AN ASSESSMENT OF MULTINATIONAL CORPORATIONS IN THE ECONOMIC DEVELOPMENT OF THIRD WORLD COUNTRIES

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Declaration

I hereby declare that, all the information in this document has been obtained and presented in accordance with academic rules and ethical conduct. I also declare that, as required by these rules and conduct, I have fully cited and referenced all materials and results that are not original in this work.

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ABSTRACT

This study focuses on Multinational Corporations (MNCs) and their importance in the economic development of Third World Countries. Recognising that, MNCs can contribute to economic growth and development, most Third World Countries are constantly working to attract them, hence their demand has become highly competitive. However, MNCs do not go without some negative effects, such as conflicts between host and investor countries, and the creation of damaging competition to local firms. These negative effects could be minimised if policies and strategies for the promotion and attraction of MNCs are part of, and integrated into, general economic development and economic reform policies and not seen in isolation. Although Third World Countries have implemented strategies to attract more MNCs, a refinement of some of these policies is needed if a country is to be successful in this regard.

Key terms: Multinationals; Foreign Direct Investment; Economic growth, Third World

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ABBREVIATIONS ANDACCRONYMS

ASEAN-	Association of South-east Asian Nations
BIT-	Bilateral Investment Treaties
BOP-	Bottom of the pyramids
CEO-	Chief Executive Officer
EEC-	European Economic Community
EU-	European Union
FDI-	Foreign Direct Investment
GATT-	General Agreement on Tariffs and Trade
GDP-	Gross Domestic Product
HMOs-	Health Maintenance Organisations
IPAs-	Investment Promotion Agencies
IMF-	International Monetary Fund
MNCs-	Multinational Corporations
MNEs-	Multinational Enterprises
NAFTA-	North American Free Trade Agreement
NGO-	Non-Governmental Organisation
OECD-	Economic Corporation and Development
RER-	Real Exchange Rate
R&D-	Research and Development
TNCs-	Transnational Corporations
TRIMs-	Trade-Related Investment Measures
TV-	Television

UK-	**United Kingdom**
UNCTAD-	**United Nations Conference on Trade and Development**
US-	**United States**
WB-	**World Bank**
WTO-	**World Trade Organisation**

Chapter one

Introduction

Multinational Corporations (MNCs) are the most prominent contemporary Non-Governmental Organisations (NGOs) (Krasner, 2003). They are corporations that have branches and subsidiaries operating on a world-wide basis in many countries. Simultaneously, they are huge firms that own and control plants and offices in at least, more than one country and sell their goods and services around the world. MNCs are major driver of global economic integration and establish new linkage among economies world-wide (Peterson, 2005).

To finance domestic investment, developing countries need capital flow from abroad, typically in the form of loans that developing countries receive from other governments or from international organisations such as the World Bank or the International Monetary Fund (IMF).In addition, the financial crisis or rising interest rates for loans can dramatically worsen the economic situation of indebted developing countries. Apart from loans, investments in these countries are financed by foreign capital from private companies. This kind of equity finance is usually referred to as Foreign Direct Investment (FDI) (Schaub, 2004).

The main problems of Developing countries begins with money and the economy. Their governments only get money from two sources; borrowing and tax. Third world countries do not have high GDP tax and they also do not have stability or security to borrow like bigger nations do. Lack of agricultural equipment, technology and infrastructure have also been a problem in developing countries even though they have extremely big and fertile land. But because of lack of ability to plant and harvest in a well-managed environment, crop potential decreases. Their products cannot be distributed because of lack of trucks, roads and rail.

Many of the developing countries are still poor today compared to industrialised countries. The scarcity of capital and skilled labour cause a low level of per capita income and prevents developing countries from realising economies of scale from which many richer nations benefit (Krugman and Obstfeld, 2000).

Trade between developing and industrialised countries have expanded and increased from rich countries to the poor areas. The link between these groups of economies has become more serious and subsequently making these two groups increasingly dependent on each other (Schaub, 2004).

Since the mid-1980s, investment in developing countries has significantly increased (Greer and Signh, 2003). The economic activities of Multinational Corporations (MNCs) have therefore been the subject of a series of research studies, which have to assess the effects of MNCs activities in the development process in the countries of the Third World. However, the findings of these studies are quite contradictory. Some studies have concluded that the activities are harmful for the development process of these third world countries. The uncertainty resulting from these contradictory findings is obvious reason for further analysis of the subject.

This study tries to contribute to the scientific understanding of how economic development of Third World Countries is affected by the presence and the activities of Multinational Corporations. Based on the above issues, this chapter focuses on areas such as the research hypothesis, scope of the study, methodology, aims and objectives and the research questions.

Hypothesis

- Multinational Corporations have positive effects on economic growth the Third World Countries.

Statement of the problem

Economic growth is the most important means of raising people's incomes and reducing poverty in the developing world. MNCs create jobs and opportunities for poor people to support their families and build stable futures. Many developing countries face particular challenges that make it difficult for them to stimulate and sustain economic growth. These challenges include weak institutions, high unemployment, poor infrastructure, lack of access to financial services and weak laws and regulations.

Aim of the study

The study examines the impact of Multinational Corporations on the economic development of Third World Countries.

Objectives

- To study factors that attract Multinational Corporations in Third World Countries and the effects of Multinational Corporations on the economy of third world countries.

Research Questions

- Why do rich countries invest in poor countries?
- How does Multinational Corporation develop poor countries?
- What are the positive and negative impacts of Multinational corporations in host states?
- Do third world countries have policies that attract investments?

Scope of the study

This study focuses on the contribution of MNCs in Third World States and how they contribute to development and underdevelopment.

Rationale for the study

Third World Countries depend on developed countries to develop economically through investments. The result of the study should provide a clear and deep understanding of the impacts of Multinational Corporations in the host country's economy. Policy makers will benefit from assessing how policies have disadvantaged or advantaged the countries and will be able to develop and implement policies to address apparent investment problems.

Methodology

The study utilises the emergent, exploratory and inductive qualitative method in view of the nature of the research. As Liebescher (1998) notes, qualitative "methods are appropriate when the phenomena under study are complex, are social in nature, and do not lend themselves to quantitative enquiry" .Therefore, qualitative research is essentially exploratory and involves methods of data collection that are non-quantitative or non-numerical (Miles & Huberman 1994). It captures the complicated details of social life and "treats actions as part of holistic social process and context, rather than as something that can be extracted and studied in isolation" (Payne and Payne, 2004). The qualitative method lends itself to the investigation of complex social phenomena without predetermining or delimiting the paths that such investigation should follow. Further, the strength of the qualitative method lies in its unassailable explanatory power and in providing detailed information on the subject matter or the research. In this way, it provides in-depth understanding of human/ organisational behaviour and of social interactions as well as the rationale for such interactions.

Data collection

Data for this study was generated through primary and secondary sources.

Primary sources

Primary data was derived from a number of sources including formal and informal interactions with relevant stake holders in Transnational Corporations (TNCs).

Secondary sources

Secondary data sources for this study consisted of books, journal articles, magazines, newspapers, government legislations/reports, company reports and the Internet. (The internet served as an invaluable source of information for the study given the contemporary nature of the subject matter of this research and the melodramatic manner in which events have unfolded in underdeveloped countries in recent times. The secondary sources provided extensive bibliographic and contextual information that complemented the primary sources, thus illuminating the study.

Data analysis

The study synthesized data gathered from primary and secondary sources in order to provide a holistic analysis of the importance of Multinational Corporations on the economy of third world countries.

Priliminary Literature Review

Multinational Corporations are important factors in the process of globalisation. Globalisation empowers big corporations and most of them originate from rich developed nations (Streamlau, 1999). MNCs develop in a large scale and are part of our everyday lives. From personal laptops, cell phones, a moving car and clothes we wear, most of these products we use are supplied by Multinational Corporations. Their presence has significant roles in our lives and they are also influential on more important actors, at macro levels. They are not only production centres that supply crucial and commercial crucial to countries but they have grown to a point where they now act as an economic, political and influential actor (Köksal, 2006).

The biggest and most effective industrial corporations are based in the United States of America, Europe, South Korea and Japan. Currently, there are over 35000 Multinational Corporations globally, controlling more than 15000 foreign subsidiaries and accounting for about one-third of the entire world production. Developing countries that received the greatest number of Multinational investment are those perceived to have high growth potential. They are generally known as the newly industrialised and include Asian countries such as China, Singapore, Malaysia, Thailand, Latin American countries such as Mexico, Brazil and Argentina. The ten biggest recipients of foreign direct investment (FDI) receive nearly 95% of the total, while all the African countries put together, receive less than 4 %. The 50 poorest countries of the world between them receive less than 2 % (Baafi, 2009).

MNCs can be classified according to the kind of business activities they pursue such as agriculture, extractive resources, industrial products, transportation, banking and tourism (Miyoshi, 2002). They are very effective in directing foreign policy of states, including that of the most powerful ones, and they set agenda for international politics. They have become a major factor in national economic decision making process (Peterson, 2005). Miller (2004) opines that the activities of MNCs may seem evidence of the growing inability today of sovereign states to control and regulate effectively economic activities within the private sector. Therefore, one of the traditional rationales for modern sovereignty is undermined.

Operations of MNCs create a variety of problems and opportunities for both home countries, states in which the MNC has its headquarters and the host countries (Carnoy, 2003; Clark and Chan, 2005). All three parties (home country, host country and MNC) benefit from the wealth created by MNCs. At least in theory, mutual interests result from the creation of wealth in the host country by MNCs. An observer calls the relationship between MNCs and host countries "a love-hate syndrome" (Bennett, 2001). This means host countries may have both advantages and disadvantages in their relations with MNCs.

MNCs may be considered as instruments of economic development for less-developed countries. However, when one looks at the functions they perform in host countries, it is observed in the study that they have a very strong bond with the home government which becomes a source of concern for host countries. MNCs challenge the state sovereignty of host countries. They may produce specialised products of which the buyer is usually the parent company. They may manipulate prices of imports and exports in host countries (Brown, 2005).

MNCs serve national interest of home countries as instruments of global economic development; a mechanism to spread ideology and a tool of diplomacy. They are, in most cases, highly centralised and dominated by the parent company located in the home country (Carnoy, 2003). The administrators are mainly from the home country, research is centralised, technology is imported from the home state, profits are often sent back to their own countries, and the policies of the firm conform closely to the economic and foreign policies of the home government (Bennett, 2001). Some consider, as pointed out by V.I. Lenin in his book titled "Imperialism, the highest stage of Capitalism", MNCs as instruments for colonialisation. Sometimes, manipulated and controlled by home governments, MNCs expand the marketing base of their home country. They increase production in the home country to supply components for foreign subsidiaries. They can ensure lower priced products from foreign subsidiaries back to the home country. They provide taxes to the home country. Stockholders in the home country gain more profit from investments made abroad. However there are many conflicts between MNCs and their home countries over taxation, trade policies, and economic sanctions. MNCs may not want to follow national policies pursued by their home governments.

One of the measures of influence of MNCs is the extent of the resources they control. They have extremely large flexibility in moving goods, money, personnel and technology across national boundaries and this flexibility increases their bargaining power with governments (Bennett, 2001).

Multinational Corporations through foreign investment is important for future development of underdeveloped countries. It is a means of increasing the capital available for investment and the economic growth needed to reduce poverty and in raising living standards in these countries. In addition, it can contribute to sustainable economic development. They claim to have been servers of technologies transfer, skills and production methods, provide access to international markets, enhance efficiency of resource use, reduce waste and pollution, increase product diversity and generate employment.

Theoretical framework

Third World Countries have received a large amount of loans from industrialised nations after the Second World War (Krugman and Obstfeld, 2000). Most of these Third World Countries depend more on capital inflows in the form of loans and equities from abroad to finance their domestic investment. Many developing countries are heavily indebted and this makes them extremely vulnerable to international lending crises because of unprofitable investments with loaned capital. There are other crises of equity finance. Many developing countries cannot get new loans because they belong to the group of the heavily-indebted countries (HIC) and most are close to default, which makes them no more eligible for new loans capital; Foreign Direct Investment (FDI) is the only source of new capital available to many of these countries.

The persistent lack of economic growth, increasing poverty and slow technological progress in countries of the so-called Third World gave rise to a series of social and economic theories in the wake of the fifties, which tried to find the causes of underdevelopment in these countries. Analyses based on these theories ascertain different causes and assume differing sets of indicators for underdevelopment. Nevertheless, they agree on some indicators: Low per capita income, high propensity to consume, low investment/saving rate, low capitalisation and low labour productivity, low industrialisation (rural economies), high unemployment rate, insufficient public infrastructure and development, high population growth rate, inadequate health care and inadequate education just to mention a few (Nohlen and Nuscheler, 1993).

There have been significant differences in the development of countries across the world and different strategies have been proposed on how these differences can be overcome. Theories of modernisation dominated by Western economists assume endogenous causes for development backlog in the Third World and propose a transition path comparable to the historical path of development of the First World, while dependency and world system theorists argue that there are exogenous causes for underdevelopment.

Theories of development are normative in nature and no universally valid definition can be applied to them. Each theory emphasises a preferred path of economic and social development, causes of underdevelopment, strategies for transformation and for launching and maintaining processes of development. In the realm of the academic debate on underdevelopment, two major theories require special attention: The dependency theory and the theories of modernisation (Welt, 1993). These theories are owe to merge the discussion in this study.

Dependency theories

In the mid-sixties, a series of social and economic studies were published which focused on the subject of dependence in their analyses. The aim of the dependency theory was to provide a theoretical explanation for underdevelopment and to develop strategies on how underdevelopment could be overcome. Underdevelopment was linked to foreign trade and international relations. Contrary to new growth theories, which were dominant in the field of economics and which argued that underdevelopment is a consequence of endogenous entailed deficits to modernisation, dependency theory focused on exogenously caused reasons of underdevelopment. Underdevelopment was no more primarily seen as status of lagging behind the state of development achieved by industrialised countries and as a consequence of poor integration into the system of the modern world, but rather as a consequence of high integration of peripheral countries into a world economy, dominated by capitalistic (industrialised) countries of the centre (Welt,1993).

