15 countries, over its life will run between $2,000 and $3,000. This means an annual cost of roughly $200 for each, and many companies have over 1,000, making a minimum annual cost of $200,000 for patent protection. While some companies receive over $1 million in licensing royalties annually, a roster of 5,000 patents would offset these earnings; and most companies receive on the order of $100,000 or less. Of course, not all royalties are for patents -- some are received for know-how and trademarks. Thus patent protection is not sought cavalierly, despite the evidence of rapidly mounting applications. There is, in fact, much pressure to keep the patentable information secret and not divulge any part of the new development to the public. If, therefore, governments want an increased flow of technical knowledge, careful attention must be paid not only to patent laws but also to the protection of unpatented (or unpatentable) know-how. Without this protection, the flow of information will be less, and the control patterns within the international corporation will be different -- and not necessarily to the advantage of either the host government or the world economy. U.S. companies are more inclined to divulge unpatented information to affiliates than even to licensees, especially majority-owned ones. The multinational enterprise, therefore, is a mechanism for expanding the flow of technology.

Management -- One of the main advantages of the international corporation is its efficient use of the scarce resource of management -- not only operational but also decision-making personnel. The competitive effectiveness of the corporation depends on its ability to place management teams where they are needed, shoring up weak affiliates and starting off new activities. Thus the mobility of personnel is important. While some of the restraints on mobility are cultural and traditional, there are also some that are legal or governmental. While it is

commendable and productive to have local management trained -- and most all large corporations follow this practice -- it is also necessary at times (if the corporation is to maintain its efficiency and reflect the centralized policies of the parent) to shift individuals as managers or technicians or even to send cadres. Governmental interdiction of these transfers will certainly slow the growth of the international corporation, at least as it is now developing. Insistence on employment of "only nationals" at top levels prevents a transfer of managers among countries to permit them to gain experience and appreciation of foreign patterns of life and ways of doing business -- necessary to appropriate decision-making by the parent. Also, the national manager of an affiliate is boxed in as far as his own promotion goes, preventing locals from becoming officials of the parent company and thereby making it more "international". As with many interventions, the end result may well be the opposite of that intended -- i.e. making the corporation less "international" in one sense while trying to "multinationalize" it.

Research and Development -- The final operation which I consider critical to the nature of the international corporation as it has developed recently is that of the centralization of research and development. There are economies of scale in this activity, as in that of production; and old guidelines of 1,500 professionals as the "optimum" are being revised rapidly upward. Not only are there physical economies, but there are also economies from removing duplication of effort. To split the research unit and attempt competition among geographically distinct units may be wasteful and may damage morale, for all investigators like to be on a "winning team". The "losing teams" may begin to lose researchers.

Some research effort is being decentralized, mostly to satisfy governments -- but most companies see this as a substantial increase in costs. Within the constraints of governments, the parents will distribute the R&D effort so as to minimize this cost -- and the distribution will not necessarily be on the basis of the criteria desired by the host governments. So long as this issue of "our own R&D" is more a publicity or political issue within a country than an economic one, what particular R&D is placed in the host economy is of no real concern. But if it becomes an economic or strategic issue, then there will be substantial conflicts among governments over which gets what R&D element of

the international corporation's activity. And, of course, one can expect that the parent government will win out when it so desires. This is an area that requires careful definition of national objectives, and consideration of the appropriate means to achieve the co-operation desired, if any.

PROBLEMS OF PUBLIC POLICY

The growth of the international corporation has sharpened some of the old problems facing governments in the foreign economic arena and has created new ones. They include the problems of pricing, customs valuation, and dumping; competition, cartels, and antitrust; licensing and market allocation; taxation; balance-of-payments pressures; technology flows; planning; extraterritorial interferences; and ownership percentages.

Pricing

The fact that an international corporation buys and sells among its affiliates means that it can set prices, shift funds, and allocate profits on a basis other than "arm's length" or "market factors". Whether or not it actually diverges from "arm's length" depends on the tax situation and governmental restraints imposed on its operations.

