

THE CONTRIBUTION OF MULTINATIONAL CORPORATIONS TO THE  
ECONOMIC DEVELOPMENT OF LESS DEVELOPED COUNTRIES:  
THE RADICAL VIEW CONSIDERED

by

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## CHAPTER I

### Introduction

What is the contribution of multinational corporations to the economic development of less developed countries? In the present world economy these two groups are becoming increasingly interrelated. Both multinational corporations and less developed countries have appeared since the industrial revolution and both are now important factors in the world economy. Paul Streeten describes the relationship between the multinational corporations and the less developed countries.

The multinational enterprise is often cited as a useful agent for promoting exports from developing countries, penetrating new markets and overcoming the obstacles of high costs of an infant industry. But the multinational enterprise raises as many problems as it solves--political problems of foreign ownership and problems of the distribution of gains between host country and foreigners and between different groups, sectors and regions in the host country.<sup>1</sup>

The multinational corporation presents opportunities and creates problems. This paper examines the radical views concerning the role of multinational corporations in the less developed countries (MNCs and LDCs).

The discussion first takes a look at the historical background of LDCs and MNCs. Second, the structure of the radical argument is presented. And finally, the radical view is critiqued with respect to the standard view.

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<sup>1</sup>Paul Streeten, "Trade Strategies for Development: Some Themes for the Seventies," in Paul Streeten (ed.), Trade Strategies for Development: Papers of the Ninth Cambridge Conference on Development Problems, September 1972 (New York: John Wiley and Sons, 1973), p. 15.

## CHAPTER II

### THE BACKGROUND

#### Less Developed Countries

The background of LDCs and MNCs is discussed here from the radical point of view. Radical thought views the industrial revolution as the origin of the dependence and underdevelopment of the less developed countries relative to the industrialized world. Celso Furtado asserts that the industrial activity which resulted from the industrial revolution violated the law of diminishing returns by causing qualitative changes in factors of production.<sup>2</sup> But those economies which did not achieve technological progress, especially agricultural economies, were constrained by the limited degree to which their production factor proportions could be altered. The availability of land governed the use of the other factors. However, industrial activity enabled a country to pass this barrier. Growth allowed further specialization of labor and equipment (greater division of labor and more complex equipment). This resulted in increased productivity and increasing returns to scale. Furtado states that

Once England had established an important industrial nucleus and consolidated its advantage over other countries, it would not be difficult to demonstrate that, in terms of the principle of comparative advantage, considered from the static point of view, it would be in the interest of other countries to buy industrial products from England and pay for them with raw materials.<sup>3</sup>

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<sup>2</sup>Celso Furtado, Economic Development of Latin America, A Survey From Colonial Times to the Cuban Revolution (London: Cambridge University Press, 1970), p. 27.

<sup>3</sup>Ibid., p. 28.



Furtado divides the industrial revolution into two phases. The first phase lasted until the middle of the nineteenth century. The second phase of the industrial revolution saw the establishment of a system of international division of labor based on a world market in the second half of the nineteenth century.<sup>4</sup> Improved transport played the decisive role in the transition of phases, particularly technological improvements in both railroads and maritime transport which reduced the time and cost of transport.

There were three notable features of the world economy during the second phase.<sup>5</sup> First, a rise in the economic growth rates due to rapid technological progress in many countries. Up to that time a long-term upward trend of growth rates had shown no significant change in living standards within a single generation. Second, public service improvements and a rise in real income brought about a dramatic rise in the rates of population growth. And third, a fund of transmittable technical production knowledge was created and rapidly expanded. These factors resulted in the growth and integration of the world economy as international specialization intensified and world trade expanded.

The countries which did not participate in this nineteenth century industrial revolution entered into world trade as primary product exporters. The extent of development derived from trade depended to a great extent on the type of commodity exported. Furtado discusses three groups of primary product exporters: exporters of temperate agricultural commodities such as Argentina and Uruguay; exporters of tropical agricultural commodities such as Brazil, Columbia, Ecuador, Central

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<sup>4</sup>Ibid., pp. 28-29.

<sup>5</sup>Ibid., pp. 29-30.

America and the Caribbean; and, exporters of mineral products such as Mexico, Chile, Peru and Bolivia.<sup>6</sup> Temperate agricultural commodities used the land extensively yielding high profitability. These countries were able to compete with the domestic production of the industrialized countries and regions of recent European settlement and were thus initially integrated into the world economy. Producers of temperate agricultural commodities showed an expansion in foreign trade and these countries achieved high rates of growth. But tropical agricultural commodities were of little significance as a factor of development on the whole. Such exports tended to open large areas of settlement but did not give rise to changes in the methods of production. (A notable exception to this case of slow development is probably the coffee region of Sao Paulo, Brazil.) Finally, the development of export mining industry entailed the denationalization of the mining sector. The industry moved from small-scale operations to foreign owned and administered, large-scale production which behaved as a separate economic system. The development influence of these exports was practically nil. The advanced technology and high capital intensity resulted in a small labor force and specialized infrastructure.<sup>7</sup>

World War I marked three important changes in long-term trends of the international economy.<sup>8</sup> First, there was a reversal of the upward trend in the external trade coefficient of the industrialized countries. Foreign trade ceased to be an increasing portion of total production in

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<sup>6</sup>Ibid., pp. 32-34.

<sup>7</sup>Ibid., pp. 32-34.

<sup>8</sup>Ibid., pp. 36-37.

These countries. Second, there was a persistent deterioration in the world market prices of primary products. Third, there was a decline in the ratio of primary products traded to the total volume of world trade. The increased overall activity in the world economy prior to World War I was characterized by increased interdependence between its parts. Two forms of development were apparent.

On the one hand, we have the development of industrial centres based on technological progress and a rapid accumulation of capital. This type of development entailed increasingly complicated production processes, which required both a change in the relative quantities of productive factors, with more capital per unit of labour, and a change in their quality, more particularly a progressive improvement in the human factor. On the other hand, we have the development of the so-called 'periphery', or outpost areas, induced by changes in overall demand and effected through the external sector. This second type of development was nearly always extensive in character; that is, it made it possible to increase the economic productivity of available factors without requiring significant changes in the forms of production.<sup>9</sup>

Peripheral development afforded little capacity to change the traditional production techniques. Theotonio Dos Santos describes the relationship between the primary product exporting countries and the industrialized countries as "financial-industrial dependence." In general

The relations of dependence to which these countries are subjected conform to a type of international and internal structure which leads them to underdevelopment or more precisely to a dependent structure that deepens and aggravates the fundamental problems of their peoples.<sup>10</sup>

The term dependence could apply to all countries which are not isolated from the world economy. But here the term dependence is not used only to denote lack of complete independence. The term implies a subserviant position of the LDCs relative to the rich countries.

