ECONOMIC ROLE OF MNCs IN DEVELOPING COUNTRIES: A CASE STUDY OF PAKISTAN

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Abstract: *Over the past years, globalization has been termed as the new world order that has transformed the pattern of global affairs. On the forefront of globalization, are the MNCs which have played a major role in defining international economic relations. Through their massive FDI flows they are destined to change the fate of ailing nations. This paper reconsiders MNCs as international cohesive non-state actors in influencing politico-economic spheres of developing countries. The debate of whether MNCs have proved to be the saviors or the predators for the developing countries is as old as the existence of MNCs. This paper will focus on the theoretical framework of MNCs, their structure, and their negative and positive impact upon the developing world. The emphasis here is on tracing the historical evolution and characteristics of MNCs. Furthermore, the case study of Pakistan is also included to observe the pattern of economic development through foreign investments.*

Keywords: MNCs, developing states, globalization, FDI, oligopoly theory

Introduction

As the new Leviathans of our time, multinational corporations are "practically in every sphere of modern life, from policy making in regard to the environment and international security; from problems of identity and community; and from the future of work to the future of the nation state."[1]

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[1] M. Gabel and H. Bruner, *Global Inc* (New York: New Press, 2003), 11.

A multinational corporation is a business corporation that runs its business and carries services in more than one country. According to ILO (International Labor Organization), MNC is any corporation that has its management headquarters in one country (i.e., home country) and operates in several other countries (i.e., host country). A multitude of reasons can explain why it is advantageous for companies to become multinationals. Firstly, increasing market share in which there can come a time when companies reach a saturation point in the local and domestic markets, and a new outlet for them can ensure survival and longevity. Hence, at this crunch time, they may export products to other places and countries; and depending on the demand of the products, they can initiate production overseas as well. The example of coca cola is an oft-cited one as they initiated this trend after WW1. Secondly, it is for securing cheaper land and labor facilities overseas. Due to globalization, MNCs and rich capitalist countries of the world have staunchly promoted global free trade for the benefit of all and sundry and in doing so they have strived to get cheaper land and labor abroad to increase their wealth and influence. Thirdly, it is for avoiding tax and trade barriers. Almost every country has to face trade barriers in the form of taxes, quotas, voluntary export restraints (VERs), boycotts, and embargo. Hence, different nations have different tax rates, and being an MNC helps to avoid such barriers. Fourthly, it is for government grants in which many foreign governments provide incentives for companies to operate in their country by providing financial support. This was observed back in the decade of 1980s when many US companies were attracted towards working in UK.

Data and Methodology

For this research paper, secondary data has been implied. Structural patterns and features of the MNCs are of special focus.

Historical evolution of MNCs

Historically, multinational corporations are closely linked with the history of colonialism and imperialism. The primordial MNCs were assigned to undertake imperial expeditions at the orders of the colonial masters of Europe. The early corporations facilitated the wave of colonialism and imperialism by creating opportunities for exploration and international trade between the far flung lands of Asia, Americas, and Africa. Hence, the earliest origins of MNCs can be traced back to the 16th century and to the colonial expeditions of England and Holland. The credit of being the first MNC in the world is given to British East India Trading Company founded in 1600 with the goal of exploiting resources and labor; and thereby, investing the accrued profits in the home country.[2] It rose to account for half of the world's trade in commodities like: cotton, silk, salt, tea, and opium. Such was its outreach and influence that it eventually ruled in India on the behalf of the British Empire.[3] Other examples of early MNCs include Swedish Africa Company and Hudson's Bay Company, which were instrumental in the colonization by creating settler colonies. With the phase of decolonization, colonial and imperial charter companies were disbanded and dissolved; but the economic and political effects of corporate exploitation are still felt today through the ever-widening North South gap.[4]

1945 onwards

The word MNC came to the fore in the 20th century with the revolution in communication and transport sectors that encouraged capital concentration and corporate mergers. Technological advances have greatly spurred new trends in the internationalization of investment and trade and have expanded global markets. MNCs have tremendously evolved in terms of geographic scope and economic clout. Post WWII witnessed mushrooming of MNCs in the industrialized and developed world where according to some

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[2] Nick Robins, *The Corporation That Changed the World: How the East India Company Shaped the Modern Multinational* (London, Pluto Press, 2006).