Underdevelopment was seen as a consequence of differential distribution of power between the northern industrialised countries of the centre and the southern countries of the periphery. For the advocates of this theory, underdevelopment neither resulted from scarcity of resources and capital nor from excessive population growth, climatic and ecological disadvantages, cultural backwardness, or reluctance to work, but rather from imperialism. Imperialism was seen as the cause for the inability of Third World Countries to develop. According this theory, imperialism keeps these countries underdeveloped in order to exploit their resources and to use them as markets for goods of industrial mass production (Nohlen and Nuscheler 1993). Underdevelopment was not seen as a result of historically independent evaluation but as a consequence of a colonialistic-imperialistic penetration and of an asymmetry of world trade forced upon these countries for centuries (Mansilla, 1986). Further arguments, summariSed for example by Mansilla (1986), are that underdevelopment cannot be seen as an early stage of a historical evolution which precedes modernity, but rather as a process linked to development and which evolves simultaneously to development, while the fate of underdeveloped regions in this process is to reduce the total costs of developed regions. The internal structure of the economy of the periphery is thereby shaped by the development and expansion of the centre, which limits the ability of dependent countries to grow. The dynamics and goals of the centre influence and deform all economic and social areas of the periphery and prevent the emergence of a genuine national identity and a self-determined path of development. The pattern of this asymmetry is mainly based on a deterioration of the terms of trade that guarantees a persistent flow of resources from the periphery to the centre resulting in a severe shortage of capital in peripheral countries and a degradation of these countries to mere suppliers of industrial inputs.

Two major approaches

Within dependency theory, two major approaches emphasise slightly differing causes for underdevelopment and strategies to overcome it.

The first approach, which is based on a Marxist point of view, stresses the deterioration of the terms of trade and the exploitation of the periphery by the centre as the main cause for underdevelopment. Unequal exchange forces developing countries to increase exports to maintain the level of imports. This can only be achieved by a constant increase of the burden on the labour force, paralleled by a decrease of the purchasing power. Transnational corporations are considered as one of the major reasons for this process because they transfer their profits out of developing countries and cause decapitalisation in host economies. Due to these terms of trade, peripheral countries are not able to develop in accordance with the needs of their society. Therefore, the exclusion of these countries from the world market by a socialist revolution is seen as a way out of dependent development (Boeckh, 1993; Welt, 1993).

The second approach emphasises the structure of the relations between economies of the periphery and the centre and the alignment of the peripheral economies with the needs of the economies of the centre. Structural change results from changing conditions of the world market. These structural changes tend to trigger only a partial modernisation, which affects only the respective sectors of export, but subordinates other sectors of the society to this respective export sector without integration. This lack of integration can lead to structural heterogeneity. While societies of the centre are seen as fully integrated in a capitalist manner, peripheral societies are characterised by this structural heterogeneity. With the presence and interaction of differing social structures in peripheral countries, the dynamic in productivity and growth of the countries of the centre cannot be achieved (Welt, 1993). In addition - as in the Marxist approach -, foreign investment and particularly transnational corporations are seen as dominant actors in this process of impeded development. Multinational corporations repatriate their above-average profits from their investments in developing countries, causing decapitalisation in the underdeveloped host economy. This impairs capital accumulation as well as productivity, which can only be compensated by increasing the rate of exploitation of the labour force and cause constantly diminishing real per capita income. The political actions taken by transnational corporations support the process of uneven economic development, resulting in great international inequalities in the periphery. The integration of peripheral economies into the global economic system dominated by MNCs, which influence the process of political decision-making at the international level, puts pressure on the host economies to comply with international economic policies. Once Third World countries have achieved a certain level of industrialisation, the most dynamic economic sectors within these economies are dominated by MNCs, which pursue interests in global profitability. These interests and the transnational linkages can undermine the goals of domestic economic policies. If monopolistic trade patterns come together with formal or informal political control by the dominant MNCs, effective state actions can be negatively affected (Evans, 1985).

Political decisions, especially those affecting economic policies can be influenced by foreign investors. If foreign companies dominate specific economic sectors – usually new sectors for the respective economy - within the host economy, they can control domestic decision-making to some extent. The creation of new economic sectors and the operations by MNCs entail an administrative, technological and financial reorganisation of the home market – tailored to the capitalistic economic system of the centre – resulting in new forms of political and social control. This reformation can leave the host with less strategic control over the production system and the economic development process, and can therefore, lead to a decrease of domestic economic autonomy (Cardoso and Faletto, 1976). The integration into the global economic system and the economic dominance of MNCs in the host economy within particular sectors is accompanied by a transformation of the economic system towards an industrial capitalistic system. This forces host countries to create a political basis to cope with the requirements imposed by this process. Participation of the masses in this process depends on the one hand, on how strongly the (modern) economic system is controlled by the state or on how close the ruling class cooperates with foreign investors for their own benefit; on the other hand, it depends, for example, on how strongly the working class is marginalised by the economic development process.

Evans (1985) pointed out that transnational linkages and the presence of MNCs can – depending on the type of industry – stimulate the development of new state capacities and can lead to an expansion of the state's role into areas which were otherwise preserved of private capital. Intensive penetration of the host economy by MNCs in the field of extractive industries can accordingly lead a rise of the state apparatus with increased control over the respective industries and with a more dominant position over the overall economy. However, this expansion of the state's role does not necessarily result in greater capacity, but can also result in ineffective intervention, corruption and capture by other social actors .The expansion of the state's role has the effect of stronger involvement of the state with the MNCs rather than exclusion, which potentially increases the state's capacity in organisational terms and in terms of power relative to local actors like labour and domestic capital. This involvement also provides MNCs also with the possibility to influence political and economic decisions, especially in the case of conflicts when the state apparatus is in the crucial position to mediate relations between the interest of local actors and MNCs. Since MNCs are often sitting astride key sources of government revenues and foreign exchange, the state apparatus can find itself deciding in favour of MNCs and to the disadvantage of local actors.

Other forms of political influence are blunt corruption. Developing countries, which are often prone to corruption, might offer MNCs various ways to influence political and economic decisions in "predatory" states, where everything is for sale – not only political decisions, but also, legal judgments, licenses or appropriations – those with enough money can get whatever they seek (Evans,1989). However, such predatory states bear also high risks for foreign investors. But generally, rent seeking politicians and the domestic bourgeoisie might give hand to serve the interest of MNCs operation in the country. If MNCs and domestic private elites are involved in corruption, the state is handicapped or even incapable of formulating and implementing goals as well as acting autonomously since decisions are up for sale.

MNCs can influence electoral battles by financing electoral campaigns. This does not only happen in developing countries, but also in industrialised countries like the US, where large foreign corporations can donate funds to the preferred presidential candidate. MNCs also dispose of the sufficient financial means to influence public opinion through TV-spots, advertisements or articles in the print media and can therefore, lobby in their own interest.

The sum of these negative effects mentioned earlier is seen to persistently prevent industrialisation of t underdeveloped countries (Chase-Dunn 1989; Welt 1993), while the ambiguous effects of the state's involvement with MNCs might result in beneficial or disadvantageous developmental effects. These views are moving towards the modernisation and post-modernisation theories as discussed below.

Theories of Modernization

Theories of modernisation have been competing with theories of dependency. Proponents of the theories of modernisation argue that endogenous factors cause underdevelopment and that the expansion of global capitalism is the driving (exogenous) factor for development. It is assumed that underdeveloped societies can develop by imitation and alignment to developed societies. Tradition and modernity represent the starting point and goal of this process. Traditional values, traditional practices and social as well as political structures are exogenously modernised, while any restriction to this process of development is endogenously caused (Welt, 1993; Menzel 1993).

Early theories of modernisation such as the new growth theories, focused on economic growth as the dominant factor for development. Equating economic growth with development respectively, made per capita income the predominant indicator while most other factors were seen to depend on low per capita income or being caused by low per capita income (Welt, 1993; Menzel, 1993). The necessary accumulation of capital should be achieved by an increasing the savings rate. The main argument is that the lack of a per capita income which exceeds the amount necessary to satisfy basic needs and allow savings constitute a vicious circle since savings leads to greater prosperity which in turn leads to higher saving rates. Due to a low saving rate, worn out means of production cannot be replaced or modernised and labour productivity cannot be increased, this prevents development in areas described by other indicators. New growth theory suggests that income should be redistributed in favour of the upper income classes in order to increase saving rate (Herkenrath, 2003; Menzel, 1993). These early theories of modernisation have been criticised because their focus on a single factor and of their over-emphasis of tradition as the opposite of modernity (Rostow, 1992; Apter, 1965).

Theories of modernisation consider underdevelopment to be an early stage of development from tradition to modernity. The focus is on the factors that delay or hamper development and not on the causes of underdevelopment itself. Underdevelopment is simply seen as a given fact and the cause of underdevelopment remain unquestioned. The major question is focusing on what the lack of progress in development. The lack of progress in development is blamed on endogenous factors, while in contrast to dependency, exogenous factors are attributed a positive function. Multinational corporations are promoted since their presence in developing countries can contribute to the accumulation of capital, provide a transfer of technology, knowledge and management skills, create jobs, contribute to a diversification of the economy and ensure the diffusion of social and political values of the centre. Further, modernisation theories emphasise the role of the centre as a model for the periphery. It is therefore proposed that, developing countries follow the path of development of the countries of centre (Herkenrath, 2003; Kiely, 1998; Welt, 1993).

As in the case of dependency theory, it is criticised that in modernization theories, modern societies of the centre are seen as the point of reference for the process of development and that the capitalistic system, as well as the values and achievements of the centre are proclaimed as the sole goal of development. In addition, for all countries of the periphery, the same path to modernity is assumed, regardless of the social and cultural structures of the respective countries. Regarding the assumed benefits of the presence of transnational corporations in peripheral countries, theories of modernisation have been criticised, especially by dependency theorists for being one-sided and indifferent about the fact that transnational corporations operate for profit in these countries and that, they have an incentive to preserve conditions for profitable operations.

World system theory

World system theory is not a coherent theory but rather, a set of competing theoretical approaches, which emerged in the 1970s. World system theory draws from many theoretical aspects of dependency theory but accounts for a wider range of social and economic concepts and therefore, goes beyond the framework of dependency theory (Bornschier, 2002).

National development is not the isolated process of a particular country but a process, which takes place within a global system and is therefore, influenced by this very global system. Modernisation and dependency theories tend to be limited to economic development respectively on the peripheral and semi-peripheral regions of the world, while world system theories expand their views on the economic, political and cultural structure of the world system. In world system theory, underdevelopment is determined by economic, political and social forces that are beyond the range of influence of the affected societies. The economic dimension is constituted by world trade and a globalising economy represented by multinational corporations. This economic dimension affects the political dimension regarding the power structures. Political regimes, international organisations or military alliances are elements of these dimension, but also the political power structure within a country. The cultural dimension reflects the cultural integration. The cultural integration, which is related with aspects of the economic and political dimension, specifies the global diffusion of norms and values (Bornschier and Chase-Dunn, 1985; Herkenrath, 2003).

As in dependency theory, transnational corporations are of great importance in world system theory. MNCs are seen as the strongest agent in the world system that promote the hierarchical order in the world division of labour and therefore, favouring a capitalistic world order. MNCs are central institutions in the world-economy that cause the internalisation of economic relations, which were previously regarded as international. They constitute a new organisational form of the world economy (Bornschier and Chase-Dunn 1985). Regarding the political dimension, a power shift from states in national economies to a transnational economy is assumed. Nations are still significant, but are only one unit within this system besides other nations and relevant political and economic institutions. Political regimes and international institutions constitute a political order in the world system, but this order can be subjected to economic interest and power.

Contrary to dependency theory, world system theory considers the whole social world structure with its institutions and dynamics. Dependence is no longer seen as a permanent state of a particular country because countries can move up or down in the economic and political hierarchy constituted by the concept of centre and periphery. That is, countries of the centre are subject to social change too. Social change in the centre affects the whole social system of the world due to the dominant position of the centre (Bornschier 2002).

This broad perspective of world system theory overcomes many of the shortcomings of dependency theory.

Structure of the dissertation

Chapter one: Introduction

- Hypothesis
- Statement of the problem
- Aim of the study
- Objectives of the study
- Research questions
- Scope of the study
- Rationale for the study
- Methodology
- Preliminary literature review and theoretical framework

Chapter two: literature review

Chapter three: Multinational Corporations in the global economy

Chapter four: summary of findings

Chapter five: conclusion and recommendations

CHAPTER TWO

LITERATURE REVIEW

2.1 History of Multinational Corporations

In the late 19th and early 20th centuries, the world shrank in its physical dimensions, as steamships, railroads, telegraphs and cables reduced distances throughout the whole world and economic conditions changed. This was a time of substantial technological advancement with new products, processes and forms of business organisations challenging the old order (Wilkins, 1991). Developments in communication and transportation had varying consequences in different areas of life. The actors in the international political and economic arena started to change in order to adapt themselves to these new circumstances. During the 20th century, states became more cooperative with the private sector and with other non-governmental organizations. The private sector changed itself with the introduction of new institutions in order to keep itself in step with developments in technology. It is believed that "Multinational Corporations" emerged from this atmosphere as one of the leading actors.

Multinational Corporations (MNCs) have been a central feature of economic activity in the past decades. According to the World Investment Report 2001, Foreign Direct Investment (FDI) by Multinational Corporations (MNCs) in 2000, grew faster than any other economic aggregated indicator (UNCTAD World Investment Report 2001). The spread of MNCs around the globe continues to generate argument about their benefits in host countries. Large corporations of an economic, political, environmental and cultural force cannot be ignored in today's globalised world. These corporations have different and obvious impacts on the lives of billions of people every day (Roach, 2007). Many of the World's Multinational Corporations (MNCs) are increasingly focusing on Third World Countries as the next merging economy. Foreign investment can play an important role for a country's economic development, through capital formation, the transfer of technology and management skills, the sharing of information and ideas and market access.

Companies from Britain, the United States, Continental Europe, Japan and Canada extended their activities overseas by making foreign direct investments and controlling some production activities from their home based headquarters (Wilkins, 1991). International trade, which is a part of the world economy, gained a new dimension with the emergence of multinational companies. These institutions broaden the meaning of international trade by adding new concepts like 'Foreign Direct Investment', 'Joint Ventures' and 'Overseas Operations'.

