BOOK REVIEWS


The multinational corporation (MNC), as an institution that interacts significantly with the pattern of world trade and factor movements and at the same time poses obvious questions relating to the exercise of national sovereignty, has been the subject of intensive research in recent years. Raymond Vernon's volume represents in many ways the overall synthesis of the principal results of his Harvard Multinational Enterprise Project. As such, and in its wide-ranging review of the numerous economic and political issues raised by MNC's, this volume is a useful contribution and should be recommended to all students of the subject.

However, the book is irritating and inadequate at several levels. MNC's raise ideologically-loaded issues and even the most fair-minded, "old-fashioned, down-to-earth" economist is unlikely to be immune to this fact. Vernon's work claims to a neutrality and objectivity which often conceals only ineffectively his sub-conscious bias in favour of MNC's. Thus, typically he starts with strong leftwing positions on MNC's, proceeds to argue that "unfortunately" the facts as usual are "muddled", cites evidence against these positions, and then in a gesture of fairness gives a few examples that go the other way. A leftwing economist could well go in the reverse direction and leave the reader with the impression that the pro-MNC positions are somewhat ridiculous.

But the subconscious pro-MNC bias in this work goes deeper; it also affects the quality of the arguments deployed plus the judgment which is reached on the evidence cited in support of pro-MNC positions. Two examples should suffice.

In discussing the impact of the MNC's on LDC's, he argues:

But these foreign-owned subsidiaries were much more than conduits for foreign capital; they were mobilizers of local resources... For less-developed economies, where local institutions for the mobilization of resources were generally not very strong, this function had a significance all its own. The degree of mobilization of resources by U.S.-owned subsidiaries is suggested by the fact that for every dollar of capital transferred from the United States to these subsidiaries in the less-developed countries, about $4 more of capital were collected by the subsidiaries from other sources, including sources internal to the less-developed areas (p. 171).

This argument must be rejected on two counts. First, several thoughtful people in the LDC's have been worried precisely by the fact that the foreign capital inflow which materializes from private firms is much too small a part of the total resource cost of the investments being undertaken, and that for small sums of money, these firms get control of large investments which are actually being financed by domestic capital. Indeed, in some instances, the bulk of the capital comes from foreign aid which would have been available anyway for domestic use. This was notoriously so in the case of the Bokaro steel plant in India where the U.S. Steel Corporation was planning to invest only $33 million and take control over an aid-financed steel mill requiring a total investment of at least $1 billion: a situation described by the then U.S. Ambassador to India as "a real bargain" for the U.S. Steel Corporation.* The use of the phrase

“mobilization” for such phenomena would be reminiscent of the use of sanitised words such as “pacification” in Asia. Second, it is amply clear that even in the poor countries Vernon cannot legitimately regard the use of domestic capital and foreign aid by MNC’s as necessarily implying the net “mobilization” of resources by MNC’s; and the uncritical use of “muddled” figures as the 1 : 4 ratio of own-to-other-resources is, at best, misleading and wrong.

Yet another example of ready resort to dubious evidence and argument in support of MNC’s is to be found in Vernon’s citation of Katz’s study on Argentina where Katz argues that there is a positive correlation between the estimated rates of technical progress in industries and the participation of foreign investment therein. But the methodology of this study is suspect. The econometric technique by which technical progress is estimated requires one to assume that, at each point of time, all firms have identical production functions. But this contradicts the hypothesis that foreign firms, as against domestic firms, have greater technical progressivity or that they have superior productivity which diffuses gradually to the less efficient domestic firms. The assumption of perfect competition in making the estimates also contradicts the hypothesis that domestic firms coexist with more efficient foreign firms. On these grounds alone, as also on well-known objections to estimating production functions in highly aggregated industries, I would regard this study as unpersuasive unless one wants to be persuaded.

Examples such as these could be multiplied. The careful reader will therefore do well to examine each argument and consult each original source of evidence before he accepts the frequent claim that the weight of evidence, on balance, shows that MNC’s promote the economic welfare of the LDC’s.

The disappointing analytical quality of this work shows up even in chapter 3 on the pattern of U.S. MNC manufacturing investments abroad. Vernon restates succinctly here his “product cycle” thesis, which seems to have two components to it. (1) U.S. firms develop new products which come to dominate the U.S. export pattern. This is nothing but the familiar “availability” thesis of Irving Kravis: emerging availability of new products, combined with the demonstration effect on foreign demands, leads to inevitable exports by U.S. innovators. (2) “...When their export position is threatened they establish overseas subsidiaries to exploit what remains of their advantage; they retain their oligopolistic advantage for a period of time, then lose it as the basis for the original lead is completely eroded” (p. 66).