Customs officials in most countries automatically assume that the parent company is underinvoicing goods it sells to a foreign affiliate; they, therefore, impose a 5 per cent to 10 per cent mark-up on the invoice before calculating the customs duty. The affiliate merely pays the added duty -- raising its expenses; it does not write up the invoice and remit the higher price to the parent -- if it did, of course, that would mean a larger drain of foreign exchange and would not be to the advantage of some importing countries. Nor does the affiliate raise the price (cost of goods imported) on its own books for purposes of calculating its resale or final-sale price. If it did, it would reduce local income taxes. The parent frequently sends the affiliate a "memo-price" on which it is to base its selling price.

The lack of adjusting price to customs valuation means that the importing country's tax revenue is increased both at

customs and in the income tax. A company might find it desirable to permit this when it is trying to increase the funds available to the affiliate -- underpricing its components or equipment or added items in the line -- but only so long as the affiliate is making losses, breaking even, or making so little profit that the added tax burden can be disregarded. Otherwise, it can sell on long terms, leaving the sale price with the affiliate as working capital.

Alternatively, the parent may wish to transfer funds out of the affiliate by raising prices to the affiliate. In this event, the customs' practice of increasing invoices raises the duty further, but the affiliate's income tax is reduced, and profits are returned to the parent automatically and without delay. This practice is of concern to tax authorities in the host country as well as to financial officials of the government if there is a deficit in the balance of international payments.

Underpricing is of concern to both countries -- the parent government because of a loss of revenue and the host government because of the possibility of the technique being used for dumping. These two interests of governments are usually sufficient to keep the larger international companies from moving very far away from a justifiable "arm's length" transaction. The problems of persuading officials of the justification for its pricing and the potential penalties for misbehaviour are normally sufficient to keep company practice on a fairly righteous road. However, there are many legitimate differences of view as to what constitutes "arm's length", and the U.S. internal revenue code has not yet been able to resolve many difficult questions.

Competition

The growth of the international corporation raises new forms of competition, tends to destroy the influence of cartels, and will bring new problems in antimonopoly regulation. The competitive structure is undoubtedly oligopolistic in that the international competition takes on the nature of that among giants. But the competition within a given national market may not be at all among giants -- rather, it will usually be between a local giant and a small affiliate of a foreign giant, who will not wish (or be able) to act like a giant in that particular market. Although the parent company may be larger than the local competitor, its affiliate in that market will not always be so dominant.

Given this situation, it is not at all certain that the local affiliate of an international company can (or would wish to) be the price leader, especially in cutting prices. Competition turns on quality, introduction of new products, service, and possibly terms of sale; but the first three are of primary importance.

Further, the injection of U.S. techniques of marketing, production, and management are, to some extent, disruptive of the host economy and market in that "established" and "traditional" ways of doing things may be disregarded. Sometimes a reservoir of ill will is filled by actions of U.S. affiliates, who are operating in ways contrary to "local mores". This possible reaction places a premium on acclimatizing the subsidiary to its local surroundings by membership in trade associations, hiring local nationals as managers, co-operation within the industry on various community and industrial problems, and sometimes accepting ways of doing business which would be unacceptable at home.

The foreign subsidiary may be caught in a bind when economic plans of the host government call for "rationalization", "concentration", or "market co-operation" among members of an industry. Each of these will probably require degrees of collaboration with local and other foreign companies which may be considered "anticompetitive" acts by U.S. antitrust authorities. Whether or not it is in the interest of the subsidiary is beside the point; it is caught between two pressures.

Alternatively, the government may wish to expand exports and/or restrict a foreign market to companies within its borders; it may then request the subsidiary to be given the sole rights to export to a particular area, or, without asking, the message may be gotten across. A willing response of the U.S. parent may run afoul of antitrust interpretations at a later date.

The fact that the U.S. international corporation cannot enter cartels has become a considerable hindrance to formation of successful cartels in the more dynamic industries. With a strong competitor outside the cartel, it is virtually impossible to make the members "toe the line". Although there are, undoubtedly, a variety of cartels operating within Europe -- or at least a variety of agreements as to business behaviour -- these are not as effective as the prewar arrangements. It appears

quite difficult for the international cartels to be reconstituted so long as the U.S. international company is enjoined from participating. This result is not due to the existence of the international company -- which may be thought of as a type of cartel itself -- but to the inability of U.S. companies to participate in cartels. This same concern for antitrust violation prevents several U.S. international companies from joining together in a single enterprise overseas. They must first obtain permission to merge within the United States before they may merge their overseas activities.