Multinational Corporation is a business organisation whose activities are found in more than two countries and it is its organisational form that defines Foreign Direct Investment (FDI). This form consists of a country location where the firm is incorporated and on the establishment of branches or subsidiaries in foreign countries. Multinational Companies are different in the extent of their Multinational activities in terms of the number of countries in which they operate.

2.2 Multinational Corporations in Third World Countries

The relationships between MNCs and a country's economic growth are still a subject of great debate. Economic growth is largely measured by the level of productivity in the country. The rates at which the country can grow, based on the growth theory, depends on the way countries deploy their resources, such as their labour forces, stock of capital and technology. When countries lack these resources within their borders, they must rely on foreign investors to bring in such resources in the form of foreign direct investment (Sawyer & Sprinkle, 2006; Lipsey & Chrystal, 2006).

Multinational Corporations (MNCs) in form of Foreign Direct Investment (FDI), has been perceived as a vehicle for driving economic growth and sustainable industrial development, particularly in developing countries. This perception was originally based on the view that multinational corporations (MNCs) would promote domestic investment and growth, lead to a transfer of specialised skills in the area of management and technology as well as link industries in developing countries with global markets (Ngowi, 2001).

Many developing countries today are trying to make their business environment more attractive to foreign investors through the establishment of a hospitable regulatory framework for Multinational Corporations (MNCs). Relaxing rules regarding market entry and foreign ownership, improving standards of treatment accorded to foreign firms and improvements in the functioning of markets are some of the means of achieving this aim. In addition to seeking a friendly and welcoming business climate, firms that invest abroad often factor in labour and capital. To this extent, countries where labour costs are low relative to industrialised countries are successful in attracting MNCs. While low labour costs and large markets are important determinants of MNCs, the level of exchange rate and volatility are both through to be determinants of MNCs (Jayaratnam, 2003).

2.3 Policies to attract MNCs into an economy

Attracting MNCs is the main focus for most countries as shown by many studies. It has become the most important source of development and economic growth. Governments recognised that MNCs can contribute to economic growth and development and as a result, most have given the attraction of MNCs high priority, especially on the African continent.

The growth of MNCs in the world has been important in recent years. Between 2002 and 2010, the World's MNCs inflow increased more than five times and after reaching a peak in that year, it experienced a decline. One of the interesting features of this growth phase was that, most MNCs transactions were between developed countries. This stands to confirm that although MNCs are important to developing countries, its distribution has been biased in favour of developed countries. The problem of unequal distribution of MNCs in developing countries has been exacerbated by the decline in World MNCs transactions and as a result of the scarcity, both developed and less-developed countries are now competing for it, especially due to the positive multiplier effects these corporations have on an economy. It is for this reason that, policies to attract Multinational Corporations have become of critical importance (Addison & Heshmati, 2003).

Multinational Corporations (MNCs) take investment decisions in response to certain pull factors. Whether MNCs will undertake Foreign Direct Investment (FDI) in a foreign country or not, depends on the existence of a number of factors that influence such decision.

In view of the above, this section discusses policies that a country can consider to attract MNCs. These can be categorised into three types: first, by general economic policies that increase locational advantages; second, by national MNCs policies that reduce the transaction costs of investors; and thirdly, by international MNCs policies that deal with agreements on foreign investments. Other general policies in addition to the above will also be discussed. Generally the economic policies work at the macro level and aim to improve the fundamentals of the economy such as the market size, infrastructure and availability of skilled labour to mention the few, which in turn, aid in attracting MNCs flows into an economy. The national MNCs policies work at the domestic level, regulate entry and exit of MNCs along with the creation of incentives and restrictions on operations of foreign firms in different sectors of the economy. International MNCs policies work at the international level and deal with agreement issues relating to the treatment of MNCs from a particular region. These agreements may ensure that MNCs from a particular region are either treated or not treated under most-favoured-national and national treatment standards.

2.3.1 GENERAL ECONOMIC POLICIES

General economic policies should help make economic fundamentals strong. Economic fundamentals should address the market size, cost factors, the exchange rate, the rate of inflation and macroeconomic factors in their policies.

Market size

Economic policies aimed at developing the market of a country should make sure that MNCs is attracted into that country. Market size may be measured by other factors that are proven to be significant not only by the population of the host country. Particularly, these are policies directed at assessing and improving the purchasing power of the local population, policies regarding the proximity and connections with other relevant countries, or policies to effect healthy competition already present in the host country.

Due to large resource base, large markets are often given more consideration than smaller markets. Firms most of the time, invest in large markets to capitalise on their own specific assets by entering the market first or by following a lead in the new market. Large firms, which mostly operate in large markets, are more willing to undertake the risk and cost associated with MNCs projects due to their large resource base. The market potential of host countries has a significant and positive effect on attracting MNCs. Lunn (1980) states that, for developing countries, previously found the market size to be an important indicator that attract MNCs.

According to Dunning and Narula (1998), countries that own small domestic market size are likely to have not just limited natural resources such as primary commodities, but also limited attraction in terms of MNCs. In this way, lack of economies of scale inhibits foreign investment/ a small population is not just indicative of small aggregate consumption, but also that, domestic firms would need to seek overseas markets in order to achieve economies of scale.

In addition, it has been argued that, firms expect to experience greater long-term profits through economies of scale and lower marginal cost of production in countries with larger market potentials as a large market size generates economies of scale and a growing market improves the successes of market potential, resulting in attracting MNCs flow (World Bank Report, 1995).

Chakrabarti's (2001) views also similar to that above, but, it is argued from another perspective. According to him, most MNCs attraction policies have focused on the size of the host markets, measured by GDP. The size of the market has been widely found to be an important incentive for MNCs and in some cases, it has proven to be the most important one, in that, a large market brings in higher returns on investment by allowing a more efficient utilisation of resources and the exploitation of economies of scale, but this does not go without disadvantages. Chakrabarti (2001) further argues that production units are thought to be located where the marginal cost of production is lowest. Traditionally, it is considered much easier for a large market to organise its production structure in a way that can exploit the benefits of economies of scale in production, which could then lead to higher efficiency gain, a lower marginal cost of production and a larger market share.

Wang and Swain (1995) have identified the size of market as an area for development in order for both developed and developing economies to attract MNC. However, Wang and Swain point out that the size of the market may be less influential or even not important when MNCs invest to exploit the host country only as a production base; for example; to reap profits from the cost advantage of the host economy by exporting the production more competitively to markets in home countries of investors or other countries.

Cost factors

Policies to attract MNCs should be directed at addressing factors that cause investment cost differentials across countries and are in this way, categorised as cost factors. These include labour, capital and infrastructure costs. Cost factors may significantly influence the attraction of MNCs into an economy.

Accoriding to Dunning (2003, to assess the cost of labour and the availability of skilled labour, real wage rates are used – lower real wages in a host country are expected to attract MNCs. According to neoclassical theories, labour cost differential is considered an important determinant of MNCs. The new international division of labour theories also focus on the cost minimisation strategies of firms. It can be argued that locational advantage caused by the low wages, increases the prospects of low production costs and could stimulate a firm to establish itself in a new market (London & Ross, 1995; Banga, 2003).

Dunning (2000) argues that the main focus is not only on inexpensive labour but also takes into consideration productivity, flexibility and the adaptability of the labour force in the host country, which effectively decreases cost. Therefore, in order to attract MNCs, the country must offer a relatively skilled and educated labour force.

The impact of the cost of capital (for example, lending interest rates) on MNCs inflows is found to be ambiguous. On the one hand, it can be argued that higher lending rates may have a positive impact on MNCs, for example; the higher the cost of capital in the host country, the more capital is bought in by foreign firms. On the other hand, it can be argued that a host country's cost of capital impacts directly on domestic consumption, which positively affects the market. Thus, the lower the interest rate, the higher the domestic consumption and hence the higher the MNCs inflows, and therefore, economic policies of host/potential host countries should include cost factors (Bende-Nabende,Ford,Sen & Slater, 2000). With regard to infrastructure costs, it is found that, all things being equal, the availability of appropriate infrastructure means a lower infrastructure cost and an increase in the ability of the host country top attract MNCs enough communications systems in particular and transportation links within and outside the country are essential to making a country attractive to foreign investors. Some of the variables involved are important to making a country attractive to foreign investors. Some of the variables involved are land and property rents, fuel costs, infrastructure and transport cost.

Developed infrastructure must cover both physical (transport and communications among others to name the few) and financial (developed financial markets, insurance, accounting and legal skills) facilities. An advancement of financial infrastructure like capital markets, money markets and property markets in a host country creates a perception in investors that the host country is more organised and has the platform to manage inflows. The more highways, railways and interior transport waterways that are adjusted according to the size of the host country, the more the attraction of MNCs inflows. Another important variable is the level of telecommunications services. Higher levels of telecommunications services will save time and reduce the costs of communication and information gathering, thus facilitating business activities. Therefore, countries with more developed infrastructure are likely to succeed in attracting MNCs, which is something that economic policy reforms should take cognisance of, especially in developing countries (Greene, 2000; Banga, 2003).

Exchange rates

The volatility of exchange rates is also important. Profits from foreign investment in an economy are often used to supplement the profit of firms in host countries and also, in home countries of foreign investors. As a result, less volatile exchange rates are necessary for an investor to repatriate its profits to the home country.

The economic policy of a country may favour a depreciating or appreciating currency, depending on the country's objective. Exchange rates may be real or nominal. The nominal exchange rate is the rate at which an organisation can trade the currency of one country for the currency of another. Real exchange rate (RER) is the rate at which an organisation can trade goods and services of one economy (for example, a country) for those of another. Trevino (2002) argues that even though there is mixed evidence on the impact of real depreciation on the host country with regard to MNCs inflows, foreign investors, who may either gain or lose from a devalued currency, may in fact gain due to the larger buying power in host countries. They can also produce more cheaply and therefore, export easily. This may attract resources — and efficiency — seeking MNCs. Trevino further argues that, foreign firms may not invest in a host country if they believe that depreciation may continue after their entrance into the host country as devalued currency is expected to encourage inflow of MNCs host countries as this reduces the initial cost of investment to foreign investors.

According to Asiedu (2002), a depreciation of host a country's currency might attract MNCs for two reasons. Firstly, a real depreciation of the host country's currency renders that country's assets relatively cheaper, motivation MNCs. Secondly, in cases where MNCs is invested for re-exports to markets at home or in other countries, real depreciation of a host country's currency enhances the competitiveness of producing in a host country, thereby raising the investor's wealth.

The volatility of a host country's real exchange rate may attract or deter MNCs. Instability of currency has often been identified as a currency significant impediment for the inflow of MNCs. The instability of a host country's currency tends to reduce MNCs inflow by discouraging the repatriation of investment returns (Chakrabarti, 2001; Banga, 2003).

Analysts argue that, caution must be exercised when examining currency fluctuations between host and home countries, because the importance of changes in exchange rates to countries can be different based on country-specific objectives and strategies. It is commonly held that, exchange-rate fluctuations increase risks and uncertainties, thereby affecting incentives to attract investment. Kwon and Konopa (1993) further argue that an unfavourable shift in foreign rates also poses a danger to MNCs.

Rate of inflation

When policies are geared towards the control of inflation in an economy, investors see this as a sign of internal economic stability in the host country. High inflation indicates the inability of a government to balance its budget and failure of a country's central bank to conduct appropriate monetary policy and hence, may reflect instability of the macroeconomic policy of a country. This type of instability creates uncertainty in the investment environment, which discourages MNCs and the reduction of MNCs is made worse by the fact that the relative costs of production in host countries rise, unless this is compensated by a proportionate depreciation of the currency (Scheider & Frey, 1985). Pedroni (2001) holds a country view that, overly tightened inflation policies lead to falling price levels and the resulting contraction in economic activities might trigger a deflationary spiral and eventually bankrupt host country's firm. This can persuade local investors to sell off their interests in host countries' companies to foreign investors at low prices, thereby expanding the inflow of MNCs.

It can therefore be argued that, if foreign investors are risk averse or even risk neutral, uncertainly about the potential for high inflation rates may lead to a reduction in MNCs, because investors do not want to risk their expected profits. As long as there is uncertainty about the future level of inflation, foreign investors will demand a higher price to cover their exposure to inflation risks and this in turn will decrease the volume of investment. Hence, economic policies must address the stability of inflation over time, which is vital to the attraction of MNCs.

Political, economic and financial stability

Generally, a country with sound economic policies that promote macroeconomic stability, has an established and practised rule of law, enforce contracts and encourage private-sector development can be expected to attract MNCs. Investors will have more confidence that a nation that has done well in the past will also be likely to do well in the future (Tallman, 2002).

The lack of policies to promote these economic fundamentals has diverted MNCs from many of the former Soviet Republics and several Balkan countries. Schneider and Frey (1985) re-examined the issues and concluded that moderate changes to policies are crucial for MNCs flows to developing countries. Casson (2003) shares the same view by explaining that a basic level of overall economic, political and financial stability is a prerequisite for MNCs in a country. He further argues that the basic institution of an economy must allow the inflow and repatriation of foreign private capital.

2.3.2 NATIONAL MNCS POLICIES

As observed by Globerman and Shapiro (1999), it is not easy to statistically examine the impact of specific policies regarding MNCs, such as incentives offered and the removal of restrictions on the operations of foreign firms, since they are hard to separate from other factors due to the fact that they are more implicit than explicit. Another difficulty in examining the impact of these policies is the difficulty in quantifying them.

According to Kumar (2002), MNCs may flow into a country not only because the host country provides certain investment incentives but also because these incentives, when compared to those provided by other competing host countries, appear to be more attractive. Also, an important fact that needs to be addressed is that, when considered individually, different incentives offered by a host country may have an important influence on MNCs when considered as a package. In view of the above, policies such as tariffs, investment incentives and removal of restrictions tax structure are discussed in this section.

Tariffs

Trade policies and, more broadly, trade cost (tariffs, non-tariff barriers and transportation costs), are generally found to have an important impact on MNCs flow.