Dependence corresponds to a situation which conditioned not only the international relations of these countries but also their

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<sup>9</sup> Ibid., p. 38.

<sup>10</sup> Theotonio Dos Santos, "The Structure of Dependence," The American Economic Review, 60 (May 1970), p. 231.

internal structures: the orientation of production, the forms of capital accumulation, the reproduction of the economy, and simultaneously, their social and political structure.<sup>11</sup>

World War I, the 1929 crash, world depressions of 1930 and 1937, World War II and the aftermath of reconstruction distracted the attention and limited the ability of the industrialized centers to influence the less developed economies. Primary product exports and available foreign exchange to import manufactures were greatly reduced. In some places there was an upsurge of development-oriented policy. A strong nationalist policy and an independent industrial drive resulted from the weakened ties with the metropolis. In these countries some measure of political power was gained by a bourgeoisie--a group not necessarily national, but nevertheless local. The industrial development was primarily for the internal consumer-goods market. Andre Gunder Frank calls this period "Bourgeois Nationalism."<sup>12</sup>

Following World War II the world economy was back to business as usual. At this point the MNC emerged in a prominent role in the world economy. The role of the MNC in the LDCs is to be examined. First, a brief account of the origin of the MNC should be made.

### Multinational Corporations

The definition of MNC in this paper will be a corporation which is headquartered in one country but makes its decisions on a world view of its international production and sales. It is difficult to determine the

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<sup>11</sup>Ibid., p. 232.

<sup>12</sup>Andre Gunder Frank, Lumpenbourgeoisie: Lumpendevelopment (New York: Monthly Review Press, 1972), pp. 75-77.

exact time at which the first MNCs appeared. Edith Penrose states that the modern corporation is a direct descendent of the older joint-stock company.<sup>13</sup> Stephen Hymer disagrees on this point.

Neither these firms (joint-stock companies), nor the large mining and plantation enterprises in the production sector, were the fore-runners of the multinational corporation. They were like dinosaurs, large in bulk, but small in brain, feeding on the lush vegetation of the new worlds (the planters and miners in America were literally Tyrannosaurus Rex).<sup>14</sup>

Instead he contends that the small workshops and the emerging capitalist class were the ancestors of the modern corporation. During the nineteenth century many small enterprises were consolidated into national corporations by merger movements. Rapid economic growth, improved transportation and communications encouraged such interregional efforts. The initial foreign investments made by national corporations in order to increase sales abroad formed the foundation of today's MNCs.<sup>15</sup>

Hymer summarizes the position of the national corporation in the early twentieth century.

At the risk of great oversimplification, we might say that by the first decade of the twentieth century, the problem of production had essentially been solved. By the end of the nineteenth century, scientists and engineers had developed most of the inventions needed for mass producing at a low cost nearly all the main items of basic consumption. In the language of systems analysis, the problem became one of putting together the available components in an organized fashion. The national corporation provided one organizational solution, and by the 1920s it had demonstrated its great power to increase material production.<sup>16</sup>

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<sup>13</sup>Edith T. Penrose, The Large International Firm in Developing Countries: The International Petroleum Industry (Cambridge: The MIT Press, 1968), p. 26.

<sup>14</sup>Stephen Hymer, "The Multinational Corporation and the Law of Uneven Development," in J. N. Bhagwati (ed.), Economics and the World Order (New York: World Law Fund, 1970), pp. 115-116.

<sup>15</sup>Mira Wilkins, The Emergence of Multinational Enterprise: American Business Abroad from the Colonial Era to 1914 (Cambridge: Harvard University Press, 1970), p. 36.

<sup>16</sup>Hymer, "Law of Uneven Development," p. 119.

At that point in time two alternative paths of corporate growth were possible: capital widening or capital deepening in the productive sector. Hyman describes the choices and the corporate decisions made at that time.

One possibility was to expand mass production systems very widely and to make basic consumer goods available on a broad basis throughout the world. The other possibility was to concentrate on continuous innovation for a small number of people and on the introduction of new consumption goods even before the old ones had been fully spread. The latter course was in fact chosen, and we now have a paradox that 500 million people can receive a live TV broadcast from the moon while there is still a shortage of telephones in many advanced countries, to say nothing of the fact that so many people suffer from inadequate food and lack of simple medical help.<sup>17</sup>

This decision was important in that product development and product marketing replaced production as the dominant problem of the corporation and the continual introduction of new products became necessary to maintain a steady, rapid rate of corporate growth.<sup>18</sup>

Early waves of direct foreign investment occurred at the turn of the century and during the 1920's. After World War II foreign operations of corporations grew rapidly--by ten percent per annum between 1950 and 1969.<sup>19</sup>

The stage for the discussion is now set. A part of the world lags behind in economic development. MNCs operate across national and play a significant role in LDC trade and investment. The question is obvious: what is the contribution of the multinational corporation to the economic development of the less developed countries?

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<sup>17</sup>Ibid., p. 119.

<sup>18</sup>Ibid., p. 120.

<sup>19</sup>Ibid., p. 121.

## CHAPTER III

### RADICAL ECONOMIC THOUGHT

#### Definition of Radical

It must be pointed out that any distinction between standard or orthodox economic thought and radical or Marxian thought is necessarily somewhat arbitrary. Economists do not wear badges of ideological identification. Even the exact meanings of standard and radical are not clear. For the purposes of this discussion the term radical will denote the view centered on conflict of class interests and the inability of reforms in the capitalistic system to solve the defects of the present system. The modern radical economists differ from the old left. They propose some new concepts and no longer view Marx and Lenin as the sole sources of inspiration. But traces of the Marxist tradition can be detected through their inherent revolutionary bias and a pessimism about the capitalist system.<sup>20</sup> The radical view emphasizes the economic dependence of the LDCs. It is alleged that political sovereignty is more illusion than reality and that trade and investment take place to satisfy the material needs of the advanced countries.<sup>21</sup> The radical arguments discussed below contribute a great deal in themselves toward defining and characterizing the radicals.