It may be argued, of course, that this prohibition against agreements among companies has stimulated international mergers and acquisitions -- just as they were stimulated within the United States by antimonopoly regulations. Whether the end result will produce more or less competition is still debatable. However, it appears to date that more competition has resulted -- though it is now among the giants, and under oligopolistic "rules".

The differences in antitrust legislation and regulations themselves will give rise to difficulties in the formation of public policies. Not only is there now a set of seven different rules and regulations within the European Common Market (one for each member and one for the EEC), but there are also additional rules in each of the EFTA countries, plus those of Canada and the United States. While it is difficult for an international corporation to wend its way through these different regulations, there is one way for the corporation to reduce its exposure to governmental pressures -- that is simply to accept the most stringent rules as binding and abide by them. However, this may not be to the interests of <u>each</u> host government. Some future reconciliation of laws is probably inevitable.

<u>Market Allocation</u>

It is obviously permissible for an international corporation to assign orders to various of its affiliates (especially when wholly owned), and this type of market allocation will have to be accepted by governments unless they wish to allocate markets themselves. However, they have frequently made representations to the international corporation that it should allocate more markets to a particular affiliate, and guarantees of the amount of production

to be exported have been exacted during negotiations on entry of the company into a given economy.

Licensing under patents or trademarks, however, permits allocation of territories by granting an exclusive licence to manufacture, use, and sell within certain countries where patents and trademarks are held. While such provisions for exclusivity are not prohibited under antitrust regulations, the U.S. Department of Justice examines closely whether there is a pattern of exclusive arrangements which tends to divide the world's markets among a few major producers. Since licensing is a major technique of transfer of technology, and since exclusive arrangements are normally desired by licensees, there may have to be some reconciliation of views in this area to maximize the flow of technical information and know-how as well as patent rights and trademark use.

Taxation

The problem of taxation has already been touched on with reference to pricing practices, but it arises also because of the desire to avoid double taxation. While there is a variety of double-tax treaties, they cover only taxes on income. It is possible, therefore, for the incidence of taxation on international business activities to rise fairly high. While recognizing this, governments may not wish to alter the situation, letting international companies bear whatever burden they must in their overseas operations and being taxed again by the parent governments.

However, there are sufficient questions remaining as to whether the proportion of tax paid in one jurisdiction reflects adequately the benefits received by the international corporation from that jurisdiction, or whether the tax reflects the income-earnings in that jurisdiction. Further, the "economic connection" basis for taxation (as applied by India, for example) raises the question of whether one tax jurisdiction merits revenue from transactions consummated in other countries.

The difficulty of determining whether the actions of an international corporation are warping the tax base within a national jurisdiction or altering the "normal" revenue due the government would tend to lead to a closer co-operation among governments on

the tax treatment of the international company. Most such corporations welcome "tax harmonization", until they begin to realize what it might mean -- for example, the determination of earnings on an arbitrary basis or the setting of intercompany pricing by governments, etc.

Balance of Payments

The size of the operations of the international companies has begun to make a significant impact on the balance of payments of many countries, and thereby becomes a large factor in the level of surpluses or deficits. For example, the return of earnings to the United States has mounted to $6-8 billion compared with outflows of capital of $3-4 billion annually for direct investment; exports related to direct investment in manufacturing have amounted to over $7 billion annually. These compared with an annual trade surplus of zero to $6 billion, and a deficit of $2-8 billion!

In Britain, U.S.-owned companies are some of the largest exporters, and in the aggregate they have accounted for over 15 per cent of British exports. About 20 per cent of total sales of U.S. manufacturing subsidiaries overseas were exports. And, of course, the international petroleum and mining companies often dominate the balance-of-payments picture of developing countries.

Most host governments are interested in the export potential brought by foreign investment; they seem less interested in the import substitution gained, though the latter may be much more important in the improvement of the basic payments position. A negative concern arises from the outflow of earnings to the parent, and this concern is voiced in each and every economy -- even one such as Britain which historically gained much of its international strength from foreign investment. Some governments have slowed down the outflow by taxing the remittance of earnings; others have placed differential exchange rates on such transfers. And underlying all concerns is a doubt that the inflow of capital at one time -- even with the real resources gained with it -- is worth the continuing outflow of earnings.