With the decline in the barriers to trade and an increase in the importance of networks, foreign investors find barriers to entry and non-competitive environments less appealing. In more recent studies, it has been found that foreign investment is prevented by high tariffs or non-tariff barriers on imported inputs and is attracted to more open economies. On the other hand, all things being equal, high amount of tariffs induces investors to set up operations in host countries (especially those with larger markets or larger potential markets) in order to avoid the cost imposed by such barriers. In reviewing cross-country regressions on the determinants of MNCs, Charkrabarti (2001) maintains that market size and openness to trade regarding tariffs have been the most reliable indicator of MNCs.

Investment incentives

National policies should consider two main categories of MNCs incentives offered by host countries to attract MNCs inflow. The first is fiscal incentives. For example; policies designed to attract MNCs inflows. The first is fiscal incentives and are designed to reduce the tax burden of a firm, and the second is financial incentives such as direct contributions to the firm from the government (include direct capital subsidies or subsidised loan). Financial incentives include grants, subsidised loans and loan guarantees, publicly funded capital participating in investments involving high risks and government insurance at preferential rates. Fiscal incentives are, however, preferred by host countries partly because these can be easily granted without incurring any significant financial costs at the time of their provision (Smith, 1991; Banga, 2003).

Fiscal incentives may affect location decision, although other incentives seem to play a secondary role. However, fiscal incentives appear not important for MNCs that is geared primarily towards the domestic market. Instead, such MNCs appears more sensitive to the extent to which it will benefit from import protection (Would Bank Report, 2003).

Removal of restrictions

National MNCs policy directives should give consideration to the removal of MNCs restrictions. Rugman (1981) and Banga (2003) suggest that various forms of restrictions have been applied to MNCs host countries in the pre-liberalised era, the nature of which either attracts or prevents MNCs. Rugman (1981) and Banga (2003) further explain that these restrictions relate to admission and establishment, ownership and control, and other operational measures. Admission and establishment restrictions include closing certain sectors, industries or activities of MNCs; screening, authorising and registraring investment; and minimum capital requirements. Ownership and control registration exist in various forms, for example, allowing only a fixed percentage of foreign-owned capital in an enterprise; compulsory joint venture; mandatory transfer of ownership to local private firms, usually over a period of time; and restrictions on reimbursement of capital upon liquidation.

Developing countries during the past decade have begun liberalising their national policies to establish a hospitable regulation framework for MNCs by relaxing rules regarding market entry and foreign ownership, improving the standards of treatment accorded to foreign firms and improving the functioning of markets. These main policies are important because MNCs will simply not take places where they are not allowed or strongly impeded. However, changes in the direction of greater openness allow firms to establish themselves in the direction of less openness ensure a reduction in MNCs (Cunningham, 2000; Banga, 2003).

Even after entry, foreign firms could face certain restrictions on their operations, such as employment of foreign key personnel and performance requirements, such as sourcing or local content requirement and export targets. Owing to the enforcement of trade-related investment measures (TRIMs), many of these restrictions have now been withdrawn and the types of restrictions relating to MNCs have been greatly relaxed in many countries. Many of these restrictions now do not require investment approvals or licensing except for few sectors that are close to MNCs. The impact of the removal of some restrictions has a positive effect on attracting MNCs and hence causes a higher flow of MNCs into an economy (World Bank Report, 2003).

Tax structure

The evidence on the impact of tax policies on MNCs is evolving. Hines (1999) shows increasing evidence that a low tax burden attracts MNCs .He further argues that the rate of taxation should not be prohibitive or unduly punitive and must not be different to the marginal rate of personal income tax. However, special concession such as tax holidays, relatively low corporate tax rates, simplicity, consistency, predictability, exemption from certain import duties and prevention of double taxation should be offered as incentives for large-scale investment projects deemed to be in host country's interest (but too general a use should not be made of this, since investors may use the opportunity for speculation, which may negatively affect investment flows by encouraging short-term investment).

A country's tax regime is a key policy instrument that may negatively or positively influence MNCs. Imposing a tax burden that is high relative to benefits realised from public programmes in support of business and relative to tax burdens levied in other competing locations may discourage investment, particularly where location-specific profit opportunities are limited or profit margins are thin, with the host country's tax burden a function of not only statutory tax provision but also of compliance cost (Nigh, 1998).

Owen (1992) shares the same view with Nigh by stating that a poorly-designed tax system may discourage capital where the rules and their applications are non-transparent, overly complex or unpredictable, adding to an investor's project cost and uncertainty over net profitability. Systems that leave excessive administrative discretion in the hands of officials in assigning tax relief tend to invite corruption, undermine good governance objectives fundamental to securing an attractive investment. Policy-makers of host or potential host countries are therefore, encouraged to ensure that their system is one that imposes an acceptable tax burden, keeps tax compliance and tax administration costs under control, and addresses MNCs attraction rather than contribution to deterring MNCs.

Navaretti and Venables (2004) indicated that the responsiveness to tax policies is mainly driven by the relative costs of production, which is becoming more prominent. Moreover, they mentioned that the evidence on tax incentives is not conclusive but that, there are some indications that transparent and simple tax systems tend to be most attractive for MNCs.

2.3.3 INTERNATIONAL MNCs POLICIES

International MNCs are those that deal with agreements on the treatment of MNCs from a particular region.

Bilateral investment treaties

There has been a large increase in the number of bilateral investment treaties (BITs) that have been signed and enforced in the last two decades, particularly in the 1990s. BITs deal only with investments and lay down specific standards of investment protection and transfer of funds (Eaton & Tamura, 1994; Banga, 2003).

Root and Ahmed (1979) show that these treaties contain provisions for settlement of disputes between the treaty partner, investors and the host state. BITs also cover a number of other areas in particular; non-discrimination in treatment and, in some cases, the entry of foreign-controlled enterprises and other related fields. Bilateral agreements shape MNCs frameworks. Over 2100 BTIs were in effect by the end of 2002. These generally contain binding commitments on expropriation, fund transfers and compensations due to armed conflict or political instability on a national treatment (UNCTAD, 2003).

Bilateral investment treaties are one of the unusual ways in which rich countries can try to increase MNCs flow to developing countries by reducing ex-ante, the risks associated with opportunistic behaviour by host governments and providing some rights to investors once they are settled in a country.

An important characteristic of BITs is a considerable uniformity in broad principles underlying the agreements, coupled with numerous variations in the specific formulations employed. BITs generally recognise the effect of national law on MNCs and accept the right of governments to regulate its entry. BITs were initially addressed exclusively between developed and developing countries. A major reason for this is that developed countries were the major source of investments. However, the 1990 witnessed an increasing number of BITs between developing countries. BITs are popular because they provide host economies with the flexibility to screen and channel foreign investment to desired sectors or locations while extending protection to foreign investors. By providing protection, BITs are expected to promote and attract MNCs (UNCTAD, 1999: Banga, 2003).

Regional investment agreements

With regard to regional investment agreements, some of the regional trade bodies in various countries have taken the initiative to improve the investment environment to make it more conducive to the free-flow of MNCs. An example of such an agreement among the Association of South-east Asian Nations (ASEAN) is the non-binding investment principles reached in 1999. The ASEAN investment agreement, signed by all member countries, commits them to opening up industries and granting national treatment to all ASEAN investors (Banga, 2003).

2.3.4 OTHER POLICIES

Resource structure

MNCs policies address the resource structure of a country and the rights of foreign investors with regard to these resources. A country may possess a significant comparative advantage or an absolute advantage in primary commodities. Such a country is likely to start domestic firms that possess advantages in the exploitation of such assets. However, especially if such an advantage is a near absolute one, it is likely to be the recipient of considerable investment. These advantages associated with the host country include the availability of skilled labour and other infrastructural facilities, and may lead to sequential investment by both domestic and international firms. As a result, a comparative advantage in a natural resource-based industry may be sustained.

The lack of a natural resource-base which is a comparative disadvantage in primary commodities would, all things being equal, result in the opposite effect. Such a country is also more likely to begin strategic asset-seeking investment at an earlier stage. Over all, these countries would become net outward investors at a considerably earlier stage of development than those well-endowed with natural resources that will attract MNCs (Dunning & Narula, 1998).

Cultural distance

Economic policies geared towards strengthening ties with other countries that share similar cultures to that of a host country is ideal for MNCs attraction. Culture can be described as an accepted way of doing things by social groups that differentiate one group from another. Investment decisions are partially influenced by cultural factors. In investigating MNCs flows for Central and Eastern Europe, Mikalak (1992) suggests that inherent variations in language and culture dissuade potential investors, except in countries that have ties.

Grosse and Trevino (1996) conclude that countries culturally dissimilar to the United States or further away tend to have less investment in the United States. Davidson (1980) finds that US firms have usually made their first foreign investments in countries like Canada and the United Kingdom due to similarity in culture. Root (1990) argues that uncertainty due to cultural distance, may also cause executives to undervalue foreign investments. Furthermore, the cultural familiarity of the host country offers a whole range of efficiency-enhancing measures including the procurement of inputs, marketing and distribution of output, thereby making the economy more habitable for MNCs.

The economic system

The economic policies of a host country or potential host country should define the orientation of an economy, which will substantially affect both economic development and the extent and pattern of MNCs flow into it. The economic orientation of a country may either be outward looking, export-oriented or inward looking. An export-oriented regime is likely to achieve faster growth and structural upgrading.

Lizonda (1990) argues that an export-oriented regime is a necessary condition for attracting MNCs and MNCs-facilitated developments. Where a country's policies are more export-oriented, the faster the process of structural adjustment and economic growth becomes, and the faster the country will attract MNCs.

According to Porter (1990), although the kind of economic system associated with a country broadly determines the path it takes, the nature of government policy associated with a particular system can be different. The differences between the macro-organisational strategies of countries at the same stage of development influence both the structure of markets and the extent to which economic activity is efficiently conducted, thereby affecting the specialisation and economic structure of the country as well as the extent of MNCs activity association with it.

Present economic indicators play a role in attracting MNCs. Current economic performance represents the current governmental regime's ability to handle the state's economy as well as other social factors. Investors will seek out countries that have had recent economic success in the hope that the trend will continue in the long run.

A country's international experience

The economic policies of a host country should consider the international experience of the country as a basis, which can be considered an important factor in attracting MNCs. Buckly and Casson (1985) state that experience reduce cost and uncertainty of serving and hosting a market. Similarly, Agarwal and Ramaswani (1992) maintain that countries without foreign market experience are likely to have more problems in managing foreign operations, as a country's knowledge base will increase with repeated experience and be embodied in personal and organisational memory.

Prior experience with a similar type of environment in a foreign country will become valuable to a firm when dealing with similar circumstances. Consequently, the firm will prefer to use the same strategies, because these enhance the firm's value by reducing implementation costs in another country, since existing routines can be used. Furthermore, firms in highly experienced countries will also be motivated to undertake market-seeking MNCs by the advantages associated with staying close to their customers and thus protecting their ownership-specific advantages from deterioration (Amemiya, 2001).

The human capital of a country

A country with sound educational and training policies should, all things being equal, attract MNCs. The human capital of an economy should be an important factor when considering investing for a long term in another country, as the investor will use the labour in the host country. It would seem that the more educated a population is, the more likely it is to attract MNCs. However, Root and Ahmed (1979) found that although the theoretical literature on MNCs presumes human capital to be among the key ingredients of MNCs flow into an economy, among the 58 developing countries they studied, none of their proxies for human capital literacy, school enrolment and availability of professional and technology workers were found to attract MNCs.

Schneider and Frey (1985), using data for 54 developing countries, found the share of an age group with secondary education to be a less significant determinant of MNCs compared with other economic and political influences. Hanson (1996), using a sample of 105 developing countries, concluded that the adult literacy rate was not an important determinant of MNCs compared with other socio-political variable. Finally, Narula (1996) demonstrated that the level of tertiary education in a population was not a statically significant explanatory variable for MNCs inflows among 22 developing countries.

All the above cross-country studies show that human capital is not necessarily an important input for MNCs. This conclusion is, however, consistent with the fact that the 1970s to 1990s was a period when MNCs in developing countries concentrated on market and resources-seeking, and/or low-end manufactured types, and cheap labour and/or abundant natural resources were more important. This still holds true for recent times.

2.4 THE NEED FOR MNCS IN AN ECONOMY

The benefits of MNCs for a host country can be very important. Some of the benefits include: knowledge and technology transfers to domestic firms and the labour force, productivity effects, enhanced competition and improved access for exports abroad, especially in source countries. Moreover, since DFI flows are non-debt creating, they are a preferred method of financing external current account deficits, especially in developing countries where these can be sustained. Also, FDI represents investments in production facilities, and its importance for developing countries is much greater. Not only can it add to invisible resources and capital formation but, more importantly, it is also a means of transferring organisational and managerial practices between locations as well as accessing international marketing networks.

The main beneficiaries are enterprises that are part of transnational systems (consisting of parent firms and affiliates) or that are directly linked to such systems through non-equity arrangements, but these investments can also be transferred to domestic firms and to the wider economies of host countries if the environment is conducive for this. The greater the supply and distribution links between foreign affiliates and domestic firms, the stronger the capabilities of domestic firms to capture spill-overs (i.e. indirect effect) from the presence of and competition from foreign firms, the more likely it is that the attributes of FDI increase productivity and spread competition.

2.4.1 The advantages of MNCs

Foreign investment is good for productivity growth and economic activity in a developing country in that it contributes to economic growth. However, as with many economic phenomena, there is no conclusive evidence one way or another, but the empirical evidence is that MNCs often, though definitely not always, contribute to economic growth. The evidence is indeed good that economic growth usually leads to reduced poverty, though not necessarily to a more equitable distribution of income (Bevan & Estrin, 2000).

Estrin (1994) maintains that poverty reduction resulting from economic growth arising from MNCs, may not necessary benefit the poor directly, however, because MNCs contribute to export growth, productivity growth and finance for balance of payments, support increases in national income that offer the potential to benefit the poor indirectly. Also, even though MNCs may not reduce poverty directly, it helps to create an enabling economic environment and increase employment, which may help many to move out of poverty. The beneficial effects of MNCs on poverty reduction are poverty stronger when these corporations are employed as a tool to develop labour-intensive industries and where it is fastened in the increase to MNEs' national labour law and internationally accepted labour standards.