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<sup>20</sup> Benjamin J. Cohen, The Question of Imperialism (New York: Basic Books, Inc., 1973), p. 93.

<sup>21</sup> Ibid., pp. 93-94.



### Standard Package Deal

Standard economic thought is by no means unanimous concerning the consequences of MNC interaction with the LDCs. A general consensus of opinion does exist on the relationship and role of the MNC in these cases. This consensus says that as a result of the historical processes described above, the MNC possesses certain skills and factors of production needed in the LDCs if they are to embark on new production activities. Standard thought views "the package deal" as the role of the MNC.

It is generally agreed that the unique contribution of inward direct investment over other forms of resource importation is the multiplicity of barriers which it can overcome for the recipient country. At one and the same time, it can offer a package deal of a superior production technology, managerial skills and marketing methods; of access to markets in inputs and outputs which it has accumulated over the years; and of being part of an organization which may be benefiting from economies of scale and integration.<sup>22</sup>

Obviously, the direct foreign investment by MNCs is not the sole method of overcoming these production barriers. Several alternatives are open to the LDC. An indigenous plant could be set up with domestic capital and other resources. Money could be borrowed from abroad, foreign engineers and managers hired, and technology purchased through licensing. Joint ventures between the multinational corporations and the host country could be established. The finished product could be imported. Or the LDC could decide to neither carry out the investment or import the product but to do without it entirely.<sup>23</sup> Most of the LDCs

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<sup>22</sup> John H. Dunning, "Multinational Enterprises and Trade Flows of Developing Countries," in Paul Streeten (ed.), Trade Strategies for Development: Papers of the Ninth Cambridge Conference on Development Problems, September 1972 (New York: John Wiley & Sons, 1973), p. 310.

<sup>23</sup> Paul Streeten, "Costs and Benefits of Multinational Enterprises in Less-Developed Countries," in John H. Dunning (ed.), The Multinational Enterprise (New York: Praeger Publishers, 1971), p. 250.



have permitted direct foreign investment by MNCs and the record shows such investment to be a significant factor in international economic transactions. It is to the radical assessment of this relationship that the discussion will now turn.

### MNC Decision Making

The relationship under examination concerns two entities: the MNC and the host government of the LDC. The MNC is seeking some form of gain from its direct investment in the LDC. It is not important at this point to determine the specific gain sought by the MNC: production behind a tariff barrier, market protection, or low wage-cost profits. It is important to note that the goals of the MNC are not the same as the goals of the host government. The goal of the host government can be taken to be economic development meaning acquiring the needed factors and skills of production from the MNCs at the lowest possible cost. The success of either party in such a relationship depends to a large degree on its relative bargaining strength. The MNC is generally the more powerful in such dealings. The host government may find itself with only a choice of permitting or forbidding proposed direct foreign investment projects of the MNC. But the MNC holds the advantage through its decision making power.

Stephen Hymer specifies the nature of the decision making power.

The qualitative evidence on the structure of business enterprise and its evolution through time suggests that both size and internationality have important positive effects on a firm's strength and ability. Since the beginning of the industrial revolution there has been a steady increase in the size of manufacturing firms, so persistent that it might almost be formulated as a general law of capital accumulation. These increases in size were accompanied by important changes in organizational structure involving

both increased subdivision or differentiation of tasks and increased integration through the creation of new organs of control. Business administration became a highly specialized activity with its own elaborate division of labor; and the corporation developed a brain to consciously coordinate the various specialties and to plan for the survival of the organism as a whole.<sup>24</sup>

Hymer uses a three-level decision making structure formulated by Alfred D. Chandler and Fritz Redlich to analyze the decision making process of the MNC. Level III, the lowest level, is the management of the day-to-day operations of the enterprise. Level II is the coordination of the managers of Level III. Level I is the top management; where goal-determination and planning take place.<sup>25</sup> In the MNCs these decision levels are geographically separated. The separation of the decision process is the source of the dependent relationship. The high-level strategic planning will be made in the major cities of the world and the lower level decisions in the cities of the LDCs. The implication of this structure for the host country is that local input into strategic decisions will be minimal and the development objectives of the LDC will have no direct influence on the decisions of the MNCs.

The contribution of the direct foreign investment of the MNC to the economic development of a LDC can be traced by looking at the MNC's decisions and their effects on the LDC. For convenience and structure of thought, chart number one outlines this contribution. The MNC's decisions affect the LDC through four main avenues: the location and nature of the direct investment, product marketing practices, transfer of technology, and transfer prices.

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<sup>24</sup>Stephen Hymer, "The Efficiency (Contradictions) of Multinational Corporations," The American Economic Review, 60 (May 1970), pp. 441-442.

<sup>25</sup>Hymer, "Law of Uneven Development," p. 123.