[3] J. Greer and K. Singh, "A Brief History of Transnational Economies," *Global Policy Forum*, accessed April 10, 2015, https://www.globalpolicy.org/empire/47068-a-brief-history-of-transnational-corporations.html.

[4] Luis Angeles, "Income Inequality and Colonialism," *European Economic Review* 51, No. 5 (2007): 1155–76, http://www.uib.cat/congres /ecopub/ecineq/papers/011Angeles.pdf.

estimates there were about 7000 MNCs in the year 1971 which have now risen to 40,000.[5]

Moreover, another trend observed in the 1980s was an increased investment of MNCs in the developing world, which were plagued with unemployment, ridden with debt, and burdened by poverty and crisis. For the developed world, MNCs are the embodiment of modernity and the prospect of wealth: full of technology, rich in capital, replete with skilled jobs. Due to this extravagance, developing states queue up to attract multinationals and tone down the protectionist policies in order to liberalize investments. On the other hand, MNCs while able to dwell in the developing world's markets, get a golden opportunity to expand their markets at lower costs with fewer legal, health, and environmental restrictions. This implies that the tendency to exploit such conditions is readily availed by most MNCs.

Contemporary critics of MNCs posit that present multinationals are set to follow the trend of exploitation established by the colonial corporations, especially the ones working in the developing world like Royal Dutch Shell and Barrick Gold where they act as predators. It has been asserted by many critics that MNCs in the impoverished and developing regions of the world are operating within the context of neocolonialism and neo-imperialism.

Understanding MNCs through a Theoretical Framework

MNCs are in the forefront of playing an integral role in economic liberalization and global economic integration. Due to their important contribution to the global affairs it is pertinent to understand the structural and operative orientation of MNCs through different theories. Theories help elaborate the notion about the functioning and goals of MNCs.

Obsolescing Model: Obsolescing model was developed by Raymond Vernon in 1977 that explains the shift in bargaining relations between the MNC and the host country. The model posits that the initial bargaining power lies with the MNC but gradually it then favors the host country. At the starting point MNC due to its

[5] Greer and Singh, "Transnational Economies," 45.

advanced technology, expert employees, and ready access to markets have an upper hand; but as the investment is made the bargaining advantage shifts towards the host country.[6]

Oligopoly Theory: The Oligopoly theory attempts to explain why firms transform into multinational corporations. Any firm through its technological know-how, market expertise, production, and managerial skills can move abroad to exploit the power of monopoly. This theory contends that few producers through extensive marketing and advertising strategies can monopolize their goods.

The Product Cycle Theory: Product cycle theory is an economic theory that was evolved to study the pattern of international trade. This theory contends that life-cycle of product in the length and breadth of the world markets eventually move away from the origin and primordial point.[7] It happens when the product is imported from the country where it was first invented or produced. This can be illustrated by the following stages of production:

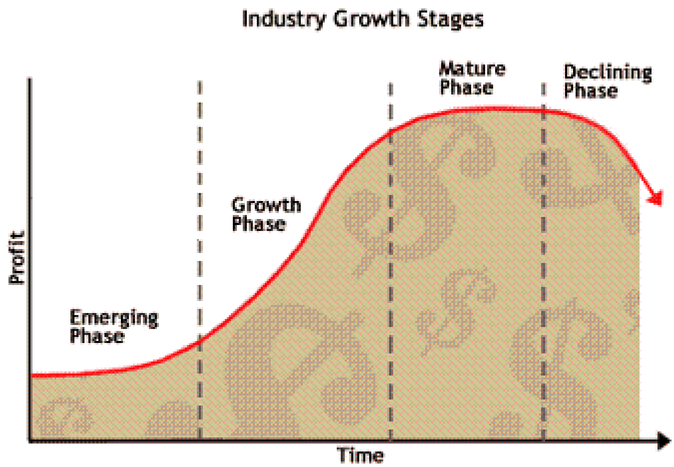
- ✓ First stage of production involves the introduction stage when due to local needs and demands a new product is introduced that is exported abroad to countries which have similar demands.
- ✓ Second stage of production involves growth stage. As a product is manufactured in the country of origin but after the maturity of the product it then has the tendency to move the manufacturing centers to other countries with lower cost of production.
- ✓ Third stage is the saturation stage where the sales of the product reaches a limit where there is no or little possibility to increase sales.
- ✓ The last stage is the decline stage which is apparent in developing and underdeveloped countries where goods

[6] Joan Edelman Spero and Jeffrey Hart, *International Trade and Finance* (n.d.: Wadswort Cengage Learning, 2003); B. L. Mathur and Raman K. Dave, *International Trade and Finance* (n.d.: Wide Vision, 2012), http://www.ilo.org/empent/units/multinational-enterprises/lang--en/index.htm.