According to Hausmann and Femandez-Arias (2000), the advantages of MNCs in contributing to economic growth are three-fold:

First, some developing countries have domestic savings that are too low to finance an optimal rate of capital building. If, at the same time, they have problems tapping into international financial markets, MNCs may be their best chance of reducing financing constraints. A similar effect occurs where domestic savings may be ample, but a deficient banking system is unable to funnel the available funds to domestic investors.

Second, MNCs are a more stable source of external finance than portfolio investment and borrowed funds. For example, in the case of a financial crisis, loans and short-term securities investments are usually taken back very quickly. Investors with a direct stake in enterprises are less likely to stop taking part in a business activity due to short-term considerations.

Finally, Hausmann and Fernandez-Arias (2000) further explain that perhaps, and most importantly, countries at all levels of development may benefit from a foreign corporate presence in their business sector in that MNCs have direct effects on the performance of the host country's business sector. The entry of foreign enterprises generally leads to productivity growth and enterprise development. This, in turn, can lead to improved competition, particularly in previously protected market segments.

Lipsey (2001) share the same view with Hausmann and Fernandez-Arias (2000) by maintaining that, MNCs have become an important source of private external finance for developing and developed nations. It is different from other major types of external private capital flows as it is motivated largely by the investors' long term prospects of making profits in production activities they directly control. Foreign bank lending and portfolio investment in contrast, are often motivated by short-term profit considerations that can be influenced by a variety of factors and are prone to herd behaviour.

As developing countries industrialise, MNCs contribute to their further integration into the global economy by engendering foreign trade flows. Several factors are considered, including the development of international networks of related enterprises and an increasing importance of foreign subsidiaries in MNEs, strategies for distribution, sales and marketing. In both cases, this leads to an important policy conclusion that, a country's ability to attract MNCs depends on investors' subsequent access to importing and exporting. Some countries have tried to use MNCs in a more targeted manner to either boost exports or limit imports. As for the former, MNCs may clearly help host countries that were financially constrained to exploit their resource endowments or their geographical location.

MNCs allow the transfer of technology, particularly in the form of new varieties of capital input that cannot be achieved through financial investments or trade in goods and services. Baldwin and Porter (1997) report that the spill-overs (positive externalities generated by MNCs) fall into two categories: technology diffusion and human capital building. These corporations bring new technologies into host countries, which are eventually diffused to the broader domestic business sector. The channels through which this may take place are many but the report concludes that the important source of technology spill-overs is vertical linkages between MNEs and local suppliers. Foreign-owned enterprises usually provide their suppliers with technical assistance, training and other information to improve the quality of their products. Also, through FDI, many MNEs assist local suppliers in purchasing raw materials and intermediate goods and in modernising or upgrading production facilities.

An important issue is the actual uses that host countries are able to make of the technologies thus transferred. Crucially, the technologies needs to be relevant to the host country's business sector beyond the specific company's business sector are of great importance. Evidence suggests that for FDI to have a more positive impact than domestic investment on productivity, the technology gap, between domestic enterprises and foreign investors must be relatively limited. Where important differences prevail or where the absolute technological level in the host country is low, local enterprises are unlikely to be able to absorb foreign technologies transferred via MNEs (Bevan & Estrin, 2000).

Meyer (1998) supports the above notion by explaining that FDI can lead to beneficial technology and management skills transfer to local firms. Owing to the fact that MNEs typically have greater technological and management expertise than local firms, such expertise can be transferred to other parts of the economy. This appears to happen most clearly when MNE has close ties with local partners, suppliers and customers. In cases where the MNE is not tightly integrated with local firms, there is evidence that technology and skills transfer takes place most likely through labour mobility, professional contacts or a general rise in competitive pressure.

Information and communication technology is a very important ingredient for growth. It helps in developing a country's productive capacity in all sectors of an economy and provides a link between economies, thereby leading to competition. It stimulates invention, innovation and wealth creation. It contributes to poverty reduction by increasing productivity and providing new opportunities. It also sharpens the effectiveness, efficiency and transparency of human capital in a society. It is comprised of indicators such as internet hosts and the number of computers, telephone mainlines, creation of bandwidths, fax machines, TV sets, radios, users of mobile phones and subscribers to newspapers (Bevan & Estrin, 2000). In the face of global competition, potential host countries are disadvantaged if information infrastructure and information technology are very low in quality.

Recipients of MNCs often contribute to employee training in the course of operating the new business, which assists in human capital development in the host country. Investment in general education is of utmost importance in creating an environment in which foreign enterprises wish to invest. Achieving a certain minimum level is paramount to a country's ability, not only to attract MNCs but also, to maximise the human capital effects that may arise from foreign enterprise presence, since magnitude of MNE sponsored training is necessarily smaller than that of general education. The direct impact of human capital from FDI comes mainly from the fact that MNEs tend to provide more training and other upgrading of human capital than domestic enterprises.

The beneficial effects of training provided by MNCs can supplement but not replace a generic increase in skills development. The presence of MNEs may, however, provide a useful demonstration effect as the demand for skilled labour by these enterprises provides host-country authorities with an early indication of what skills are in demand (Smith, 1991).

Grabbe (2001) shares a similar view that MNCs can improve the skills and wages of the labour force in that, MNEs provide training and better employment opportunities for development of labour. There is strong evidence that MNEs pay better and train employees more thoroughly than domestic firms in developing economies. He further illustrates that the presence of MNEs in the labour market provides an incentive to local firms to improve the conditions and wages of workers. However, this creates a negative impact in the sense that, local firms, in order to control labour costs, may adopt a negative stance with regard to the reception of FDI.

Human capital levels and effects are closely interrelated with technological transfers. Technologically advanced sectors in host countries are more likely to see human capital effects and conversely, economies with a high capital component lend themselves more easily to technology effect, since technological development differs with the capital level of a country. Consequently, efforts to get the benefits of technology and human capital effects could gain effectiveness when policies of technological, educational and training improvements are undertaken jointly.

MNCs can also promote competition in the domestic input market. The European Commission Report (2004) identified two main categories of efficiency gains from these corporations; the effects on competition and the effect on enterprise restructuring and development. As for competition, since the early 1990s, a wave of mergers and acquisitions has reshaped the global corporate landscape. At the same time, a surge in the number of strategic alliances has changed the way in which formerly independent corporate entities interact. There has also been a wave of privatisations that has attracted considerable MNCs mainly in developing and emerging countries. This adds up to an increasing degree of concentration in national markets, which could have important effects on competition.

Foreign entry also has the potential to increase competitive pressure in a previously cosy national market. This argument is underpinned by the fact that MNE entry is generally found to increase productivity levels among host-country incumbents. Without any surprises, this effect is strongest in markets where there appears to have been little competition before the foreign entry (European Commission Report, 2004).

Foreign market entry may lead to the closure of weaker enterprises, which may also lead to increasing market concentration thus, removing competition. While it is desirable that strongly performing entrants be allowed to replace less productive domestic enterprises, policies to safeguard a healthy degree of competition must be in place. The best way of achieving this is by expanding the relevant market through increasing the host economy's openness to international trade. In addition, efficiency-enhancing national competition laws and enforcement agencies are needed to minimise the anti-competitive effects of weaker firms exiting the market.

Foreign-orchestrated takeovers lead to change in management and corporate governance. MNEs mostly impose their own company policies, internal reporting systems and principles of information disclosure on acquired enterprises and a number of foreign managers are normally appointed with the takeover. Where foreign corporate practices are superior to the ones prevailing in the host economy, these boost corporate efficiency. However, in some cases country-specific competences are an asset for managers in subsidiaries, therefore, MNEs need to strive towards an optimal mix of local and foreign management.

Foreign participation in the privatisation of government-owned enterprises is a case in point. Experiences from the transition economies in Eastern and Central Europe have been largely positive. Participation by MNEs in privatisations has consistently improved the efficiency of the acquired enterprises. Some political controversies have, however, occurred because the efficiency gains were often associated with sizeable job loses. Moreover, it has been argued by some that the good experiences with MNE participation in the privatisation process of transition economies could simply reflect the fact that few domestic private investors were brought into previously publicly-owned enterprises, important efficiency gains also occurs (Breuss & Egger,2002).

The privatisation of utilities is often particularly sensitive as these enterprises often enjoy monopolistic market power within segments of the local economy. The first-best privatisation strategy is to link privatisation with a largely unreconstructed economy prior to privatisation. Local authorities often try to attract foreign investors by promising them protection from competition for a designated period. In this case, it is a heightened need for strong, independent and domestic regulatory oversight (World Bank Report, 2000).

Lall (1980) indicates that FDI is generally done by MNEs which are usually concerned with making profits. Therefore, the investments are usually well targeted towards setting up a business that will make money and create jobs. This contrasts sharply with aid and loans to governments which are often squandered through corruption or spent inefficiently on unneeded infrastructure or other vanity projects. Profits generated by FDI contribute to corporate tax revenues. A successful foreign-owned firm will generate profit and hence tax revenue for the host country. Those taxes can then be spent on necessary infrastructure, social programmes and education just to mention a few. This is a strong incentive for government encouragement of FDI. However, in some cases, the tax benefits can be disappointing. One risk is that the government may provide too great a tax amnesty as an incentive. For example, a sharp decline in corporate tax in some of the member countries of the Organisation for Economic Cooperation and Development (OECD) may result in transfer pricing. This occurs when a foreign-owned entity produces an intermediate good that is purchased by its parent company (such as car parts shipped to an assembly plant in another country). When the subsidiary sells its products at an artificially cheap price to the parent company so that it can pay lower taxes, this has a negative effect on the host country's tax revenue.

Furthermore, FDI may improve access to export markets. This is because MNEs almost by definition, require substantial skills in importing and exporting. Many economists and policymakers believe that a key benefit of FDI is that the presence of export-oriented foreign firms in a country can help improve shipping and logistics infrastructure for example, increase presence of international shipping firms and agents. There is probably also knowledge transfer in this regard where managers of local firms learn from the example of the MNE on how to open new export markets (Mallampally & Sauvant, 1999).

Jayaratnam (2003) argues that FDI does not only improve skills and wages of labour and lead to technology transfer, but can also provide additional demand for output of local producers. Another key component of positive effects is the increased demand for inputs from local suppliers that new MNEs can create, leading to increased profits and higher tax revenues for the state. A key determinant of the benefits to national income from FDI is the extent to which the foreign enterprise sources locally rather than importing its inputs. Similar to the above, if an MNE creates a product previously imported by local producers or otherwise in short supply, FDI can lead to a decrease in production costs for local firms and corresponding higher productivity and profits.

Since exports will earn foreign currency, an export-oriented foreign-owned entity can improve the current account of the balance of payments of a nation. The balance of payments benefits are reduced, however, by the extent to which the firm imports its production inputs. In addition, the initial FDI investment itself can also be an important source of foreign currency since the MNEs will need to use local currency to either purchase a local entity or contract for work and equipment in setting up a new entity. This will be regarded as an inflow on the financial accounts of the BOP. However, MNEs will also eventually repatriate profits and retain earnings periodically, which causes an outflow of foreign currency (Christie, 2003).

FDI is also viewed as "good cholesterol" because it is thought to be bolted down and cannot leave so easily at the first sign of trouble. Unlike short-term debt, direct investment in a country is immediately re-priced in the event of a crisis (Christie, 2003).

Lim (2001) shares the same view with Christie (2003) by elaborating on the fact that FDI is thought to be more useful to a country than investment in the equity of its companies because equity investments are potentially "hot money" which can leave at the first sign of trouble, whereas, FDI is durable. Also, since FDI is usually in the form of a factory or some other fixed object, it is very illiquid and thus a long-term investment. Moreover, MNEs are less apt to leave the country during speculative periods. This is one reason why FDI is so important to a country. Alfaro (2003) also concurs that because FDI is generally spent on real assets such as plant and equipment, the capital embodied in FDI cannot flee a country in times of crisis as easily as debt capital can. Even in instances where the FDI is a service-related effort, time is spent on developing an ongoing business and owners will be reluctant to sacrifice this investment in human capital. Thus, FDI is said to be less likely than debt capital to exacerbate a crisis situation.

The presence of foreign firms in a host country may improve access to international markets, since many are well connected globally in terms of access to financial markets, consumer outlets and transportation networks. Foreign firms can act as catalysts for domestic exporters by providing externalities that augment the exporting prospects of domestic firms. Foreign firms may also be seen as natural conduits of information about foreign markets, foreign consumers and foreign technology and they provide channels through which domestic firms can contribute their goods (Aitken, Hanson & Harrison, 1997). This raises a country's potential to increase foreign-exchange earnings from exports for purchasing imports and servicing debt.

2.4.2 Disadvantages of MNCs

MNCs are not without disadvantages to a host nation despite the various advantages of listed above. MNCs may lead to decapitalisation; damaging competition; creation of monopolistic power and social disorder; generation of undue influence on the shaping of policy; environmental degradation; exploitation of natural resources; strain in international relations; dissipation of potential gains; information bias between host and investor countries; and excessive borrowing in domestic credit market. Furthermore, it may be unstable, exacerbate or create resources and indicate economic weakness.

If foreign ownership becomes too extensive, decapitalisation can occur. As foreign- owned firms become established and profitable, they begin to repatriate earning to their home country. In so doing, the local currency is converted to their home – country currency and capital leaves the country. If the base of foreign-owned companies is large enough, this can lead to serious capital drain. This is especially a concern if in times of crisis, all foreign-owned companies repatriate retained earnings simultaneously. The effect of this could be similar to the effect of foreign lenders refusing to roll over short-term loans. The country can be starved of capital and a bad economic situation can be made dramatically worse. This is sometimes cited as one of the primary risks of a country becoming too reliant of MNCs (Rasmini, 2000; Mallampally & Sauvant, 1999).