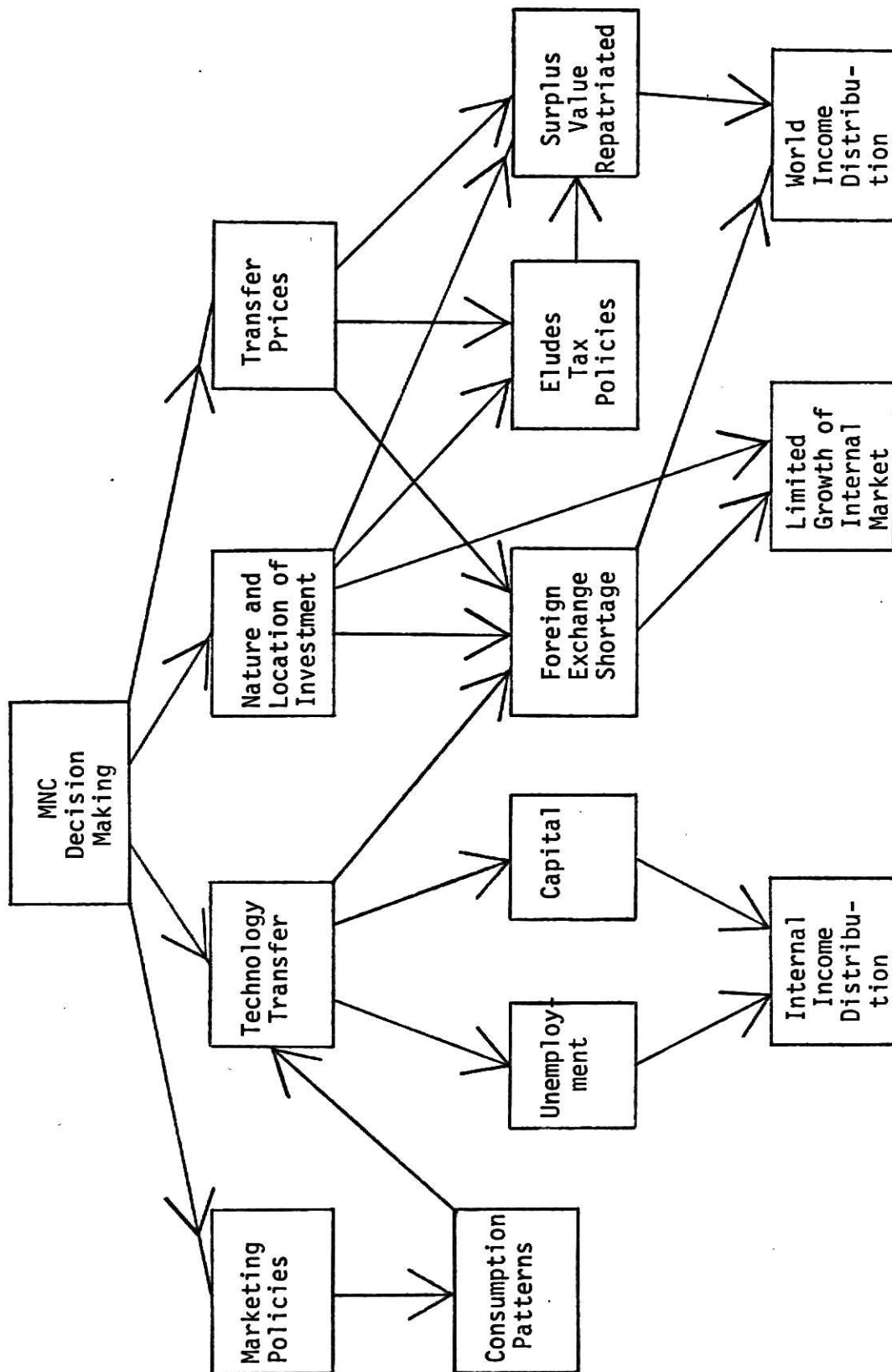


TABLE 1. THE EFFECTS OF MNC DECISION MAKING

### Location and Nature of the Investment

The decision making process of the MNC determines the nature and location of the initial direct investment in the LDC. Included here is the decision to locate in a certain country, the origin of the finance capital, and the choice between creating new production facilities or buying existing facilities.

The MNC decision on where to locate a subsidiary is guided to a large extent by the profit motive. So a high level of government support services (such as protection of property, infrastructure, labor force development), and a low tax rate form a desirable basis for a large profit. On the other hand, the LDC is interested in maximizing the government surplus--total revenue from the MNC minus the cost of the government support services. Stephen Hymer compares the LDCs to the local governments of a country in this regard. "Their competition to attract corporate investment eats up their surplus, and they find it difficult to finance extensive investments in human and physical capital even where such investment would be productive."<sup>26</sup> However, it is vital that the government levy a sizable tax burden on the MNC. LDC expenditures on infrastructure and support services are necessary in order to attract MNC investment. But sufficient tax revenues are needed in order to finance these projects.<sup>27</sup> So the LDC wanting to attract MNC investment faces a dilemma. Sufficient tax revenue must be raised to provide the needed government services but high tax rates are not attractive to the profit

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<sup>26</sup>Ibid., p. 128.

<sup>27</sup>Ibid., p. 128.

seeking MNCs. While not of primary interest in this discussion, foreign aid to LDCs is often viewed as rich country support for the host government in its provision of services for the MNCs. This aid could be considered support from the taxpayers of the rich countries to the private profit of MNCs.

One of the "package deal" arguments favoring the investment by MNCs in the LDCs is that the MNC brings in foreign capital. However, there is evidence to show that MNCs do not bring their own finance capital from abroad. Rather the capital investment is financed from local (LDC) sources. Muller cites evidence on the source of finance capital. "Only 17 percent of the total finance capital used by MNCs in their gross investments came from non-local savings."<sup>28</sup> Subsidiaries are able to borrow from the local financial institutions under the credit rating and backup resources of the parent MNC. The local business enterprise, which already faces the usual finance capital shortage of the LDC then faces the formidable competition of the subsidiary for this small capital supply.<sup>29</sup>

Along with deciding on the country in which to make the investment and the source of the finance capital, the MNC also decides whether to create new production facilities or to buy out existing domestic enterprises. One of the MNC contributions is generally considered to be investment in the creation of new production facilities. Such facilities would be a net addition to the LDC's production capacity. The 'method

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<sup>28</sup>Ronald Muller, "The Multinational Corporation and the Underdevelopment of the Third World," in Charles K. Wilber (ed.), The Political Economy of Development and Underdevelopment (New York: Random House, 1973), p. 136.

<sup>29</sup>Ibid., p. 129.

<sup>30</sup>Ibid., p. 138.

of entry' is often however buying out a local, domestically controlled enterprise.