The latter part of the “product cycle” thesis, as quoted above, is its apparently novel feature; but it is also extremely unsatisfactory to the professional economist. (1) Examination of the studies cited in support, as also Vernon’s own account, show that nearly everything that has always been argued as influencing overseas investment is thrown into the catchall phrase “threatened export position”: host-country tariffs and quotas, the growth of domestic production in the host-country, the entry of other MNC’s there, and so on. The multitude of these factors, with no quantitative analysis of their relative importance in explaining the allegedly product cycle variety of overseas investments by the U.S. MNC’s, contrasts unhappily with the fact that the “export threat” interpretation of some of these phenomena is not the only possible one. Thus, for example, it is conceivable and probable that even a pure monopoly, once external sales in an overseas market reach sufficient scale, would be able to find overseas production profitable relative to exports if tariffs and transports costs are reasonably high and local factor and input costs are advantageous. Since such cost-reducing elements for undertaking production abroad in preference to exports are always present in some degree or the other in all cases, and could presumably be considered often the decisive factors when overseas production is undertaken, how does one discard this kind of hypothesis in favour of Vernon’s “export-threat” thesis? Vernon and his associates not only do not settle such issues; they do not even raise them. (2) Nor does Vernon consider the other critical question for his thesis: why do some firms in an industry respond to export-threats and not others? After all, not all firms in an industry go abroad; and some are content to continue exporting. (3) And then there
is the more unasked question: why do the MNC's investing in external production, while choosing that option in preference to exports, not prefer to sell the knowhow for undertaking such production? Since there is a large market for sale of technology, and many R&D intensive firms occasionally enter it, this is indeed a pertinent question and a theory of external investment cannot be logically complete unless it is answered.

But, despite these difficulties with the product-cycle thesis, the fact that MNC's substitute foreign production for exports is admittedly an important part of the MNC activities. But it is surely only a part. Leaving out the extractive ventures, on which Vernon has a very useful chapter 2, the MNC's indulge in one or both of the following additional varieties of external investments: (i) they produce, even before exports are undertaken, in some markets; and (ii) they assemble components in some countries and ship them out to home base or to third markets where the final production facilities are located.

There is also at least one more dramatic form of international investment which neither Vernon nor other researchers in the MNC field has noted but which may well be the pattern to emerge as a dominant form. In contrast to the case where the MNC's, having developed new products via R&D, export them and then transit to producing them abroad, there is an alternative "model" where MNC's in different countries have R&D-induced advantages in producing different types of sub-products (e.g. one MNC in Japan is excellent with small cars and one MNC in U.S. has an edge on large cars; or tire firms in different countries have acquired edge in producing and competing effectively in different types of tires). In competing in each other's home countries or in third markets in both types of sub-products, it is natural that each MNC would find it difficult to compete effectively with the other in sub-products where it does not have the edge. I would expect that, in this situation, there is likelihood of these MNC's deciding that mutual equity inter-penetration, with productionwise accommodation in sub-product specialization according to the advantage possessed, is profitable. Thus, the MNC in U.S. (say, GM) that finds it difficult to compete in the small-car field with the MNC in Japan (say, Toyota) that finds it difficult to compete with the MNC in U.S. in the large-car field, would each decide that the best strategy if you cannot compete with comfort is to follow the policy: "if you cannot beat them, buy them". Thus GM would want to buy equity in Toyota for the small-car production and Toyota in GM for the large-car production; and GM in U.S. would go off spending resources in producing and improving its own small cars while Toyota in Japan would similarly hold back on its own large-car efforts. One thus gets mutually interpenetrating MNC's within industries, with accompanying division of labour and a novel form of "cartelisation" which goes by sub-products. Linder has made us familiar with trade in commodities between similar countries as consisting of sub-product exchanges; and Hymer and Rowthorn have noted that MNC's from different countries penetrate into each other's countries. My "model" essentially combines these two and predicts that MNC's with R&D-induced specialization in different types of sub-products within an industry in different countries will inter-penetrate.