Singh and Jun (1996) and Mallampally and Sauvant (1999) indicate that, because MNEs often have skills, technology and capital firms that cannot match, they may create damaging competition to local firms, and that this is often cited as a primary negative effect. This is a significant and complex risk to evaluate. Lehman and Mody (2002) note that it is certainly true that local firms could be damaged or even put out of business and may even result in unemployment. It is also true that in many instances, competition from more efficient foreign-owned producers can be seen as a benefit to the economy as a whole, improving overall productivity and forcing local firms to modernise and improve efficiency.

Lankes and Venables (1996) clarify, that by their access to finance and advanced technical and management expertise, MNEs can possibly force all local competitors out of business, which can lead to market dominance by MNEs. One of such monopolistic power is obtained, MNEs can then raise prices and extract excessive profits, potentially eliminating any overall benefit of FDI. Lankes and Venables (1996) further warn that monopolistic power gained by MNEs is a risk associated with FDI that should be closely monitored by host countries.

Mills (1995) explains that large-scale flows of MNCs will tend to create reliance on them, so that policy is constrained by the need to avoid any move that discourage continued corporations. Foreign investors in general and multinationals in particular may, tend to have undue influence on the shaping of policy. The danger of abuse of market power will be particularly strong when the entry of large MNEs raises concentration levels within an economy. Then, if the bargaining and regulatory capabilities of the host country are also weak, democracy, indigenous development and the welfare of population may also be undermined.

New production facilities may lead to environmental degradation. A frequent example is that MNEs attempt to locate polluting facilities where environmental controls are the weakest. It is true that most developing countries have fewer environmental regulations and less ability to enforce regulations, which may result in terrible accidents and great environmental harm caused by MNEs. However, there is no concrete evidence to prove that MNEs are more likely to pollute than domestic firms. Evidence may actually point the other way because MNEs, due to their higher profile, are considered to be more sensitive to environmental issues than local firms (Mallampally & Sauvant, 1999).

According to Graham (1995) environmental and natural resources costs may also be involved, requiring careful consideration of the short-term advantages to be gained from MNCs and the longer-term implications for the country's resources base and general state of the environment. The large-scale exploration of natural resources is often associated with large-scale environmental damage. Graham (1995) further argues that sometimes, and even more importantly, politico-strategic interests could also be at stake when MNCs comprises a large component of the total investment and involves a loss of control over strategic sectors of the economy, vital infrastructure and natural resources. Moreover, in some circumstances, the county's sovereignty maybe at stake.

MNCs often create conflicts between the host and the source country. This is because MNCs in the host diminishes the market share of domestic firms in the source country, which in turn, has adverse effects on the level of employment and profits in the source country. The host country does not lose out if there are no major domestic firms in the country and in fact, it encourages MNCs in order to reduce the level of unemployment. However, foreign firms often import inputs from source countries and therefore, the host country does not benefit fully from these corporations. In order to reap the full benefit of MNCs, host countries tend to impose content restrictions on the products of the investor, which effectively reduces the expected advantage of both the source and host countries (Grosse, 1989).

Woodward (1997) alsomentions that MNCs can generate unfair discrimination between source and host countries, and this raises serious political and economic implications, especially in middle-income countries, with some affected groups asking why foreigners should be given better treatment than domestic investors.

Special treatment for some projects or sectors may also reduce net benefits from MNCs. In attempting to foster particular sectors or specific investment projects, authorities may negotiate special conditions for foreign investors on a base-by-case basis. This is however, very risky. In a competitive world, they may end up dissipating all the potential gains form such investment (World Investment Report, 1999).

MNCs may not necessarily benefit the host country. Through MNCs, foreign investors gain crucial inside information about the productivity of the firms under their control. This gives them an information advantage over uninformed domestic investors whose buying of shares in domestic firms does not entail control. Taking advantage of this superior information, foreign investors tend to retain high-productivity firms under their ownership and control, and sell low productivity firms to the uninformed investors. As with other adverse selection problems of this kind, this process may lead to over-investment by foreign direct investors.

Excessive leverage can also limits the benefits of MNCs. Domestic investment undertaken by these corporations' may be heavily leveraged owing to finance that may be obtained from the domestic credit market. As a result, the fraction of domestic investment actually financed by foreign savings through MNCs flows may not be as large as it seems because foreign investors cOULD repatriate funds borrowed in the domestic market, and the size of the gains from MNCs may be reduced by the domestic borrowing by the foreign-owned firms.

Recent studies also cast evidence on the stability of MNCs in a new light. Though it is true it can be difficult to move out of a host country at short notice, financial transactions can sometimes accomplish a reversal of MNCs. For instance, the foreign subsidiary can borrow against its collateral domestically and then, lend the money back to the parent company. Likewise, because a significant portion of MNCs is inter-company debt, the parent company can quickly recall it (Winham, 1996).

Winham (1996) believes there are some other cases in which MNCs might not be beneficial to the recipient country, for instance, when such investment is geared towards serving domestic markets protected by high-tariff or non-tariff barriers. Under these circumstances, MNCs may strengthen lobbying efforts to perpetuate the existing misallocation of resources. There could be a loss of domestic competition arising from foreign acquisitions leading to a consolidation of domestic producers, through either takeover or corporate failure.

CONCLUSION

In this chapter, the researcher looked at the factors that can attract foreign investors from developed countries into less developed countries. The effects of MNCs on host countries were been examined and, aside from their negative effects, there appears to be more positive net effects, justifying the cause for studying the need for this type of investment.

CHAPTER THREE

3.1 MULTINATIONAL CORPORATIONS IN A GLOBAL ECONOMY

Traditional forms of international trade, as well as newer forms of multinational business operations, international business and multinational corporations have become large in scale and a major influence over political, economic and social developments throughout the world. The emerging global order has introduced many new concepts and actors into the world agenda. The new economic relations, the new tools for trade, the new interdependence not only between states but also between states and multinationals, have created new circumstances (Tolentino, 2000). The unstoppable rise of multinational gave them both an economic and political power to influence state actions. The interference of these private actors in state affairs spread to inter-state relations and even to domestic issues of Third World states *via* other state's foreign policies.

The emerging global order is led by a few hundred corporate giants, many of them bigger than most sovereign nations. The new giant firms of the 21st century have achieved something that no other nation could manage today. They have reached out to millions of people through different kinds of global webs like shopping, culture, workforce and finance. These world-wide webs of economic activity have already achieved a degree of global integration that has never been achieved before by any world empire or nation state (Tolentino, 2000).

From a mere three thousand in 1990, the number of multinationals has grown to over 63,000 today. Along with their 821,000 subsidiaries spread all over the world, these multinational corporations directly employ 90 million people (of whom some 20 million are in developing countries) and produce 25 per cent of the world's gross product. The top 1,000 of these multinationals account for 80 percent of the world's industrial output (Gabel and Bruner, 2003).

When we consider these powerful corporations, they may seem to be a boom to mankind, replacing the nation-state, diffusing technology and economic growth to developing countries and interlocking national economies into an expanding and beneficial interdependence (Modelski, 1979). Or they may seem as imperialistic predators, exploiting all for the sake of the corporate few while creating a web of political dependence and economic underdevelopment. Many of them are extremely powerful institutions and possess resources far in excess of most of the member states of the United Nations. The rise of multinationals has threatened the absolute power of nation states. Both domestically and internationally, states start to share their political and economic power with institutions like MNCs. Interdependence is not valid only between states anymore, states and private actors have to cooperate in order to protect their interests (Sen, 1999).

Nowadays, it seems that the sovereign states are feeling naked. Concepts such as national sovereignty and national economic strength appear curiously drained of meaning. Even in 1971, governments had begun to ask how these entities were affecting their national interests and what policies were needed to deal with them. Multinationals used various kinds of tools to achieve success, such as Foreign Direct Investment (FDI), Joint Ventures and Portfolio Investments. While they were crossing the border, they did not only interact with host governments but they also co-operated with home governments. When multinationals broadened their businesses, they became great political and economic tools for their home governments to intervene in domestic affairs of their neighbours. While states sometimes saw foreign multinationals as rivals or intruders, they did not miss the opportunity to use their home based multinationals to interfere with other state's domestic affairs. Many developed countries, like the United States, have always tried to use the big U.S multinationals, especially in 3rd World countries, to interfere in the domestic politics or in bilateral relations with that particular country on the economic or political sense. The United States' interference in the domestic or political affairs of South American countries via U.S originated firms is a good example (Vernon, 1971; Gibbs, 1991).

The international political system after the 1980s and 1990s started to be defined as a global system with the concept of interdependence heading world politics. Globalisation and interdependence between states and firms came to a point to affect our social, political, economic and cultural lives.

The emergence of developments in science and technology had not only created multinational corporations. With the disappearance of the absolute national border lines and improvements in communication, technology and transportation and with economic agreement pacts like EEC, NAFTA, the world has become more like a global village where people could meet, trade, interact and effect each other more than ever. Globalisation, which is perhaps the most repeated phenomenon of the century, has changed the rules of the games of economic, international relations and politics.

While some scholars believes that globalisation has added much to the integration of the world, others maintain the process of global economic integration is stimulating political and social disintegration (Barnet & Cavanagh, 1994). Scholars like Ohmae view globalisation as de-legitimising the national economy and the nation state (Dent,2003) While the nation state is losing power, other non-governmental actors such as MNCs have a stronger influence on the national and international economic issues of states.

As a Realist, Robert Gilpin argues that despite all polemics against multinational corporations, there is little evidence to support the view that multinationals have been very successful in replacing the nation state as the primary actor in international politics. He also asserts that MNCs are successful in influencing their home government's policies and are able to influence the host government policies *via* home governments which act as agents for their own countries (Gilpin, 1993).

A globalised world defines the interconnection of political, cultural and economic events and makes them intensely affected by developments taking place in one another. One of the reasons for globalisation is economic developments as mentioned above. With the dissolution of the bipolar world, economic integration within the states has become one of the most important aspects of the 21st century. Not only by trade agreements like GATT/WTO, but also, with regional integrations like EU or NAFTA, nation-states are trying to overcome the effects of new interdependence as the outcomes of globalisation. Nation-states, even the wealthiest or the most powerful ones like U.S, can no longer stand alone with the distance of multinational corporations in economic and political arenas. The structural changes in the world economy and competition on products and markets created have new kinds of relationships between states and corporations. Governments have initiated several strategic economic policies to overcome and tackle the new standards and hard conditions of international markets mostly affecting their relations with MNCs.

3.2. Home and Host Country Relations with MNCs

Since 2000, it has been recognised that governments, firms and markets are partners in advancing economic development and national competitiveness. Governments promote market friendly policies in order to take advantage of the new globalised economy and in order to cope with multinationals. As a result of the emergence of the new global world, it has become necessary to conform not only to economic developments but also to political issues. After the two world wars, the collapse of the Soviet Union and the breakdown of the Berlin Wall, capitalism became the major economic system and power diffusion among the states became more obvious favouring the United States. American power ushered in liberalisation. The power became one of the most important aspects (in terms of political, military and economic power) which brought the American structure into the scene. American leadership introduced globalisation and globalisation brought in multinationals to be one of the leading actors not only on the economic platform but also, on the political platform. Probably, the main factor behind economic globalisation, which also brought in political changes, is the technological advancements. Today, technological changes not only affect economic issues but also socio-cultural structures of societies. Countries that aim to take a privileged position in global markets spend a large amount of capital on Research and Development. Besides governments, as partners in world markets, MNCs also lead the R&D competition in the technology race.

Due to the emergence of globalisation, governments have had to pass multiple legislative measures, regulations, executive orders and court decisions enabling foreign firms to operate in their territories, their own firms to operate abroad and to make their markets global. As quoted in several articles and books, the emerging consensus is that: globalisation is reducing the autonomy of states (Sassen, 2003;Sen, 1999).

Globalisation is de-nationalising the capabilities that are the basis of the territorial organis ation of military powers of the state (Sen, 1999). Globalization is not only internationalizing the financial and natural resources of a nation state but also at the same time, it creates interdependency among nation states, multinational corporations and international organisations that weakens states' will and right to use their military, economic and political power to protect their rights in every single arena.

This kind of circumstances (or what we call today a global village or globalisation itself) to a certain extent naturalises the use of the sovereignty power of a nation state. An important point highlighted by Sen in his article is about the relation between globalisation and interdependence. He states that "Globalisation is closely related to economic interdependence per se, but not synonymous with it. The former is a structural phenomenon because it institutes a deeper level of economic interpenetration than the latter and becomes more consequential as a rule" (Sen, 1999).

Dent explains this interdependence and globalisation equation between firms and governments as a state's ability to conduct an effective diplomacy with foreign MNCs. This depends on the state's own power base, technocratic capacities, general adaptive qualities and the development level of the economy over which it presides. While MNCs seek to extract policy concessions from states and influence state's economic policy-making processes, they also view those states endowed with sufficient technocratic capabilities as adaptive partners, whereby, both agents gain by working in conjunction to respond to the mutual challenges presented by globalisation (Dent,2003).

Besides the partnership of the two actors, the goals of multinational firms and the home or host countries are not always identical. To be more concrete, what is good for the U.S based multinational company is not necessarily what is good for the national interest of the United States or any other state. Each nation state tries to maximise its own national goals. Therefore, inevitably, a potential conflict exists between the multinational enterprise and the nation state. In all business operations, whether domestic or international, the business enterprise and governments have common interests that overlap and are in harmony as well as potential areas of conflict where the interests of the two parties diverge.

As a sovereign power, nation states have the power and the responsibility to govern business transactions within their boundaries that will increase national interest and intervene on outside intruders because: "The multinational corporation not only promises the most efficient use of the world resources but as an institution, it poses the greatest challenge to the power of a nation-state since the temporal position of the Roman Church began its decline in the 15th century" (Behrman, 1975).

The challenge that MNEs pose against the sovereignty of the nation state have different degrees. Economic sovereignty reflects the ability of a government to choose how best to manage its resources for wealth-creating activities. Cultural sovereignty reflects the freedom of a country to determine its own way of life, including the extent to which it wishes to adopt the customs, ideologies and values of other societies. Legal sovereignty defines a country's authority to devise its own laws and regulations, independent of any outside interference. Political sovereignty embraces economic, cultural and legal sovereignty. It is the prerogative of a country to manage all its affairs as it wishes and without any unacceptable influence from another jurisdiction. Political sovereignty in any meaningful sense, rests on the status, power and independence of a nation-state in relation to that of other nation-states which may directly or indirectly affect its own well-being. In order to understand how an MNC has an effect on a nation-state's sovereignty, it is necessary to examine the extent to which and what ways the ultimate sovereignty has been effected (Dunning, 1992).