The implications of this analysis for the Third World are clear in regard to the so-called financial contributions of MNCs. In the manufacturing sector, currently the most important to the future of development of Latin America, 78 percent of MNCs' foreign investments are financed from local savings. Of this finance capital, 46 percent is used to buy out existing locally controlled firms, whose profits would otherwise be retained domestically and thus contribute to local consumption and/or savings. But from the date of the acquisition and hence forth, some 52 percent of those profits leave the country, resulting in a net decrease in the LDCs' savings which would have been available and an increase in their already acute shortage of foreign exchange. Given these results, it is impossible to see how the MNCs' financial impact on Third World countries could possibly assist in the alleviation of their underdevelopment.<sup>31</sup>

### Product Marketing Practices

Stephen Hymer discusses a marketing process called trickledown or two-stage marketing which is a form of the international demonstration effect. This process is derived directly from the world structure of decision making, the structure of status and authority. Parallel to the decision structure is a structure of income and consumption. The citizens in the capital cities are the highest paid and new products which are accepted by this group of people trickle down to others who follow this demonstration of consumption. Thus, consumption patterns are spread outward from the metropolis to the periphery. "Multinational corporations help speed up this process, often the key motive for direct investment, through their control of marketing channels and communications media."<sup>32</sup> Hymer shows the rationale of the MNC in production for the relatively small markets of LDCs.

The development of a new product is a fixed cost; once the expenditure needed for invention or innovation has been made, it is

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<sup>31</sup>ibid., pp. 138-139.

<sup>32</sup>Hymer, "Law of Uneven Development," p. 125.

forever a bygone. The actual cost of production is thus typically well below selling price and the limit on output is not rising costs but falling demand due to saturated markets. The marginal profit on new foreign markets is thus high, and corporations have a strong interest in maintaining a system which spreads their products widely. Thus, the interest of multinational corporations in underdeveloped countries is larger than the size of the market would suggest.<sup>33</sup>

The international demonstration effect influences the consumption patterns in the LDCs. Part of the LDC society is adopting the consumption patterns of the more developed countries while a large part of the population, often two-thirds, lives in poverty. Of course, this spreading of products is coupled with the process of capital deepening discussed above. This introduces the third main avenue of effect of the MNC's decisions, the transfer of technology.

#### Technology Transfer

Ronald Muller contends that the process of industrialization being pursued by most of the LDCs necessitates the acquisition of mechanical technology and human technical skills. "In other words, the voluntary or involuntary institutionalization of Western consumption values as the goal of economic growth has, in turn, brought about the need for a technology which can satisfy this pattern of consumption."<sup>34</sup> Furtado shows the unavoidable role which the MNCs play as the source of this technology. He states that in the present international economy markets are superseded by internal transactions of the MNCs.

Decentralizing their productive activities in response to the dimensions to the local markets of the dependent economies, MNCs have transferred technology into transactions internal

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<sup>33</sup>Ibid., pp. 125-126.

<sup>34</sup>Muller, "Multinational Corporation," p. 126.



to the new firms. On the other hand, access to technical innovation constitutes a necessary condition for growth based on the patterns of consumption created in the rich countries. Working on the basis of blueprints and minimizing the cost of research and development, MNCs can overcome some of the limitations imposed by the smallness of local markets and the lack of external economies. Thus, a precondition for keeping the process of industrialization going is the cooperation of MNCs. Other channels of transmission of technical progress, required by this type of industrialization, are more expensive and less accessible.<sup>35</sup>

The new products of the MNCs are vital to the LDCs but they also tighten the links of dependence. So it is asserted that the transfer of technology is necessary for the industrialization of the LDCs. What is the radical criticism of this trend?

Generally the radicals feel the technology used by the MNC is too capital intensive (high capital-labor ratio) for maximum benefit to the LDC. The effects of the transfer of technology in three areas will be considered: employment, income distribution, and supply of foreign exchange.

Obviously if the MNC technology is too capital intensive, it is labor saving. A major problem in the LDCs is unemployment. What is the employment contribution of the technology of the MNCs for the LDCs? In Latin America the manufacturing sector has produced an increasing share of total national output while employing a decreasing share of the labor force. Muller contends that the MNCs eliminate more jobs than they create.<sup>36</sup>

The second area affected by the transfer of technology is the distribution of income within the host country. This distribution is

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<sup>35</sup>Celso Furtado, "The Concept of External Dependence in the Study of Underdevelopment," in Charles K. Wilber (ed.), The Political Economy of Development and Underdevelopment (New York: Random House, 1973), p. 121.

<sup>36</sup>Muller, "Multinational Corporation," p. 133.



partly the result of the increasing rate of unemployment. As a smaller part of the labor force is hired for production, a smaller part of the total bill for factors of production goes to the workers. At the same time most economies of the LDCs are based on the legal institutions of capitalism, meaning that the owners of capital resources receive the income generated by those capital resources. So as the MNC introduces new technology which generates a larger proportion of income from capital than labor resources, the distribution of income becomes more unequal. Muller summarizes the income distribution impact of technology transfer. "It is a contribution to the richest 5, 10, or 20 percent of these populations, but an absolute disservice to the human condition of the greater majority of the populations of LDCs."<sup>37</sup>

The supply of foreign exchange is the third area affected by the transfer to technology. Muller points out that from 50 to 65 percent of the investment value for the establishment of a subsidiary operation represents the cost of the subsidiary's technology, as valued by the parent MNC.<sup>38</sup> This same point will be discussed below in reference to tax policies. Here we are concerned with the shortage of foreign exchange. Furtado contends that an increasing imbalance now exists in the world economy as a result of MNC growth. This imbalance is characterized by a relative reduction of real flows to the LDCs coupled with an increasing number of cases in which the MNCs are reaping the benefits of the increased productivity in those countries.

In other words, the expansion of MNCs entails an increasing flow of invisibles from the center to the periphery, and the cost of

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<sup>37</sup>Ibid., p. 135.

<sup>38</sup>Ibid., p. 135.

such invisibles has to be matched with a flow of goods from the periphery to the center. The problem is how to reconcile this with the present slow growth or relative decline in the dependent countries' ability to make international payments.<sup>39</sup>

The shortage of foreign exchange is termed the balance of payments problem and is generally considered to be a "bottleneck" to economic development. The LDC has difficulties paying its foreign debts. A shortage of foreign exchange will impede the development of locally owned enterprises.

### Transfer Prices

The final main avenue through which the corporate decisions affect the economic development of the LDC is the practice of intra-company transfer prices. These transfer prices are the value of technology, value of intra-firm imports of intermediate materials used in production, and the value of exported products.