This model is almost ideally illustrated by the following example which Martin Zimmerman has unearthed for me. Forbes of November 15, 1970, (p. 22) notes the following "international marriage":

Long the friendliest of competitors, Dunlop and Pirelli neatly complement each other. Dunlop is primarily a manufacturer of conventional cross-ply tires, Pirelli concentrates on radials. In Europe, Dunlop has perhaps 18% of the market, Pirelli 12%, as against 12% for Michelin, the next largest competitor. In Europe, Pirelli crosses Dunlop's path only in West Germany: Elsewhere, where Dunlop is active, Pirelli stays out; where Pirelli is active, Dunlop stays out. Outside of Europe, Pirelli is active mostly in Latin America, Dunlop in the Commonwealth and North America.

The two companies have even diversified into different areas—Dunlop into sporting
goods and precision engineering products, Pirelli into paper, electronics and cables.

Eventually, of course, both marketing organizations will work as one, with Dunlop pushing Pirelli products where Dunlop is strong, and Pirelli pushing Dunlop products elsewhere. "The greatest benefits should come from a pooling of R&D, however," explains J. Campbell Fraser, a Dunlop director: "In the 'seventies and 'eighties, competition will be more and more in terms of innovations. In the U.K. we have a home base of about 55 million people – that isn't big enough for the kind of R&D we'll need. Pirelli has an even smaller home base, about 45 million. By merging, we'll have a home base of 100 million, enough for the kind of R&D we'll need around the world... There will not even be any exchange of public shares. Instead each will acquire an interest in the other's operating subsidiaries. The British and Italian companies will operate on their own."

The report goes on to note (p. 23) that there will be four companies: Dunlop Home (U.K. and Europe) with Dunlop owning 51% and Pirelli 49%; Dunlop International (rest of the world) with Dunlop holding 60% and Pirelli, Milan and Switzerland, 20% each; Pirelli Milan (Common Market) with Pirelli Milan holding 51% and 49%; and Pirelli Switzerland (all other Pirelli operations) with Dunlop holding 40%, Pirelli Milan 20% and Pirelli Switzerland 40%.

But interpenetration among MNC's with competing R&D-induced specializations in different sub-products may not be the only important new form of international MNC investments to emerge. Alternative possibilities are one-way penetrations by MNC's. Thus, it is entirely possible for GM to expect to buy its way into profitable Japanese small-car production, for example, by merely offering its distributive outlets, access to funds and/or R&D facilities, and perhaps the political offer of not clamouring for quota protection. Indeed, the recent political pressures on MITI in Japan to open up Japan to U.S. investment in several areas has been so considerable that it seems entirely probable that the model of one-way penetration is about as relevant as the model of interpenetration.

These emerging new patterns of MNC investment are not merely interesting in marking new departures from traditional patterns of MNC investments. They also have differential impact on several questions of a political-economy nature. Consider, for example, the impact of MNC's on the pressure groups for free trade versus protectionist policies. An own-export-substituting type of MNC investment, along Vernon's lines, would normally imply that the MNC would transit from being interested in free trade to relative apathy on the issue (except insofar as export of components to the overseas subsidiary is involved or later expansion abroad leads to third market or reverse-flow sales). On the other hand, the penetration-model MNC is going to shift to a free trade position from having protectionist impulses prior to the penetration.

The political economy of MNC's clearly therefore varies with the type of MNC investment abroad. The focus on only the so-called product-cycle model prevents Vernon from considering such questions, thereby limiting also the utility of his chapters on the social and political factors which interact with MNC's. In fact, Vernon misses the main point about MNC's and political economy today: as his own detailed statistics show, MNC's are different from 19th century private investments abroad, not in being more significant in relation to the recipient-country economies but rather in having become tremendously important in the countries of their origin, especially in the United States. The nature of the political influence that they can, and almost certainly seek to, exercise in matters concerning international economic policy positions, mainly on trade and aid matters, as also in regard to the pressures brought to bear on the recipient countries' government and politics, is therefore of the utmost concern and merits serious analysis. The relative complacency on such issues in this volume contrasts dramatically with the recent disclosures of I.T.T.'s politicking on President Allende's election in Chile and the recurring evidence of considerable corporate lobbying in Washington as the normal way in which at least this Anglo-Saxon democracy works. The issues here are admittedly complex; and,
as I have argued, the implication for all these issues will vary with the type of MNC investments. Unfortunately, the reader is unlikely to get a proper sense of the importance of these issues, or even a useful and sharp definition thereof in this volume.