[7] Ibid.

are exported abroad due to lack of markets and consumers.[8]

Figure 1: stages of growth



Source: www.investopedia.com

The tariff jumping-off hypothesis: This hypothesis is centered upon the concept of foreign direct investments, which maintains that MNCs use FDI as a tool to jump over tariff or non-tariff barriers of the host countries. This trend was observed as US and Japanese MNCs willingly invested in Ireland and UK to jump-over tariff barriers and to get ready access to western European markets. As these two are members of the EU, investment here will improve access to other members of the EU as well.[9]

Another instance of barrier jumping is observed from the Japanese FDI flow to the US. This jump occurred in 1981 as a result of Voluntary Export Restraint (VER) that Japan had imposed on its automobile exports into US markets pertaining to American pressure. The purpose of the VER was to protect American auto-mobile industry from foreign competition. In reaction to the VER, Japanese investments continued in the decade of 1980s whereby Japan was free of tariff restrains. This resulted into increase of Japanese production

[8] Ibid.

[9] Ibid.

capacity in the US from zero in 1980 to about 2.8 million units per year by 2004.

Structure of MNCs

There are different structural patterns of MNCs: horizontal, vertical, and diversified.

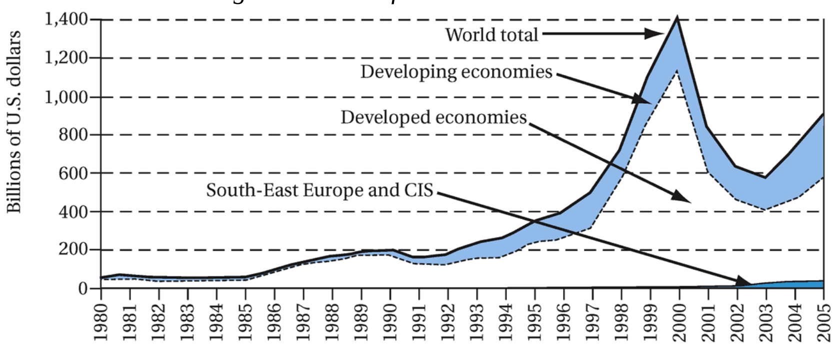
S. No.	Structure of MNC	Description
1	Horizontally Integrated MNCs	The MNCs that are managing production sites located in several countries manufacturing same or similar products are categorized as horizontally integrated multinational corporations
2	Vertically Integrated MNCs	The MNCs that are managing production sites in several countries to manufacture products that are used as inputs in other production sites of the world for producing finished goods (example: Adidas).
3	Diversified MNCs	The MNCs that are not managing production sites located in several countries of the world that neither falls in the category of horizontal nor vertically integrated MNC (example: Hilten Hotels).

MNCs operate on a larger scale with numerous products in various countries. They may operate manufacturing activities in the host country or they may also be involved in the marketing activities. The term ‘MNC’ is a comprehensive term and includes corporations operating on the international and transnational level. MNCs are always differentiated on the basis of their orientation; they will always be profit oriented. These transnational companies are referred to as ‘big business’ and ‘engines of economic growth’ where social welfare or human right concerns are purposefully ignored. The parent company is the holding company whereas the subsidiary company operates under the complete guidance of the parent company and also the subscribed and dictated policies. MNCs are driven by conscious struggle to maintain a certain level of quality products. This perfection is sustained by an active engagement of experts. Hence, most MNCs are ardent followers of total quality management to enhance their production capacity. Due to their superior position and clout most MNCs are highly active in setting up disparate and divergent branding strategies to remain in a competitive position.

Positive Impacts of MNCs

Provision of Employment Opportunities: Employment opportunities are created through FDI flows. The concept of FDI needs elaboration, according to the definition, a foreign direct investment (FDI) is a controlling ownership in a business enterprise in one country by an entity based in another country. As with the end of the Cold War, financial aids and grants have also declined, developing countries have to rely upon Foreign Direct Investments. FDI is instrumental in bringing opportunities for employment by the creation of new economic sectors through the transfer of technological know-how. As FDI is a major source of external finance for the developing countries this leads to economic development.