MNCs may affect the sovereignty of a nation-state by their actions or by their reactions to the policies of governments in the political, social or cultural arena. But perhaps, the most important effect of MNCs is on national security and in political areas. Although nation-states, with or without their permissions are obliged to overlook the interference of other actors on their sovereignty, there are some strategic interests like national security upon which no nation-state can tolerate outside influence.

In order to explain the bargaining between the governments and corporations and the influence on sovereignty, Vernon has figured out a thesis called "Sovereignty at Bay" (Vernon, 1971). This thesis assumes that bargaining advantages are, and always will be, on the side of the corporation. In contrast to the corporation's vast resources and flexibility, the nation-state has little with which to bargain. Most nation-states lack economies of scale, indigenous technological capabilities, or native entrepreneurship to free themselves from dependence upon American or other developed county originated multinational corporations. According to this argument, the extent to which Nation-states reassert their sovereignty is dependent upon the economic price they are willing to pay and it assumes that when confronted with this cost, they will retreat from nationalistic policies.

In an age of rising economic expectations, the sovereignty at bay model rests on an important truth: a government will be reluctant to assert its sovereignty and drive out the multinational corporations if this means a dramatic lowering of the standard of living, increasing unemployment or decreasing tax income etc. Nation-states are still the core element of the international system and they are, in appearance, at least the sole user of the sovereignty power in many senses but are not alone anymore on the game field.

3.3 Interdependence and Triangular Diplomacy

In the 21st century, governments have come to recognise that their increased dependence on the scarce resources has been controlled by firms. When Keohane and Nye stated in one of their articles that: "We live in an era of interdependence" (Keohane & Nye, 1993), they were referring to the power calculations which are now more delicate than in the previous ages among states. Today, we are living in a world of vulnerabilities and benefits between states, other states and even multinational corporations. Actors of the international arena are sharing more common economic or political interests than they did the past. The referred to the challenge between the Modern and the Traditional way of thoughts and point out the debate of whether the territorial state, which has been dominant in world politics for four centuries since the feudal times, has ended or is being eclipsed by non-territorial actors such as multinational corporations. Nowadays, almost five of the ten dominant power of the world are not nation states. World politics still seem to be ruled by powerful states but the main actors are not only states anymore. What traditionally oriented scholars forget to calculate are the outcomes of the fundamental changes in technology, communication, social and economic transactions which lead us to a new world of interdependency among nation-states and multinational corporations.

The turmoil, which is the result of globalisation, in world politics in the last decade, has altered relationships among states and non-governmental actors. Growing interdependence among states in economic growth, trade surplus or political superiority and influence have created rivalry between states and multinational corporations. Once the only competitor for a nation-state was a superior one, but now, they also have to because of powerful multinationals unbalancing their trades, interfering with their import-export balances or manipulating the political position of a home or host government. Securing their place in world economy and politics, not only among nation states but also among other actors like NGOs and more specifically among important economic actors as MNCS, has become far more significant. The competition for power as a means for wealth has created global competition for wealth as a means for power. These changes in world politics have added two new dimensions to diplomacy. No longer do states negotiate among themselves, they must now also negotiate with foreign firms (Strange & Stopford, 1991).

Multinational firms are becoming more like statesmen as they seek corporate alliances to enhance their capacities to compete with others for world market shares. These structural changes in international political economy have altered the nature of the game, thus, affecting the actions and responses among firms and states.

Intensifying cross-border competition brings interdependence among governments and firms. No longer have they absolute powers in their states, within their territories, it becomes applicable for governments to use transnational politics. National boundaries do not define the rules anymore. Negotiation and action carried out on a triangular basis is the name of the game in the global century. In addition to the traditional players of the old game, such as minister and ambassadors, executives of both domestic and multinational firms are now involved. The growth of global competition can be seen as moving the world towards a position where events are conditioned more by an emerging private managerial technocracy than by the traditional notions of state power. Besides, the competition and diplomacy among the actors, supra-national bodies (another gift of globalisation) have emerged to offset the growing power of the world market such as free-trade areas and agreements (Strange & Stopford, 1991).

Change in the international economy points one direction: states are losing their power to pursue independent policies and now must master the new game of triangular bargaining. The new game is about keeping relations at a level which please everyone at the same time. States are now in the middle of a Bermuda triangle. Governments need to manage a series of difficult trade-offs among competing internal and external objectives. The more complex the economy, the greater the difficulty in establishing and maintaining explicit policies in these trade-offs, several kinds of relationships have to be taken into consideration.

This new diplomacy has three critical ingredients: bargaining among states for power and influence, competition among firms contesting the world market and the specific bargaining between states and firms for the use or creation of wealth-producing resources. All three are critically influenced by and in turn, influence the world structures of security, finance and knowledge. Changes in these structures throughout the last century and in this century, have also created new possibilities for obtaining wealth. States and multinational corporations adjust themselves to these changes in order to take the best advantages from the triangular diplomacy of world affairs. The influence of state-firm bargaining has proportionally grown. The growing interdependence of the world economy has grown proportionally not only in the international arena but also in domestic politics. The growing interdependence of the world has put new pressure on national political authority. Opinions may differ on the relative contributions of different factors to the changes, but the pressures are pushing governments further and faster into the arms of multinationals. States are being drawn, without order, into a new game with more complex rules. The new game of competing for world market shares alters the order of importance of the functions of the state. The dual role of the state both to support business and provide finance on the one hand and to be the guardian of social welfare and redistributors of resources on the other, is exceedingly difficult to manage coherently. The choice indicates how much the state is willing to take on an active role of managing national resources for greater international competitiveness. There are bargains between ministers within the government, there are bargains between political parties supporting the government, there are bargains with labour unions, with business associations, with religious groups and ethnic minorities. There are also bargains which interlock all these together with foreign corporations, foreign governments and international organisations. In all of these bargains, being overgenerous with one partner can cost dearly in relations with another. The global strategies and the interference of multinational corporations in state actions force states to share some of their rights and reorganize their structures (Strange & Stopford, 1991).

When we look at the relations of nation state and foreign firm, we see governments typically perceiving themselves as caught between the upper milestone of structural changes which force them to compete for world market shares, and the lower milestone of their dependence for survival both on foreign investors and on local political support. On the other hand, multinational firms have to use corporate diplomacy to get the best possible deal from their home and host governments. A private corporation may wish to protect its exports in a particular country and persuade its own government to suspend actions that might otherwise be undertaken by using corporate diplomacy.

Governments now give greater priority to the accumulation of wealth-creating resources. This has direct implications for the preassumed Hobbesian international society and nation state, where each state claims sovereignty and there is no superior ruling authority or interfering multinationals. The over-riding concern of every state was its own security (Strange & Stopford, 1991). This view assumed that governments as guardians of the national interest, pursued power as a means of securing their independence from interference by other states. International relations was therefore about the pursuit of power as a means of self defense and wealth was primarily needed to provide the state with the revenue with which to match the offensive military capability of predatory neighbours. Nowadays, it is argued that wealth is needed to preserve the state more from internal rather than external threats, for example, multinational corporations. Without wealth, or the prospect of future sources of wealth, even if there is no external security threat, the state loses its power to exercise the right of sovereignty and even begins to fall apart.

First of all, no one can deny that multinationals have gained enormous power since their existence. Multinationals have experienced a type of economic and even political power development which has global economic, social, political and cultural roots. Multinational corporations are the driving force behind globalisation and many commentators agree that they have benefited from it the most. Larger than many host nations, multinationals are often in a powerful position to dictate terms. Payment of bribes or 'commissions' has fuelled corruption and secured favourable terms for multinational companies in their operations around the world (Pliger, 2004). The consequences of this growing corporate power can be seen clearly in relation to their foreign investment role. At its best, investment by a foreign company can provide jobs, stimulate economic growth and offer developing countries access to key technology and skills. At its worst, multinationals exploit cheap labour or natural resources which poor countries offer, and leave them with nothing in return. How therefore can countries ensure that all investments follow the best practice? Many governments have laid down performance requirements of multinationals to ensure that their presence works for the benefit of the host community. For example, any hotel chain wishing to start up business in China, has to do so in partnership with a Chinese enterprise (Pliger, 2004).

In 1952, General Motors CEO, Charles Wilson made the famous statement that "What is good for General Motors is good for the country" (Anderson & Cavanag, 2013). During the past decade and a half, General Motors and other global corporations have obtained much of what they claimed was good for them. They have succeeded in obtaining trade and investment liberalisation policies that provide global firms with considerable freedom to pursue profits internationally. They have also persuaded governments to take a generally hands-off approach to corporate monopolies, claiming that mega-mergers are needed for firms to compete in global markets.

In September 2000, Business Week magazine released a Business Week/Harris Poll which showed that between 72 and 82 percent of Americans agree that "Business has gained too much power over too many aspects of American life." In the same poll, 74 percent of Americans agreed with Vice President Al Gore's criticism of "a wide range of large corporations, including 'big tobacco, big oil, big polluters, the pharmaceutical companies and HMOs.'" 74-82 percent agreed that big companies have too much influence over "government policy, politicians and policy-makers in Washington." A kind of interdependence was formed among nation-states and corporations due to this complex formation. We can even say that in some cases, MNCs have become so enormous that they can influence not only the economic agenda but also, political issues among nation-states where they have interests.

Briefly, governments as a group have indeed lost bargaining power to multinationals as the possibilities for collective action have diminished. Intensifying competition among states seems to have been a more important force for weakening their bargaining power than the changes in global competition among firms. This is not to deny that governments maintain considerable power in their dealings with any of the foreign firm. States still control access to land and to the labour living on the land. Firms control capital and technology or at least, have access to both. They can raise both debt and equity capital on international markets, whereas, governments have started to lose their access to capital nowadays. Governments, in other words nation-states of the global century, have become inadequate in catching up with the rapid changes of world economy. In order to survive, they have to become inter-dependent on multinationals which are in favour of their national interests or find emergency exits for interest-clash issues. One can easily argue that from their original position before the global economy emerged, states have started to lose power. One can also argue that multinational corporations have great effects on nation-states and influence their policies on different issues.

CHAPTER 4

4.1 FINDINGS

Multinational Corporation is a business concern with operations in more than one country. These operations outside the company's home country may be linked to the parent by merger, operated as subsidiaries, or have considerable autonomy. They have the capacity to shape global trade, production and financial transactions. Multinational Corporations are viewed by many as favouring their home operations when making difficult economic decisions, but this tendency is declining as companies are forced to respond to increasing global competition. Multinational Corporations are sometimes perceived as large, utilitarian enterprises with little or no regard for the social and economic well-being of the countries in which they operate, but the reality of their situation is more complicated

Multinational Corporations have existed since the beginning of overseas trade. They have remained a part of the business scene throughout history, entering their modern form in the 17^{th} and 18^{th} century with the creation of large, European-based monopolistic concerns such as the British-East-Indian company during colonialisation. Multinational concerns were viewed at that time as agents of civilization and played a central and important role in the commercial and industrial development of Asia, South America and Africa. By the end of the 19^{th} century, advancements in communications closely linked world markets and Multinational Corporations continued their favourable image as instruments of improved global relations through commercial ties. The existence of close international trading relations did not prevent the outbreak of two World Wars in the first half of the twentieth century, but an even more closely bonded world economy emerged in the aftermath of the period of conflict.

In more recent times, MNCs have grown in power and visibility, but have come to be viewed more ambivalently by both governments and consumers world-wide. Indeed, multinationals are today, viewed with increased suspicion given their perceived lack of concern for the economic well-being of particular geographic regions and the public impression that multinationals are gaining power in relation to government agencies, international federation and organisations, and local, national and international labour organisations. Despite such concerns, MNCs seems poised to expand their power and influence as barriers to international trade continue to be removed.

The World Trade Organisation and the World Bank are the three institutions that underwrite the basic rules and regulations of economic, monetary and trade relations between countries. Many developing nations have loosened trade rules under pressure from the International Monetary Fund and the World Bank. Domestic financial markets in these countries have not been developed and do not have appropriate laws in place to enable domestic financial institutions to stand up to foreign competition. The administrative setup, judicial systems and law-enforcing agencies generally cannot guarantee the social discipline and political stability necessary in order to support a growth-friendly atmosphere.

As a result, most MNCs are investing in certain geographic locations only. In the 1990s, most foreign investment was in high- income countries and a few geographic locations in the south like East Asia and Latin America. According to the World Bank's 2002 World Development Indicators, there are 63 countries considered to be low-income countries. The share of these low-income countries in which foreign countries are making direct investment is very small. It rose from 0.5 percent to only 1.6 percent in 2000.

Although Foreign Direct Investment in developing countries rose considerably in the 1990s, not all developing countries benefited from these investments. Most of the Foreign Direct Investment went to a very small number of lower and upper middle-income developing countries in East Asia and Latin America. In these countries, the rate of economic growth is increasing and the number of people living at poverty level is failing. However, there are nearly 140 developing countries that are showing very slow growth rates while 24 richest developing countries (plus 10-12 newly industrialised countries), are benefiting from most of the economic growth and prosperity. Therefore, many people in developing countries are still living in poverty.

GDP growth is usually the parameter to measure economic growth of a country, even though it is not the only parameter. GDP includes all the production within the country for the given period. Foreign direct investment is included in GDP and much has been done to uncover the relationship between MNCs and growth.

Many research works have shown that the contribution of MNCs to growth is positive. Using different data and methodologies, many researchers have concluded that MNCs has positive impact on growth. For instance, in a paper by Loungani and Razin (2001), it was reported that of the three sources of capital flow to developing countries (FDI, portfolio investment and primary bank loans), FDI was discovered to be the most resilient during the global financial crises from 1997-1998 and also during the Latin American financial crises in the 1980s. Moss, Ramachandran and Shah (2005) had a similar conclusion in their study which focused on three countries in Africa: Kenya, Tanzania and Uganda. It was revealed that the percentage of export from MNEs is far more than the one from local investors. This shows that MNCs in the form of FDI contributed more to GDP than local investment in the three countries.