Nonetheless, the volume will repay careful and critical reading; and it must be considered indispensable for anyone who wants to know quickly the major sources and familiarise himself with many of the principal concerns which currently dominate research in the area of MNC's.

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As a summary of the state of the art and the stage of the argument in the late 1960s, this collection of essays on the multinational enterprise is an exceedingly useful document. The fourteen papers in the volume were produced by a distinguished group of authors, under Professor Dunning's able editorship.

Dunning's own introductory essay, sketching in the background of the debate over the multinational enterprise, is admirable in its coverage. Even so, his essay illustrates a problem that the book as a whole confronts. The issues that are touched on in his essay tumble and spill over one another in a bewildering array. The allusions to studies, policies, and problems are almost too much to grasp.

For all that, no book on this timely subject can hope to be complete. A flood of new studies on the multinational enterprise have appeared in the two or three years since the papers in the Dunning volume were prepared. Accordingly, some of the essays in the collection already seem dated.

Certain themes covered in the book, however, are relatively durable. One such theme is the debate over the relative efficiency of two competing models that are used to "explain" the investment decisions of multinational enterprises. Professor Aliber, representing the Chicago school, predictably explains these decisions in terms of the differences in prevailing returns on capital between a capital-exporting and a capital-importing country. Practically everybody else in the symposium sees these investment decisions as the marginal acts of large oligopolies, which are explained by economies of scale or by monopoly elements in the market. This model is explicit in Dunning's comments on the Aliber paper and implicit in many of the other essays. Ten years ago, the Aliber approach would have dominated such a conference.

As in most discussions of multinational enterprises, the authors sometimes have some difficulty in maintaining their scholarly cool. Professor Penrose, for instance, argues energetically that the multinational enterprise is a peculiarly American institution, not a global phenomenon; that it is an instrument for spreading the American hegemony to foreign countries; and that American economists therefore view it as both more benign and more enduring than the facts themselves would suggest. With her usual refreshing astringency, she takes "the Americans" to task for their myopic views of the present situation and of likely future developments. (The "Americans" in this case turn out to be mainly Kuznets and Kindleberger, with Canadian-born Hymer accused of concurring in at least part of the diagnosis.)

Professor Penrose's own view of the future of multinational enterprises is suggested by her projection for the oil industry, of which she is an outstanding expert. She expects that the
oligopoly structure of the oil industry created by the multinational enterprises will tend to disintegrate. At the same time, she anticipates that the disintegration will hurt no one, not even the exporting countries, even though they have managed to become the principal beneficiaries of the oligopoly rent collected by the companies. The basis for assuming no one will be hurt by the decline of the oligopoly is not revealed, and represents one of the more mystifying aspects of her projection.

Paul Streeten’s speculative essay on the costs and benefits of multinational enterprises in the less-developed countries reflects his usual good sense and maturity. Occasionally, however, his speculations are marred by the exercise of a certain amount of poetic license. Without reference to the evidence, for instance, he says of the inequalities of income and wealth, it creates new oligarchies and it destroys a sense of participation.

Materials bearing on the effects of multinational enterprises are now piling up at a rapid rate: materials on balance-of-payment effects, employment practices, production techniques, export propensities, and so on. When studies of this sort did not exist, generalizations ex cathedra were often the best that were available. Today, however, scholars are in a position to test their speculations against the available evidence.

One especially rich tidbit in the book deserves the final word. The early fruits of an unusual study by Max Steuer and John Gennard are presented, describing the practices of foreign-owned firms in the United Kingdom in the field of labor relations. Many of the results are provocative and illuminating, easily worth the price of the book.

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The volume under review reprints, with moderate editing or updating, six articles from IMF Staff Papers (1958, 1961, 1962, March and July 1964, and 1966), two of the Princeton Essays in International Finance (no. 58, 1967, and no. 67, 1968), and one article each from the Economic Journal (1951), the Review of Economics and Statistics (1956), and Economia Internazionale (1956). Two hitherto unpublished papers complete the volume.