The value placed on the technology embodied in the subsidiary firm, mentioned above, is from 50 to 65 percent of the total cost of plant and equipment. Muller cites findings from Mexico where numerous cases of secondhand technology have been reported transferred to subsidiaries at higher prices than those of independent markets or those declared for new equipment. In Columbia overvaluation of technology was found in all cases. Muller, interviewing managers of MNC subsidiaries, found that overvaluing technology was a common practice.<sup>40</sup>

What are the effects of the overvaluation of transferred technology? First, in many LDCs the tax on the firm's profit is based on

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<sup>39</sup>Furtado, "External Dependence," p. 122.

<sup>40</sup>Muller, "Multinational Corporation," p. 136.

the sum of profits calculated as a percentage of the value of the fixed investment. So the higher the value claimed on the fixed investment, the lower the rate of return on that investment and the lower the tax on the subsidiary. Second, in addition to avoiding the tax policies, many LDCs place limitations on the amount of profits a MNC may repatriate in a given period based on the value of the fixed investment. Here the higher the value of the fixed investment, the higher the amount of profits which the MNC may remove from the country.<sup>41</sup>

Transfer prices of imports for a MNC subsidiary tend to be higher than the normal market price. This practice effectively reduces the amount of taxes assessed to the subsidiary by the host country. In overpricing the imports, the MNC is extra-legally transferring funds from that subsidiary to another part of the corporation. This is a method of disguising the removal of profits from the LDC. The immediate effect of the overpricing of imports is the repatriation of surplus value. Ultimately these transfer prices contribute to the imbalance of world income distribution and limit the growth of the internal market of the LDC.

MNCs frequently set transfer prices that undervalue exports. A large part of the exports of a subsidiary tend to be exported to other subsidiaries of the same parent corporation.

A look at the export pricing of a large number of MNCs in manufacturing industries in Mexico, Brazil, Argentina, and Venezuela shows that 75 percent of these firms sold exports only to other subsidiaries of the same parents. In turn, these 75 percent on the average underpriced their exports by some 40 percent relative to the prices being received by local firms.<sup>42</sup>

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<sup>41</sup>Ibid., p. 135.

<sup>42</sup>Ibid., p. 142.

The practice of exporting to related subsidiaries makes the practice of underpricing possible. This undervaluation reduces the rate of profit and the amount of tax paid by the subsidiary. Moreover, the performance of the exports of MNCs has not achieved the full measure of its expectation. Muller cites evidence which shows that MNCs are not significantly different from local enterprises in terms of export performance. Thus, the expectation of a significant positive impact on the balance of payments problem has not been fulfilled.<sup>43</sup>

As was the case with overpriced imports, underpriced exports from the subsidiary firms ultimately affect the economic development of the LDC in two areas: the imbalance of world income distribution and limitation of growth of the internal market of the LDC.

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<sup>43</sup>Ibid., p. 141.

## CHAPTER IV

### STANDARD VIEW OF RADICAL THOUGHT

In what ways does radical thought diverge from the standard thought? And what criticisms are made of these divergences by standard thought? Several areas will be considered: definition of economic development, the concept of surplus value, dependence and exploitation, and technology transfer.

#### Definition of Economic Development

Ronald Muller describes the radical definition of economic development.

It will not be assumed that an increase in average per capita income constitutes 'development.' Instead, a MNC activity and its impact will be judged a contribution only if it results in an increase in the consumption potential of the poorest 60 percent of a LDC's population. For we believe that unless economic growth brings some alleviation to those suffering most, such growth is a contribution not to development but rather to the continued underdevelopment of Third World nations.<sup>44</sup>

N. P. Shemelev states that in the standard (he uses the term "bourgeois") criterion of economic development, the index of economic development is the rise in per capita national income regardless of socio-economic relationships.<sup>45</sup> This is a fair assessment of the standard definition. Gerald M. Meier defines economic development as "...the process whereby

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<sup>44</sup>Ibid., pp. 131-132.

<sup>45</sup>N. P. Shemelev, "A Critique of Bourgeois Theories of Economic Development," The Journal of Development Studies, 1 (October 1964), p. 80.

the real per capita income of a country increases over a long period of time."<sup>46</sup> And in defining economic development he excludes the views which say development means growth plus change, not merely expansion through a simple widening process.<sup>47</sup> Meier does not accept the radical definition of development and he points out the source of the difficulty of definition. "The phenomena that one chooses to denote as 'economic development' are very much a matter of what one values as the economy's policy goals. And any definition of development becomes a 'persuasive definition,' implying that development--as so defined--is a desirable objective."<sup>48</sup> So the essential difference between the radical and standard definition of economic development is that the radical view takes account of qualitative (especially class conflicts and distribution of income) as well as quantitative changes in production.

#### Surplus Value

Another recurring theme in the radical literature is that of surplus value and the tendency of the MNCs to reap the surplus. Current radical thought is no longer centered around the traditional Leninist approach. This Leninist view emphasized the tendency of the falling profit rate in the capitalist economies making economic imperialism the only available outlet for capital investment. Paul Baran and Paul Sweezy define economic surplus as "the difference between total

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<sup>46</sup>Gerald M. Meier, Leading Issues in Economic Development; Studies in International Poverty (Oxford University Press, 1970), p. 7.

<sup>47</sup>Ibid., p. 6.

<sup>48</sup>Ibid., pp. 6-7.

output and the socially necessary costs of producing total output."<sup>49</sup> Baran, in an earlier work, had distinguished between the actual economic surplus and a potential economic surplus which he defined as the possible production (given natural and technological constraints) over essential consumption.<sup>50</sup> Such words as "possible" and "essential" are the basis for disagreement between standard and radical thought. "Criticism such as this clearly involves some powerful normative judgments. Who is to say what is or is not 'essential' consumption? Who is to say what is irrational or wasteful? Surely these are matters on which honest men can honestly disagree."<sup>51</sup> Baran and Sweezy emphasize the monopoly profit earning power of the MNCs. But their argument falls down when they fail to make a distinction between monopoly and obligopoly. Cohen criticizes this failure.

However, in practice it makes a great deal of difference whether a firm faces no competitors or a few. If it faces none--if it is a true monopolist--then of course prices can be maintained without much difficulty. But if it does face some competitors within the framework of an oligopolistic market, matters become much more complicated. Though the firm can try to maintain its prices, it may not always succeed. And even if price competition can be avoided, competition will still continue along various dimensions other than price (e.g., by way of product differentiation, advertising, or credit schemes), all of which will effect the cost structure of the firm. In the end, therefore, firms may not be able to raise their profit rates quite so easily as Baran and Sweezy suggest.<sup>52</sup>

So a radical conclusion which is considered to be an iron law, should more logically admit greater uncertainty. Radical thought certainly

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<sup>49</sup>Paul A. Baran and Paul M. Sweezy, Monopoly Capital (New York: Monthly Review Press, 1966), p. 76.