The OECD (2002) simply stated that MNCs increases efficiency of resources and raises factor productivity in the host country, so it sees the influence of MNCs on growth as positive. Some research works concur that the contribution of MNCs to growth is positive but depends on some factors in the host country. Alfaro (2003) concluded that the contribution of MNCs to growth depends on the sector of the economy where the MNCs operate. He claimed that MNCs inflow to the manufacturing sector has a positive effect on growth whereas, MNCs inflow to the primary sector tends to have a negative effect on growth. For the service sector, the effect of MNCs inflow is not so clear. However, an economy with a well-developed financial sector gains more from MNCs (Alfaro et al, 2003). The impact of MNCs on growth also depends on the local condition of the host country. Chowdhury and Mavrotas (2003) maintains MNCs' contribution to growth depends on factors such as human capital base in the host country and the degree of openness in the economy, and even when MNCs are contributing to the economy, its impact might not be easily noticed in the short run. Lall (2002) believes MNCs inflow affects many factors in the economy and these factors in turn, affect economic growth. Therefore, the impact of MNCs on growth cannot be measured directly since the impact is through its contributions to these other factors.

Countries with high growth can attract MNCs better than countries where the economy is not in good shape. This confirms the fact that even though MNCs contribute to growth, growth also influences the level of MNCs in a country. Chowdhury and Mavrotas (2003) conducted a Toda-Yamamoto test of causality on three countries (Malaysia, Chile and Thailand) from 1969-2000 to explore the degree of causation between MNCs and growth. They discovered that it was GDP that caused MNCs in Chile and not the other way round. They also discovered that there was bi-directional causality in the other two countries. Kumar and Pradhan (2002) also discovered that in the majority of cases, the direction of causation between growth and MNCs is not pronounced. Furthermore, in poor countries, the direction seemed to be running from growth to MNCs in an equal number of cases as from MNCs to growth. This conclusion is similar to that of Hansen and Rand (2004), who argues that foreign direct investment and growth have a positive relationship, but the direction of causality is not clear. Knowing this direction of causality is very important for the formulation of economic policy. Although the contribution of MNCs to growth might be positive, Ray (2005) does not believe it helps develop local industries in the host country. Hence, multinational companies can be flourishing in the host country while local firms are not developing. This type of contribution is not good for the economy in the long run.

It is worth noting that some research work has claimed that the contribution of MNCs to growth is not positive. In a study by Carkovic and Levine (2002), it was concluded that MNCs do not have a robust independent influence on growth. The study employed two models for the empirical work and used data from 75 countries. Mwlima (2003) also does not consider MNCs as an important tool for development. He claims that incentives and tax holiday adopted by most African countries to attract foreign investment have not been successful; instead, it adds to economic problems of some countries. He maintains most African countries are competing to attract FDI to the level that each country wants to give the best incentives. This sometimes leads to a situation where the incentives could be more than the gain obtained from the foreign investment. This can leave the country worse off than it was before the investment. Zambia has been mentioned as a specific example. He concluded that there is no real evidence that MNCs bring development, noting that the aim of any MNE is to make profit and not to provide development. If these claims are anything to go by, developing countries should approach and introduce MNCs with caution.

Before now, most developing countries were not so receptive of MNCs. They were more comfortable with local investors who had no influence from the western world. After decades of skepticism, international events reshaped the attitude of developing countries towards MNCs as the debt crises affected most of them in the 1980s and access to credit and portfolio investment were very difficult for most countries (Alfaro 2003). Today, almost every country wants MNCs to supplement local investments and this has increased the activities of MNEs in developing countries tremendously. It should be noted that the influence of MNEs in world economic growth in recent years cannot be underestimated. UNCTAD reported that the world FDI inflow was 648 billion dollars in 2004. Out of this sum, the inflow to developing countries increased to 233 billion dollars, which amounted to 36% of the world total inflow.

By implication, FDI inflow to developing countries increased by 40% compared to 2003 figures while the inflow to the developed world dropped by 14% (United Nations, 2005).

According to Alfaro et al. (2004), MNCs were mostly welcome by developing countries in the 1980s because of the debt crises these countries were facing, and more recently because of the bad shape of the economy which they believe MNCs can help improve. Another thing that has contributed to the increase in MNCs inflow to developing countries is favourable policies by the host country towards these corporations. The growth of MNCs has been facilitated by positive policies by governments of the host countries and by the efforts of multinational companies to utilise opportunities created by the favourable policies. MNEs are likely to get cheaper labour in developing countries and this can reduce the total cost of production. The United Nations (2005) reported that intense competitive pressure in developed countries is leading many multinational companies to explore new ways of improving their competitiveness. Some of these ways are by expanding operations to developing economies to boost sales and by rationalising production activities with a view to reaping economies of scale and lowering production cost. African countries, like other developing countries, are trying to attract MNCs because of their perceived importance. According to Mwilima (2003), all African countries are keen on attracting MNCs. They have different reasons for attracting them, but the reasons are like those of other developing countries and can be summarised as follows: trying to overcome scarcities of resources such as capital and entrepreneurship; access to foreign markets; efficient managerial techniques; technological transfer and innovation; and employment creation. These benefits of MNCs to African countries are difficult to assess but will differ from sector to sector depending on the capabilities of workers, firm size and the level of competitiveness of domestic industries.

Most African countries now have investment promotion agencies (IPAs). The roles of these IPAs include attracting FDI and protecting MNEs that come with the mention to invest. Agencies like these, if given the right tool to operate, can actually increase MNCs inflow to developing countries by creating a good image of the countries to potential international investors. Despite the effort of policy-makers in Africa, the continent is not attracting these corporations as it is supposed to. Africa's share of FDI to developing countries has been declining over time, from about 19 percent in 1979 to 9 percent in the 1980s and to almost 3 percent in the 1990s (Chowdhury and Mavrotas, 2003) and the rate at which it is declining is high. MNCs to developing countries increased by 40% in 2004, but the flow to Africa remains the same as it was in 2003, $18 billion.

It should be noted that a major part of foreign investment to Africa is channelled to the oil and gas sector. The strong investment in this sector is because of high prices of oil and gas which will increase investor's profitability (United Nations, 2005). The reason why the African share of the world's FDI is not increasing includes, but not limited to, political instabilities and inconsistent policies in most countries. Any MNE will want to operate under a lesser level of uncertainty but this cannot be guaranteed in some African countries. In a study by Rogoff and Reinhart (2003), some African countries were compared with countries from other parts of the world with focus on inflation and currency instability. It has been revealed that high inflation and unstable currencies are some of the major reasons why Africa cannot really attract MNCs. Apart from the inflation rate, another factor that is limiting the inflow of MNCs to Africa is infrastructure. MNEs prefer economies with good roads, uninterrupted power supply and other amenities. Production costs are usually lower in countries with well developed infrastructure than in countries with poor infrastructure. But the effect of poor infrastructure on MNCs inflow is lower than factors like foreign reserves and natural resources (Onyeiwu and Shrestha, 2004).

A report by the OECD (2002) attributes the spectacular failure of African countries to attract MNCs to a mix of unsuitable national economic policies, poor-quality services, closed trade regimes and problems of political legitimacy (United Nations, 2005). Alaba (2003) indicated that exchange rate uncertainty is one of the major reasons why MNCs are not increasing in Africa. According to him, "Proper management of the exchange rate to forestall costly distortions constitutes an important pillar in determining the flow of MNCs to Nigeria and indeed sub-Saharan African countries." Based on the above reasons why Africa cannot attract MNCs, if the continent wants to increase its share of MNCs, there must be political stability, good infrastructure and economic stability. If all these are put in place, the continent will be able to attract MNCs like other developing countries. But it will take a considerable time to achieve these, hence the inflow of MNCs to the continent might not increase in relative terms for a long time to come.

Similarly, MNCs are viewed as being exploitative of both their workers and the local environment, given their relative lack of association with any given locality. This criticism of Multinationals is valid to a point, but it must be remembered that no corporation can successfully operate without regard to local social labour and environmental standards, and that Multinationals in large measure, do conform to local standards in these regards.

MNCs are also viewed as acquiring too much political and economic power in the modern business environment. Indeed, corporations are able to influence public policy to some degree by threatening to move jobs overseas, but companies are often prevented from employing this tactic given the need for highly trained workers to produce many products. Such workers can seldom be found in low-wage countries.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

CONCLUSION

It is evident from the theoretical review that a number of factors are important in attracting Multinational Corporations by host countries. Understanding the specific ownership, internalisation and locational advantages of multinational firms will aid in understanding the behaviour of firms as countries seek to attract the right kind of foreign investment. MNEs could seek resources, large markets or low-cost production as motives driving their international expansion across countries. It can be noted that various factors of MNCs affect different countries differently depending on their individual country characteristics, policies and location. While a number of studies on MNCs have been carried out for developing countries, there is no consensus as to particular factors that affect a group of countries or individual countries. Mixed results are evident with regard to the importance of certain variables in determining MNCs. Variables considered include growth, skills, labour, market size, openness, infrastructure, exchange rate and international interest rates. Other broad factors include national policy frameworks and government incentive policies. The empirical review established that the importance of each of these factors varies across regions, countries and time. Therefore, the lack of knowledge on other factors determining inward MNCs provides a rationale for this study on developing countries.

RECOMMENDATIONS

Based on the experiences with MNCs in Africa, a SADC seminar that brought together researchers, trade unionists and NGOs in Windhoek, Namibia in February 2001, recommended the following:

- Africa should abandon its open door policy to MNCs;
- Africa should determine the national policy and set the context for MNCs. Social policy and the public sector cannot be handed over to international institutions or the private sector;
- Africa should resist all additional conditions that come with MNCs and instead;
- African governments should set up their own conditions with regard to MNCs;

- Africa should retain savings as the basis for domestic capital accumulation. Other areas that need to be addressed in order to maintain own financial resources are:
  - transfer prizing (changing prizes charged by companies when moving their products between their units in different countries in order to avoid high taxes)
  - Payments for consultations
  - Fees for copy-writes and patents
  - losses due to privatisation
  - losses due to structural adjustment programmes
  - Loss through increased costs of interest payment
  - Loss through continuing debt payments, especially for debts that were created by the apartheid regime;
- Africa should obtain technology that is not tied to MNCs;
- Trade Unions and NGOs should put pressure on Southern African governments to join forces in order not to succumb to pressure from the North during negotiations in the WTO;
- There is a need to stop the liberalisation of capital movements and speculative capital flows at global level;
- Africa should develop regionalism as defined by the people and not by the EU or the US; and
- Africa should use the concept of selective de-linking from the global economy within regional settings but not as a form of national autarchy.

Due to many socio-economic problems faced by developing countries, most have become desperate in trying to find solutions. The problems vary from high unemployment rates, poverty and lack of technology. In their efforts to overcome these problems, most developing countries have received advice from bodies such as the IMF and the World Bank to liberalise their economies in order to attract MNCs which in turn, they believe, will bring development. The liberalisation of economies have led to developing countries engaging in privatisation, introducing incentives to attract MNCs in the form of tax holidays, relaxing regulatory framework and introducing investment promotion agencies responsible for Social Observatory Pilot Project – Final Draft Report – FDI attracting MNCs. Since most of the developing countries have liberalised their economies, it would be expected that MNCs flow, to developing countries, would have risen, but to the contrary, actual flows of MNCs to these countries have been on the decline.

The privatisation process, preached by the IMF and the World Bank as one of the prerequisites for attracting MNCs to developing countries has not been successful and has often resulted in further hardships for the poor in these countries.

One of the main outcomes of using incentives to attract MNCs is the increase in competition among developing countries. This has led to countries engaging in a 'race to the bottom', offering investors more and more attractive financial incentives and reducing the regulatory requirements on firms. Engaging in this type of competition almost inevitably means that even the country that 'wins' (the investment) has paid too high a prize for it. Competition on investment incentives raises the distinct possibility that every country - big or small – could be worse off than if it were to stop using MNCs incentives altogether.

CUTS have pointed out that incentives are only useful to the extent that they succeed in attracting investment from one country to another and that, they do not create new flows of MNCs (CUTS, 2001). It has been proven that incentives do not work in attracting firms as foreign firms come due to factors such as the size of the market, privatisation, resource extraction and personal reasons. Some developing countries go to the extent of making changes to their regulations and restrictions on mobility of capital, whereas, some countries have introduced structural adjustment policies to try and attract MNCs. The fact that most countries have created a conducive environment to attract MNCs, but that, MNCs flows to developing countries are still on the decline has shown the contradiction to the claim that the 'conducive environment' is critical for MNCs. Thus, it can be concluded that, it is not conducive environments or incentives that attract MNCs, but that, MNCs decide on where to invest based on other reasons.

As Tandon has pointed out, nothing seems enough to attract MNCs into one economy, more and more incentives are needed to seduce MNCs. For example, workers are expected to abstain from strikes and not even bargain for better salaries. Fear of sending the wrong signal to investors has led to workers' rights being compromised. Tandon indicates that there is no real evidence that MNCs bring development, just as there is no evidence that liberalisation, in general, brings development (Tandon, 2002). It is important to keep in mind that MNCs are not in business for development, but to make profit, whereas, governments are supposed to ensure development. The fact that the goals of both government and investors are not the same, indicate that it becomes a very difficult task to direct MNCs in a way that will lead to development.

Thus, the theory that MNCs bring development and growth needs to be reviewed in order to prove whether or not this holds water. Tandon could be right when he stated that it is growth that attracts MNCs and not MNCs that bring growth. The main challenge is for the IMF, World Bank and others who argue that MNCs are important for growth and development, to present information in the form of case studies to support their argument. Developing countries should exercise caution when they open their doors to MNCs. In the process of attracting MNCs, government should assess what kind of development the country needs, target MNCs accordingly and then, set up policies which will guide the developmental process of the country. MNCs must only be allowed to operate under Social Observatory Pilot Project – Final Draft Report – FDI certain nationally determined conditions and must conform to certain performance requirements that will ensure a positive impact on development.

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