The three journal articles listed last above form Part One of the book. Dealing as they do on an abstract level with general topics, these are the essays likely to hold the greatest permanent interest for economists. The first, "On Making the Best of Balance-of-Payments Restrictions on Imports," is a recognized classic; it examines the possible virtues of discriminatory as opposed to non-discriminatory restrictions and prepares the way for further theorizing on second-best policies. The second essay considers the use of tariffs to affect terms of trade so as to redistribute income internationally. The optimum tariff from an international standpoint — to use the title of the article — is shown to depend on different marginal utilities of income in rich and poor countries. The third essay shows that even high tariffs would cause rather small losses of real income under plausible "elasticity" conditions. These three articles, along with a few
others, illustrate the use of mathematics in a straightforward way that contrasts with the all-too-common use for decoration or impressiveness. Fleming takes care to define his symbols and to use them in support of reasoning also outlined in words.

Most of the book's remaining articles deal with problems caused by the par-exchange-rate system and with their possible palliation. The essays in Part Two consider the concept of need for international liquidity, methods of estimating appropriate amounts and growth rates, methods of creating and distributing new types of liquidity, and rules regarding acceptance of such liquidity and the composition of reserves. In these and other writings, Fleming made a substantial contribution to discussions that eventuated in the system of Special Drawing Rights. The implementation of that system, however, now leaves these writings rather dated.

The papers in Part Three return to topics of more nearly permanent interest -- the correction or palliation of balance-of-payments disequilibria. Fleming develops grounds for optimism about the domestically inflationary impact of currency devaluation, even on the relatively unfavorable assumption that devaluation aims at achieving actual balance-of-payments improvement rather than at permitting relaxation of import restrictions. His article on domestic financial policies under fixed and floating exchange rates stems from his observation that the Canadian experiment of the 1950's had been impaired by failure to appreciate how the appropriate fiscal-monetary mix differs under alternative exchange-rate regimes. An article written with Robert Mundell reaches an unenthusiastic view of what might be accomplished by official intervention on the forward-exchange market. The next article constructs and discusses a possible code of responsibilities to be shouldered and actions to be taken by deficit and surplus countries in correcting payments disequilibria. The suggested guidelines envisage a number of restrictions on current and capital transactions. In discussing appropriate domestic demand policies, Fleming implicitly but unmistakably acknowledges the international inflation bias of the adjustment mechanism, such as it is, that operates under the Bretton Woods system.

The first of the two unpublished papers, written in 1968 and provided with a mathematical appendix by Michael Kuczynski, theorizes about the now rather topical device of dual exchange rates for current and capital transactions. Without giving very detailed attention to just how the necessary segregation of markets might be implemented, Fleming recognizes the serious problems that would arise. His concluding paper, written in 1969, reaches the heavily qualified conclusion that widening the margins of exchange-rate fluctuation would probably have desirable results, on balance.

Most of the papers in the book serve to dramatize the extent to which the exchange-rate peggers and their intellectual bodyguards have themselves manufactured the fascinating problems with which they deal. In the absence of pegging, worries about balance-of-payments crises and policies, about the financing of payments deficits, about types and amounts of international liquidity, and about institutions and negotiations dealing with such matters -- all would substantially vanish. With them would vanish much of the excitement, prestige, influence, and position that central bankers and other practitioners now enjoy. So would much scope and much readily available material for lectures and journal articles. This consideration must be especially relevant to economists with one foot in the academic world and the other foot in the world of practice. In both worlds, then, the currently prevailing incentive structure favors maintenance of the par-value system.

Though Deputy Director of the Research Department of the International Monetary Fund, Fleming demonstrates intellectual independence in his assessment of flexible exchange rates. As he says in his introduction to his book, most of the essays in Part Three "provide evidence of [his] belief in the desirability of maintaining and increasing the flexibility of exchange rates if the advantages of full employment and price stability (so far as these are mutually compatible) are to be combined with those that derive from freedom of international transactions". His essay on widened bands of fluctuation mentions historical experience in support of his judgment
that, given domestic monetary stability, fluctuations in free exchange rates might “take place within limits little, if at all, wider than those resulting from the margins envisaged here”. Since Fleming judges that widened bands would facilitate adjustments in parities by making them less traumatic than otherwise, the reader might well expect him to agree that free-rate fluctuations would not be significantly wider, whether over the short run or the long run, than fluctuations under a widened band combined with small and potentially frequent parity adjustments. As for the supposed trade-deterring effects of exchange-rate flexibility, Fleming develops some reassuring considerations.

The essays happily gathered in the book under review display high competence in economic theory combined with concern for real issues and familiarity with relevant institutions. Years of experience with the British government and with international organizations have helped equip Fleming to make enduring contributions to both academic and applied economics. His work amply deserves the broadened audience that this sampling will win for it.

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