The outflow of earnings is, however, only one part of the entire process of direct investment. It would be a more acceptable focus with reference to portfolio investment, but even here there are inadequacies in focusing on the return of earnings alone. As indicated in a previous section, there are contributions to the economic growth of the country in many areas, and each of these has an impact in turn on the payments position of the country. In addition, the export capacity (or import substitution) brought by the direct investment itself must be taken into the calculation. In any event, if the tax rates are fairly high, the earnings returnable are relatively low, and it is not the practice of international companies to return all possible earnings.

Technological Transfers

At least three policy issues arise in the field of technology: the drain of high-capability manpower from host countries to the parent organization, the selected inflow of technology determined by the parent company, and the dampening of initiative within the host country to perform R&D on its own. While there are pluses and minuses in each of these areas, there is a large plus in the very fact that new technology is available to the host country -- technology which it is not currently able to acquire any other way than to import it from abroad.

Some of the international companies have been charged with enticing technically trained manpower out of host-country operations into parent-company laboratories. While there has undoubtedly been some of this type of movement, the "enticement" part is probably overplayed. If a man abroad becomes interested in moving into the United States, he can find attractive offers outside the parent company; U.S. affiliates abroad reported a large number of such transfers yearly to companies other than the parent. By far the largest part is not within the same company, though the opportunity to entice would be there if the parent wished to take it. In fact, most are too concerned to acquire good technical personnel abroad and keep it there to play the role of Pied Piper.

Of much more legitimate concern is that the parent company has a fairly firm control over what technology is transferred to the affiliate for its use. And even when the affiliate has its own

laboratory, the parent can (and in a sense must) determine where and when the new developments are actually put into production. While there is some small inducement to let an affiliate innovate an invention it has made or discovered, in the longer run this cannot be the ruling factor in such decisions -- that is, merely that a given affiliate made the discovery! Thus the technological development of the affiliate is limited by the wishes of the parent. However, it would be even more limited without the transfers from the parent! This fact is too often overlooked in criticism of the behaviour of international corporations. And it is doubtful that governments could impose a requirement that the parent must permit a governmental (or affiliate) choice of the technology it employs or the products it manufactures. Imagine, for example, the difficulties which would arise if governments made an international political issue of where the IBM computer memories were to be produced over the world! The best that governments can hope is that there will be a balancing out of decisions by such companies such that each will have the chance to produce some significant portion of some company's total line and thereby diversify its industrial activity. Of course, a government could require more; but remembering the interest of the international corporation in avoidance of interferences, it is questionable whether any government really has that much magnetism under present-day international economic conditions. (While some governments of developing countries have made some fairly stringent conditions stick, and direct investment still flows in, it is my own view that this is a passing phase and will cease as soon as these countries open their economies internationally -- as, in a sense, Japan has recently decided to do vis-à-vis foreign direct investment.)

The third problem with reference to imported R&D is the tendency of local enterprise to rely on foreign sources and not build up sufficient indigenous research efforts to satisfy the government's desire for "national self-sufficiency" in some of the key areas. Without attempting to give evidence, it is my firm impression that there are some critical technical areas in which some of the countries of the world (and, in fact, most of them save the largest) are not economically large enough to sustain the levels of research in several key fields necessary to meet the demands of "national interest", at least as currently defined by governments. It should prove to be in their national

interest both to specialize in some things and to group their activities in others. This is, apparently, the trend in the EEC, where joint research efforts are being undertaken by European companies.

Planning

There have been complaints that the existence of foreign-owned companies in an economy prevents the government from implementing its economic planning. While it is true, as shown above, that the international company does have elements of power and ability to avoid certain situations and interferences, it should be stressed that it does not have the capacity to evade governmental requests. Thus a company operating within a host economy, and expecting to be there for many years (as all do), is quite careful to accede to the demands of governments. It will, therefore, be assiduous in meeting plan targets if such are provided it by the government.

In fact, it has been argued that foreign companies are more careful to respond to signals given by a government than locally owned companies. This is the case not only because they feel more exposed being under a foreign jurisdiction, but also because they do not want to suffer public criticism or governmental investigation or antipathy -- to be avoided almost at whatever cost!