Figure 2: FDI Inflows: 1980-2005



Source: United Nations Council on Trade and Development (UNCTAD), *World Investment Report, 2006* (New York: United Nations, 2006), fig. 1.1. Reprinted with permission.

Improvement in Balance of Payments: Balance of Payments refers to a record of country's import and export over a period of a year. Hence a country that has MNCs working in its geographical boundaries will have an improved BOP. Investment in developing countries ensures direct flow of capital from the MNCs that greatly boost the economic well being of the ailing economies.

Taxation revenues: MNCs are subject to tax payments all over the world where they operate, which is a source of revenue for the host country. Usually a MNC is subjected to national tax jurisdiction or territorial tax jurisdiction depending on government decisions of the host country.

Enhanced Productivity: MNCs due to their vast capital and infrastructure are in a better position to subdue local firms. This supremacy of MNCs often creates competition that encourages local producers to adopt similar tactics to enhance their capacity. Hence, this benign rivalry enhances overall production capacity of the developing countries.

Benefit through Achieving Economies of Scale: MNCs are in position to benefit from economies of scale. This implies that the cost per unit has been lowered through specialization. This is made possible when in a large workforce work is divided making labor do limited jobs effectively.

Negative Impact of MNCs

Size and Income: Surprisingly, among the 100 largest economies of the world, MNCs constitute about 52 of them and with only 48 countries in the list with the sale figures reaching up to as high as $247 billion. Furthermore, 70% of the world trade is dominated by 500 powerful industrial corporations which have come to have accumulated sale figures of 28% of the GDP of the world in 2002. Amazingly, these corporations provided employment to merely 0.82% of the global work force. International Finance Corporation (IFC) has estimated that FDI flows to the emerging and developing markets have grown approximately by 23% per year between 1990 and 2000. The combined value of stock markets in emerging economies is set to exceed $5 trillion in 2006, and has more than doubled in the past decade. Corporate growth has sky-rocketed to four times as high as global economic growth. Through this, the gap between the rich and the poor has been widened; as according to the reports published by Forbes, 15% rise in the number of billionaires since 2005 has resulted in their having a combined worth of $2.6 trillion.

Job Losses: International Labor Organization (ILO) has estimated that global unemployment rates are at an all time high. Out of over 3 billion workers in the world, half of them have not been able to lift themselves above the poverty line, which implies that the same proportion of the people was impoverished a decade ago. Also, due to the portable nature of MNCs many workers lose their jobs when they shift to more favorable conditions.

Health Issues: Due to their profit maximization approach, MNCs overrule many sensitive issues as they cannot be held accountable for their misdeeds. Nestle has been accused of the deaths of approximately 1.5 million children in the 1980s through polluted water that was used to make infant formula. Although it has often been boycotted but the products of Nestle still finding way to the markets where people readily buy them. This situation has been made possible through vigorous and fierce marketing by Nestle.

Human Rights: Disregard for human rights has become a tenacious practice of most MNCs through their evolution. Most notable human rights violations have been witnessed in the case of Chevron and Coca Cola, which have been indirectly involved in the violent killings of workers while operating in developing countries in trying to suppress workers rights. Several instances of kidnappings, torture, discrimination, health violations, fuelling conflicts, illegal use of child labor, and even sex trafficking have all been documented and recorded as occurring under the auspices of the largest corporations.

Influencing Society: MNCs have been attributed with affecting the social fabric of the societies existing in the developing world while altering their choices. This has become realizable through extensive marketing. One estimate cites that projected global advertising expenditure for corporations in 2006 is over $427 billion dollars.

Public Relations: Almost all major and influential corporations, especially the ones having the most negative impact on environment, have undergone a new makeover after which they claim as having ‘green’ credentials. British Petroleum’s repackaging of themselves with a new environmental friendly logo and extensive campaign can best illustrate this notion. As a result of this farce, most MNCs are able to shift public attention from the reality that the corporation in question is one of the corrupt and leading polluters in the world.

Case Study of Pakistan

Globalization has brought about a new and a unique development for the regulation of international businesses, trade and investment. The world has become a global village where prosperity and well-being is ensured by integrating the world and by removing barriers to trade and investment. No country can survive in isolation and this notion stands true in the case of Pakistan as well. MNCs have proved to be the supports of the globalization process and have proved themselves as the engines of growth. Pakistan being a prominent South Asian state and also an important actor in the international affairs have also taken several measures regarding liberalizing its economic setup to embrace the trends of globalization. Following is an account that traces the history of MNCs in Pakistan.