<sup>50</sup>Paul A. Baran, The Political Economy of Growth (New York: Monthly Review Press, 1957; reprint ed., New York: Monthly Review Press, 1968), p. 23.

<sup>51</sup>Cohen, Imperialism, p. 105.

<sup>52</sup>Ibid., pp. 111-112.

contains elements of truth, but its shortcoming is the tendency to draw conclusions which are too general and binding. Standard thought, while admitting the potential tendencies of surplus value, does not agree that the alleged results must necessarily follow.

### Dependence and Exploitation

The argument of surplus value leads to the broader argument of dependence and exploitation. Like the case of surplus value, standard thought admits the validity of part of the radical contentions, but the final conclusions are not acceptable to standard thought. The radicals charge that the motives of the principal participants of the capitalist system, MNCs and their home governments, determine the degree of dependence in the periphery. Policy decisions of MNCs are motivated by the profit incentive and a traditional capitalist imperative of expansion. In this regard the standard thought is in agreement with the radical view. But the radical literature also contends that the home governments of the metropolitan center pursue policies of dependent relations which are motivated by material needs of capitalism.<sup>53</sup> A leading proponent of this radical view is Harry Magdoff who says that the capitalist expansion imperative involves a close relationship between the MNCs and their home governments which is translated into political and military actions. He describes "the competition among groups of giant corporations and their governments which takes place over the entire globe."<sup>54</sup> The standard thought, while agreeing that

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<sup>53</sup>Ibid., p. 203.

<sup>54</sup>Harry Magdoff, The Age of Imperialism (New York: Monthly Review Press, 1969), p. 15.



the motives of the MNCs perpetuate dependence to a degree, disagree with similar assertions concerning the motives of the metropolis governments. Charles Kindleberger writes:

The only interest in Magdoff's book is to see what radical youth have adopted for their bible in the interpretation of United States economic foreign policy. Taken at face value, the book is a rather empty collection of statistics and string of quotations, all from respectable sources, which are intended to make the point that United States economic foreign policy is unrelievedly evil. The Marshall Plan had its sole purpose in preventing Europe from becoming socialist; foreign aid to less developed countries is to keep these countries dependent; United States' policies in the stabilization of international money are designed to use the dollar as a main instrument of control over the capitalist world. The argument, however, is asserted as self-evident, rather than reasoned. No use is made of the rigorous test of analyzing counterexamples. And the whole text is a botch of contradiction, misstatement of fact, analytical error, and empty rhetoric.<sup>55</sup>

One could conclude that Kindleberger was not favorably impressed. Standard thought views the sovereignty of the nation as the principal motive of the metropolis government's foreign policies, not the profitability of its MNCs or the material needs of capitalism.<sup>56</sup> The policies of MNCs and their home governments may coincide at times, but this is not necessarily the case.

The radical view alleges exploitation of LDCs by relations of dependence with MNCs. Cohen shows both the difficulty of definition and impossibility of agreement on the meaning of exploitation.

According to some writers, the word simply means 'utilization for one's own advantage or profit.' If that is the meaning we choose, then we must conclude that exploitation is one of the most ubiquitous of all human conditions, for only saints and fools ever enter into interrelationships with absolutely no thought of some sort of personal aggrandizement. Ordinary mortals--and nations--naturally expect something of value, some advantage or profit, to result from social intercourse. Otherwise, they would be hermits.

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<sup>55</sup> Charles P. Kindleberger, Review of The Age of Imperialism by Harry Magdoff, in Public Policy, 19 (Summer 1971), pp. 131-132.

<sup>56</sup> Cohen, Imperialism, p. 203.

A more reasonable definition of exploitation would add the adjective 'unfair': exploitation means 'unfair' allocation of value (an 'unjust' bargain). This means, of course, that there can be no such thing as an objective definition of exploitation. The word 'unfair' implies an ethical or value judgment, so it follows that only a normative definition of exploitation is possible. There can be no agreement on the empirical question of whether exploitation even exists unless there is prior agreement or consensus on the conceptual question of the relevant normative beliefs.<sup>57</sup>

The radical view states that dependence and international inequality necessarily means a net loss for the LDCs. While agreeing that some degree of dependence exists in the MNC-LDC relationship, the standard criticism of the radical argument is that the radicals treat dependence and exploitation as identical concepts.<sup>58</sup> Standard thought rejects the equating of dependence and exploitation, terming such a concept tautological and thus begging the issue. Here again standard thought questions the necessity of an alleged relationship. This raises the question of whether the interests involved could be reconciled to everyone's advantage. The standard view leaves the possibility of mutual benefit open for investigation. Benjamin Cohen summarizes the standard critique of dependence.

I mean to suggest that exploitation is not inherent in the present organization of international economic relations. Capitalism does not necessarily make victims of all the poor, even if it does make them dependent. The theory of neocolonialism, in this respect, is simply not supported by the evidence. That outlook is still much too deterministic.<sup>59</sup>

### Technology Transfer

And finally, radical thought is critical of the technology transferred to the LDC by the MNC. It is contended that the corporation's

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<sup>57</sup>Ibid., pp. 208-209.

<sup>58</sup>Ibid., p. 210.

<sup>59</sup>Ibid., p. 218.

technology is too capital-intensive to produce favorable long-term growth. Most economists have come to realize this point. But the standard view again qualifies the radical blanket appraisal of pessimism. First, to some extent, MNCs do adapt their technologies to the local economy.<sup>60</sup> Obviously the profit-motivated MNC would not hold to a standardized technology if significant gains could be realized through adaptation. But as Harry Johnson points out, the development of a technology involves a high cost which largely determines the firm's behavior.