Where the international company may thwart plans of governments is more in the area of indirect controls over the economy -- such as the attempt to clamp down on borrowing or capital expenditures. Having financial resources from outside, and generating significant funds internally, the company may avoid the normal monetary restraints established within the host country. However, most of the companies also go to the local capital markets and are then caught in the restraints just as any other company.

Finally, as indicated earlier, with reference to the desire of the host government to direct location of industry according to a long-range plan of industrialization and relief of depressed areas, international companies are most frequently readily enticed into conforming with such plans.

Extraterritoriality

One of the most difficult aspects of public policy concerning the international corporation is the fact that the company is under the jurisdictions of several governments simultaneously. What is under their jurisdiction is legally only one entity -- the corporation or unit formed under the laws of each -- yet these are also legally part of another single entity, incorporated under the laws of another country. Because of the relative significance of the parts of the international corporation, it lies within the power of the parent government to influence the activities of affiliates, through its ability to command the parent company. (If one of the affiliates were, in fact, larger than the parent and more important to the whole than the headquarters unit, it is likely that some suasion could be exercised back up the chain by the government of this affiliate. In this event, it might be considered necessary by the parent to shift its headquarters to the other country; however, this has not yet been done -- it is being considered as a measure possibly necessary in extremis by some few companies.)

The exercise of authority by the parent government over acts by a foreign affiliate are, in a sense, acts of extraterritoriality. They will normally be successful unless they contravene the law, regulations, or interests of the foreign (host) government. When they do, the resulting conflict of laws or policies must be settled by direct diplomatic negotiation or through the courts. There have been few of the latter, however, and even these have also involved diplomatic representation (for example, the Freuhauf case with France).[1/] The extraterritorial reach of the U.S. government has been exercised mostly in two areas: that of "trading with the enemy" or export controls and that of antitrust regulations, though in a sense the Voluntary Capital Restraints also have an extraterritorial implication.

1/ This case and other aspects of extraterritoriality are discussed in detail in my book on National Tensions over the Multinational Enterprise, Englewood Cliffs, N.J., Prentice-Hall, 1970, Chaps. 8-9.

In practically every case where the U.S. Government has decided to use its power, it has been able to get the U.S. parent company to comply. It has not always been able to achieve compliance of the affiliate, but this was either because the parent company did not have sufficient control (less than 50 per cent ownership, for example) or the foreign courts or executive intervened. However, in the case of licensees, and even where there is no equity interest, the U.S. Government presumes that licensors have sufficient control over licensees to prevent them from shipping items made with U.S. technology to prohibited destinations, even though the shipments might be permitted or even approved or desired by their own government. Interference of the U.S. Government has been a reason given by some potential licensees for not signing with a U.S. company. The point to be stressed here is that the parent complied or attempted to have its affiliate comply! There have been no instances in which the U.S. parent company asserted that it could or would not comply because the U.S. Government did not have jurisdiction, through it, over its affiliate's operations. We may conclude, therefore, that there are -- and can be -- no truly international companies, because each and every one will be subservient in critical ways to a national government. It cannot, therefore, serve the interests of all governments dispassionately; nor is it able to balance them off to meet its own desires or interests -- unless no dominant government has an interest in the same matter. But once the parent government, or another under which major assets reside, becomes interested, the response of the international company can no longer be either "international" or "multinational" (whatever these terms may mean).

Nor is it realistic to expect any government to disavow use of the power it may have over its international companies. Britain, despite a long history of divorcing economic matters from politics abroad, placed strong pressure on its international companies in its embargo of Rhodesia. The United States has done the same in its policies towards China, Korea, East Germany, and others. Sweden has done the same on the Rhodesian embargo. And fifteen governments have restricted trade with the Soviet bloc under multilateral arrangements through the Co-ordinating Committee (COCOM). The U.S. Government has gone further than others in extending its jurisdiction over affiliates, but the hands of other governments are not completely "clean"

on the issue. Nor is any government likely to tie its hands on these matters except through some international agreement. But it seems a bit early to expect such an agreement or that the agreement would leave the international company free to decide which national interest it would serve on what matters, if any at all! This is an area in which much remains to be done.