History of MNCs in Pakistan: Even before Pakistan got independent, a foreign investment was made by the Steel Brothers in 1913 at Morgah, Rawalpindi. This is now known by the name of Attock Oil. The year 1932 saw another foreign investment from the German firm, Siemens. The year 1935 saw ICI (Imperial Chemical Industries) investing in Khewra. Just after independence, Pakistan attracted companies like Unilever, (Formerly known as Lever Brothers), Shell, Burma oil, Imperial Tobacco, and many noted banks that lined up to invest in the newly born state.

MNCs in Pakistan: A large number of multinationals, over the years, have extensively invested in Pakistan. The US and UK lead investments amount up to $190 million and $ 122 million.[10] While other countries that have invested in Pakistan are: Netherlands, UAE, Switzerland, Singapore, Hong Kong, Japan, and South Korea. Furthermore, attraction for these MNCs in Pakistan is due to following reasons.

Geo-strategic location and Population factor: Pakistan sits on the crossroads of the most important trade routes of the world. It is located in the heart of Asia and is the gateway to the landlocked

[10] R. Leingo, "Existence of Multinational Corporations in Pakistan," accessed April 07, 2015, http://robertoleingo.hubpages.com/hub/MNCs-in-Pakistan-MultinationalCorporationsinPakistan-MNCsinPakistan.

resource rich states of Central Asia, borders emerging superpower China and a regional player India, and also offers a vast coastline for maritime trade. Its strategic location proves to be enough for attracting foreign investors. With a growing population estimated around 187 million (2011 census) in Pakistan. This statistics encourages investors to pour money, as it ensures a positive indicator that young professionals could be incorporated into multinationals; and through training, will help improve the standard of corporations.[11]

Availability of Cheap Labor: Most attractive factor for investors is to avail the opportunity of cheap labor offered in most developing countries. Pakistan serves as the top countries to offer affordable labor costs.[12]

Lack of Regulation and Exchange Rate: MNCs find it beneficial to operate in Pakistan as there are no strict rules and regulations and it helps MNCs tremendously in gaining huge revenues. In terms of rating profits exchange rate is another advantageous factor for the multinationals as the rate of rupee has fallen enormously in comparison to dollar. Hence this helps generate extra revenue and profits back the home country.

Multinational Company Mindset: Due to tremendous marketing of the products that MNCs have to offer, the elite and the upper middle class prefer consuming products with an attached 'foreign product' due to perceived quality or durability.

Key Areas for FDI in Pakistan: As a favorable environment for a liberalized economy in Pakistan have attracted large inflows of FDI, but this investment has not been equal in all sectors. Presently, the key areas for FDI in Pakistan include; energy sector, IT, engineering, mining, tourism, pharmaceuticals, beverages, equipments, textiles, power sector, telecommunication sector, chemicals and fertilizer, oil and gas, and banking and finance. Despite grave issues, including law and order and unstable political situation of Pakistan combined with massive corruption, it has somehow sustained the economic growth and has been included in

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[11] Ibid.

[12] Ibid.

the Next Eleven with a potential of becoming a leading economic state in the 21st century. The year 1999 witnessed FDI flow of $1 billion, since then an upward trend has followed rising up to $10 billion in the subsequent years.

Conclusion

MNCs have been declared as the engines of global economic development, prosperity, technological transfer, economic integration, and deepening globalization. Although it has been argued that globalization has played a vital role in improving the standards of living throughout the world, but many critics have asserted that MNCs have assumed the role of exploitative tools and are no more than predators on the developing countries.

Pakistan is also a developing country and has been plagued by several issues; but owing to increase in the consumer demands, it is pertinent to attract MNCs and foreign investments to meet the needs of the population and also to boost the economy. About 30,000 MNCs are working in Pakistan, out of which 600 have foreign capitals and are making huge profits for the economy. Political instability and governance issues have derailed the process of economic development, and many foreign corporations hesitate in investing in Pakistan due to the threats of terrorism. Therefore, the government of Pakistan should take steps to chalk out policies favoring foreign corporations as this will positively affect the economic growth of the country.