It is presumably cheaper to transplant an already known technology to a different environment to which it is not entirely appropriate, paying some extra cost in terms of inferior efficiency, than to develop a new technology more appropriate to that environment; otherwise firms would not engage in the practice, and there would be no direct foreign investment.<sup>61</sup>

Of the main areas compared in this discussion, technology transfer is the most purely 'economic' in terms of freedom from sociopolitical criteria. It is also the area in which divergence between the radical and standardized views is minimal.

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<sup>60</sup>Ibid., p. 179.

<sup>61</sup>Harry G. Johnson, "The Efficiency and Welfare Implications of the International Corporation," in Charles P. Kindleberger (ed.), The International Corporation (Cambridge: The MIT Press, 1970), p. 41.

## CHAPTER V

### CONCLUSION

#### The Essence of Radical Thought

What then is the essence of radical thought? Basically it is contended that the dependent status of LDCs prevents their economic development. Insofar as the MNCs effect and perpetuate this dependence, they prolong the underdevelopment of the LDCs. The radicals view the contribution of the MNCs as a negative influence on the economic development of the LDCs. The standard disagreements have been detailed above. The answer to nearly every radical contention is "not necessarily."

#### The Future Role of MNCs

The standard and radical prospects for the future contribution of MNCs to the economic development of LDCs are as divergent as their arguments of the status quo. Standard thought is optimistic about the MNC's potential to integrate the world economy.

It is accepted by most economists that, in the long run, the unhindered movements of goods and factors of production best serves the world's economic interests and that of individual countries--though, in certain circumstances, and in the short run, certain constraints may be necessary to protect economies against some of the vagaries of the free market. There is much to be said for countries adopting the same basic attitude towards the operations of multinational enterprises, and for governments, sometimes in conjunction with another, to create the economic environment which enables them to contribute most to the GNP, and only intervene when there is

some reason to suppose that market is unable to produce a 'first best' solution to resource allocation in which they are involved.<sup>62</sup>

But radical thought is pessimistic about the MNCs role and predicts its failure.

Hymer notes that the current trend in the world economy is one of integration of one industry over many countries by the MNCs. The alternative, he says, is the integration of many industries in one country and the development of noncorporate linkages between the countries for the flow of goods and information.<sup>63</sup> Hymer predicts the failure of the world economy based on MNCs.

One could easily argue that the age of the Multinational Corporation is at its end rather than at its beginning. For all we know, books on the global partnership may be the epitaph of the American attempt to take over the old international economy, and not the herald of a new era of international cooperation.<sup>64</sup>

Thomas Weisskopf describes the final difficulties of the capitalist system.

As the revolutionary consciousness grows, however, a repressive policy becomes increasingly difficult to maintain. The repression itself is likely to breed greater hostility to the status quo, and the cost of controlling popular unrest will rise. The elites of the poor countries will have to rely more heavily on external assistance and military support, and the cost to the major powers of maintaining the capitalist system in the poor countries will also rise.<sup>65</sup>

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<sup>62</sup> John H. Dunning, "The Multinational Enterprise: The Background," in John H. Dunning (ed.), The Multinational Enterprise (New York: Praeger Publishers, 1971), p. 48.

<sup>63</sup> Hymer, "The Efficiency of Multinational Corporations," p. 448.

<sup>64</sup> Hymer, "Law of Uneven Development," p. 133.

<sup>65</sup> Thomas E. Weisskopf, "Capitalism, Underdevelopment and the Future of the Poor Countries," in Jagdish N. Bhagwati (ed.), Economics and the World Order (London: The MacMillan Company, 1972), p. 64.

It is not the purpose of this paper to predict the eventual outcome of this argument. The radical arguments have been presented and contrasted with the standard view. Generally the radicals are guilty of claiming too much in their conclusions. But their contentions still contain enough truth to merit the attention of development economists. What is the contribution of MNCs to the economic development of LDCs? The radical reply is "harmful." The standard reply is "not necessarily." Indeed, the MNC can make a positive contribution to development.

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THE CONTRIBUTION OF MULTINATIONAL CORPORATIONS TO THE  
ECONOMIC DEVELOPMENT OF LESS DEVELOPED COUNTRIES:  
THE RADICAL VIEW CONSIDERED

by

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AN ABSTRACT OF A MASTER'S REPORT

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Multinational corporations and less developed countries have become important in the present world economy. Both evolved to their present status since the industrial revolution. The multinational corporations have been playing an increasingly important role in the less developed countries, particularly since World War II. The paper is centered on the radical view of the role of the multinational corporations in the economic development of the less developed countries.

The radical view of the historical process leading to the present status of the less developed countries begins with the industrial revolution. Changes in the production processes in the industrialized countries enabled that part of the world to gain an advantage over those parts without the production changes. The countries which are now considered to be less developed did not benefit from the technological advances of the industrial revolution. They were largely exporters of primary products and importers of manufactured goods. It is contended that the less developed countries are in a dependent position with the industrialized world.

The multinational corporation evolved from the initial foreign investments of national corporations in order to increase sales abroad. The growth of these corporations followed a path of capital deepening which made product marketing and the introduction of new products essential to the sustained rapid growth

of the corporations. Initial waves of foreign investment occurred at the turn of the century and during the 1920's. Following World War II the multinational corporations grew rapidly.

Radical economists are characterized by their disillusionment with the reform of capitalism as the solution to current economic problems. Standard thought points to the advantages of the "package deal" offered by the multinational corporations. From this point of view, direct foreign investment is viewed as a convenient source of many of the needs of the less developed countries. But the radical view counters these alleged aids to development. Stemming from the structure of decision making, which is centered in the major cities of the industrialized world, the less developed countries are affected by the location and nature of the direct investment, product marketing practices, transfer of technology, and transfer prices.

Standard economic thought differs from the radical view in several main areas; definition of economic development, the concept of surplus value, dependence and exploitation, and technology transfer. The differences between the two views can be attributed in part to the nature of the analyses. The standard view tends to be more free from the influence of socio-political ideologies relative to the radical view.

It is concluded that the radical arguments are weakened by their tendency to claim necessary negative harm by the multinational corporations in the less developed countries. While the standard view may agree to the possibility of negative effects, such cases

are qualified with the phrase "not necessarily." The role of the multinational corporations in less developed countries seems certain to be one of greater involvement in the future. The radical view says this role will be harmful to these countries. The standard view says the role is not necessarily harmful and may indeed be an aid to economic development.