Ownership

The ownership problem is tied to governmental desire to maintain a high ability to control economic resources and industrial capacity. Since the multinational company, composed of wholly owned subsidiaries, has some extra "degree of freedom" in responding to governmental positions, many governments feel that they can reduce this freedom by insisting on joint ventures. This insistence is buttressed by the desire to maintain "national" control over national industrial capabilities and to provide opportunities for nationals in the industrial growth of the country. Whether or not these attitudes are realistic or serve the country, they exist; corporations have to decide whether the threat is sufficient to cause them "voluntarily" to accept joint partners.

But acceptance of joint ventures raises the possibility of violations of antitrust and therefore gives a U.S. company pause. If it refuses a joint venture for company policy or antitrust considerations, it may find other areas of co-operation from the host government, and even some marketing opportunities, effectively closed off or reduced. To meet the problem halfway, companies have found means of satisfying ownership requests but of maintaining effective control over the company. This still does not void antitrust problems and may, in fact, lead to some serious problems if the host government later requests mergers in order to achieve the advantages of large-scale production within the industry.

Financing of foreign ventures raises problems for both host and capital-exporting countries. When the capital markets or balance of payments of the parent country are causing concern, the burden of financing foreign ventures is thrown more strongly on foreign capital markets. If the foreign market is already tight, with high interest rates, added demand for local financing makes it difficult for host governments to follow their own

financial policies. This kind of conflict was generated by the U.S. Voluntary Capital Restraint Program.

If, conversely, the host government wishes to ease pressure on its own capital market and control the demands made on it, the foreign company may find itself less eagerly received. From the standpoint of financial expansion, therefore, it may be desirable to take local partners -- either directly into the business or through issuance of shares rather than debentures, and even the issuance of shares may be circumscribed by restraints on ability to tap capital markets.

FUTURE DIRECTIONS OF DEVELOPMENT

The pattern of development within the international corporation during the past decade has mirrored the growth of the U.S. (domestic) corporation.

U.S. Pattern

Can the international corporation be expected to continue to follow U.S. developments? The international company grew first as a selling activity in another "region", just as West Coast operations did for the large eastern firm in the United States. Then, as the market opened up, production units were installed, and new items in the line were added as the market could absorb them. A type of product integration occurred later, in which the various branches produced components or parts, and assembly took place at various locations to serve regional markets. Finally, the company has been organized along product lines, rather than regional ones, with some of the major product units relatively autonomous in their operations if not their policies.

The same pattern is being repeated internationally, and the larger European (international) companies are following the same road.

The basic economic factors operating abroad are those that gave rise to multiplant operations within the United States: product diversification and geographic location. From a location standpoint, a company either desires to get near the raw materials or

near the customer, or at an optimum distance from both; as the market expands, location factors change and have induced multi-plant locations within the U.S. economy. The growth of markets abroad (partly stimulated by U.S. exports) induces precisely the same shift in plant operations -- but this is a shift of growth not a mere transfer of an activity from one place to another. The overseas facilities are additional to the company's output even if they are sometimes built from obsolete equipment from the United States, or even if an existing plant is purchased. Product diversification and the drive for company growth have also been strong factors; it is easier to maintain growth in a given product area by moving abroad, and even diversification of products and market areas is facilitated by moving into different national markets which offer varying growth opportunities. Differential profit rates are not a sufficient explanation unless a very long-term view is taken -- so long as to make profit comparisons impossible. Rather, the objective is continued growth of the corporation. And U.S. companies have amassed both capital and manpower (managerial and marketing), with sufficient time and energy to devote to development of overseas operations. Given this objective and capability, we can expect no significant letup in the drive to invest abroad.

Political factors have accelerated this trend. During the immediate postwar period, most countries imposed controls over imports so as to be able to pay for what they required. If sales were to be made in what were former markets, production had to take place behind trade barriers. Both licensing and investment were possibilities, but in many instances capital was needed as well as know-how. In the politically safer countries, investment was not so unattractive an alternative. The same inducements -- trade barriers, exchange restrictions, content requirements, etc. -- have been operative in accelerating investment to the developing countries. However, political and economic instability has been sufficient to reduce the flow significantly.

The move to licensing was an interim step for many companies, leading to investment. Its attractiveness recedes as the market expands, and the licensee finds it does not have the capital to expand production sufficiently. In addition, the licensee sometimes does not have the marketing skills necessary to sell in rapidly growing markets. And given the desire to integrate

operations of affiliates, the parent company requires more control. These factors and others have induced a good many U.S. and European licensors to look much more closely at licensees as potential joint ventures or acquisitions. It is likely that the existence of a network of licensees will accelerate the growth of joint ventures, even if the U.S. company would prefer complete ownership, because of its inability to buy out all licensees simultaneously. But licensing will, in many cases, prove to be a road to investment rather than a final form of doing business overseas; although it will be used by many companies as an interim or complement and frequently as a contractual relationship with a subsidiary, its very success tends to bring its end. In sum, the stimulus is economic and political pull rather than economic or political push. U.S. capital has not slowed its outflow when investment opportunities were high within the United States nor increased when they were low; nor has it abandoned operations in the United States, even when high-cost, to substitute foreign operations (save in very exceptional cases); nor has it responded readily to pleas by the U.S. Government to seek opportunities in the developing countries. When the opportunities have been found, and when the market has been large enough, the government sound enough, or the risk premiums high enough over the long run, capital has moved. And the new affiliates have been gradually integrated into the total activities of the company. The international activities have not, as yet, been welded wholly into the product-division structure, save in a few companies. This is a future step anticipated by most.

Next Steps?

We may then ask whether the next stages of international business development are already on the scene in the larger national economies? The United States is witnessing the formation of "conglomerates", -- i.e. companies made up of affiliates having no common product or industrial basis. They are, more or less, financial and management trusts rather than integrated companies seeking economies of scale in production and distribution. Is such a move likely, internationally? It has at least two strikes against it: the first is that this process is essentially one of acquisition and merger, which is a technique of expansion abroad normally least liked by governments. One could expect governments to clamp down hard on such requests. The second

is that there is little or no technical contribution made by the parent, yet this contribution is more desired than others by most governments. It does not appear to me that this is a pattern likely to be extended overseas. There are, however, some few examples of foreign conglomerates that have arisen out of necessity -- such as that being formed by American Foreign Power, as it invests in a variety of activities with funds gained from the nationalization of its public utility holdings but which it cannot return to the United States. Save for these special cases, it is highly doubtful that foreign governments would see any advantage in the formation of international conglomerates.

Possibly including, but largely apart from, the U.S.-based international company, we can expect to see further international concentration and mergers of large companies. The French and other governments are now pressing for concentration of national industries to fend off the threat of domination by larger international entities. However, none of the national concentrations is likely to be large enough to sustain the types of R&D needed and to sway the international market. While it will be some time in coming, one can easily postulate conditions under which CIBA and Hoechst or Siemens-Olivetti-Ericcson would find it desirable to merge. At present, the incorporation laws of the members of the EEC make it difficult; but the eventual (five years?) development of an EEC incorporation law would facilitate these mergers by permitting stock-swaps and the creation of a new (non-national) identity.

Once the EEC makes some further progress towards integration, we can anticipate not only new entrants into the class of international corporations but a strengthening of some of the largest by merger. If so, the trends we outlined earlier in this essay will be accelerated, and the problems of governments will be exacerbated.

One tactic proposed is to put a "slow" sign on the road for international companies and to adopt intergovernmental policies promoting the transfer of technical know-how among enterprises, but prohibiting the acquisition of equity positions by the licensor. There is no doubt that if all governments accepted this as a policy, the international companies that exist today, and the potentially new ones, would shift their activity to licensing, at

least in areas where their current activities did not reach. But the effect of such constraints would merely be to accentuate the headstart position of existing international companies, which would undoubtedly not be "rolled back" to a pre-existing position as of some date; nor would they likely be stagnated in their growth. Such an action would simply be too costly and complex.

Further, the restriction of international business to the technique of licensing assumes that the licensee is in fact capable of using the technology effectively -- that is, that it has the management and physical resources necessary. Such is not the case. And unless the country recipients are prepared to wait the same 30 or 40 years that Russia took to train its own technicians (with the help of foreign technicians), this restrictive tactic is unlikely to work. For, by the time they were able to catch up, the technological train would have long since left the station.

Like it or not, the governments of the world are faced with a situation in which radical changes will have to be made in the pattern of business and economic and legal relations. The change does not have to be in the direction of the American pattern. It is likely to be so, out of default, unless the governments of the major countries reassess their positions, powers, and objectives very carefully and come to an agreement as to how to limit, use, and direct this new phenomenon of the international corporation.

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