

Economics from the Ground Up

Economic benefits and costs of multinational corporations

Some of the benefits of multinationals include those listed below.

- Multinational corporations investing in an area may result in a significant injection into the local economy. This may provide **employment** directly to local people in the MNC's operations, or create demand for support services from local companies who supply to the MNC, thus increasing demand for labour. Either way, MNCs may reduce local unemployment, and, in the case of developing countries, raise living standards. As was discussed in Chapter 9, there will be a multiplier effect across the economy as newly employed workers spend their income on consumption.
- Specifically a benefit for developing countries is the fact that multinational corporations tend to **provide better pay** than their domestic counterparts, especially those operating in developing and emerging economies. A report by the OECD in 2008, "Do Multinationals Promote Better Pay and Working Conditions?", found that MNCs in general pay 40% higher than local firms, and the differential is higher in low-income countries in Asia and Latin America. The report speculated that this higher pay may be an attempt to minimise worker turnover and reduce the cost of monitoring workers. No matter what the motivation of the MNCs, the fact that they are paying higher wages means they contribute to increased incomes and material living standards in those countries.
- Because of the lower production costs due to efficiency gains of large scale production, the products of MNCs can sometimes be **less expensive** than locally produced products. Although some say this can lead to local producers being "crowded out" of the market, others point out that the lower prices flow on to both local consumers and business that use MNC products as inputs, improving material living standards through access to cheaper goods and services.
- Regardless of whether it takes place in a developing country, or a richer, developed economy, when MNCs undertake foreign takeover of local firms this does lead to higher wages across the board, according to the OECD 2008 report on pay and working conditions in MNCs.
- Multinational corporations can bring **business investment** into many countries. Increasing GDP and incomes depends upon the investment in **capital equipment** that can increase the productivity of other resources – namely labour and land (natural) resources. This is important in all countries, but especially so in developing countries, where a lack of capital investment and insufficient use of technology has been an ongoing cause of underdevelopment. In fact, some economists argue that for the poorer countries of the world, local savings and investment will never be enough to raise the standard of living substantially, and it is only through high levels of foreign investment, namely through MNCs, that these countries will be able to raise output, productivity and incomes.
- Many MNCs also introduce **new technology** or bring with them new **knowledge** of production processes and specialisation. Increased technological skills can be particularly important in the context of developing countries, where they may provide training and

education for employees, creating a more highly skilled labour force. It has been argued that **managerial and entrepreneurial skills** learned from MNCs can contribute to the development of an improved business culture in some developing countries. In fact, the OECD 2008 report on MNCs found that local firms that recruited managers who had experience working with multinationals tended to then go on to enjoy higher productivity. MNCs are also, on average, larger and have higher rates of productivity than local firms in developing countries.

- MNCs pay tax on their profits, and these become revenues collected by local governments. These revenues can then be used to provide essential services in countries, including in developing countries where these kinds of revenues can be scarce. For example, in Australia an Australian registered company is considered an Australian tax resident and is subject to corporate tax of 30% on profits. Another option for foreign investment in Australia is to be a branch of a registered foreign company, where the foreign company carries on business directly in Australia, and if it has a permanent establishment here in Australia, the government will tax the profits made in Australia, again at the corporate tax rate. So, clearly, if a company is operating in Australia it is required to pay tax on profits generated by its Australian operations to the Australian government. (This is not without its limitations, though, as in the case of the manipulation of transfer pricing discussed in more detail below.)
- MNCs have allowed some countries to **take advantage of their comparative advantages in production**. As has already been discussed, by focusing on labour-intensive, low-skilled manufacturing, China has transformed itself, over a period of around 30 years, into a global economic powerhouse. The role of MNCs in utilising this pool of available labour and then exporting the products of their labour to a global market has been enormous.

Some of the costs of multinationals include those listed below.

- One negative effect of MNCs is that the **after-tax profit** that they generate are often be **repatriated** (returned) to the country of origin of the company. This can add to **balance of payments instability** in some countries, as it is an outflow of income on the current account. In Australia, one of the main causes of our continual current account deficit is the annual migration offshore of profits of overseas-owned MNCs.
- Some observers claim that **the disproportionate power of MNCs** in the global market place means they can hold countries to ransom and that they are in a strong bargaining position relative to local workers, particularly in poorer countries. As was shown in the introduction to this section, many MNCs are very large, and in fact worth more than the economies of some of the countries in which they operate. It has been argued that because of this they can exert significant influence on governments to gain tax concessions or other advantages. A case study of a firm that has been accused of just this type of behaviour, Fiji Water, is included in Application exercise 12s below. Even in a country as large as Australia, the power of large corporations has been felt politically, as was discussed in section 12.8 above regarding the implementation of the Mineral Resources Rent Tax.
- Multinational corporations may employ mainly managers from their country of origin, which means that some of the income generated in the country where they are operating remains with a **relatively small group of workers**. If this is the case, it may in fact limit development opportunities for local employees, and entrench their role as low-cost, low-skilled labour, and widen the gap in income distribution in poorer countries.

- Because MNCs are always **chasing the cheapest possible labour**, as the benefits of MNC investment bear fruit and incomes rise in the countries where they have established their production facilities, so does the price of labour for the MNCs. Many of the favourite locations of the early period of MNC expansion, including China and Mexico, are already finding that they are falling from favour as activities **move to new locations where the labour is cheaper**. For example, China is slowly losing its low-cost labour advantage to other countries such as Vietnam and Bangladesh. This can mean that countries suffer higher unemployment and falling living standards as MNCs withdraw their investment, unless the country has also developed its own economy sufficiently to pick up the slack in terms of excess resources available.
- Some critics accuse MNCs of using **inappropriate technology** in developing countries, since some of them use more capital intensive production methods. Since developing countries are usually endowed with large low-cost, low-skilled labour forces, this may leave large numbers of the population still **unemployed**.
- While MNCs pay better than their domestic counterparts, an OECD study in 2008 confirmed that MNCs **don't necessarily offer better non-wage working conditions** in poorer countries. The OECD noted that those who argue that the improvement in wages offered by MNCs has a positive flow-on effect to local suppliers of those companies in poorer countries, the actual effect is very small. It is, however, important to acknowledge that those wages are very low by comparison to developed countries, and this has often been a source of great concern for many critics of multinational corporations. In fact, in some countries, despite the incredibly long working day, workers can receive pay so low that it barely provides for their basic needs.
- There have also been a number of cases of incidents in factories in poor countries where workers have ended up dying as a result of **shonky work practices**, or where they've not been able to escape from a dormitory or factory when a fire has broken out. In September 2012, almost 300 workers died in a factory fire in the Pakistani city of Karachi. They were trapped inside the factory when the fire broke out because the building had no fire exits and metal grilles on the windows.
- Some argue that MNCs encourage developing countries in particular to **overspecialise**, and hence develop an excess dependence on certain sectors of the economy. For example, China's incredible growth has been built largely on an extraordinary capacity to export, but this also makes China very vulnerable to external shocks, such as a downturn in the global economy and its major export markets of the United States and Europe. This became evident in the wake of the GFC and the global downturn that followed, when China's growth slowed.
- Australia's tax system relies heavily on taxing incomes, and this comes mainly from individuals and companies. The capital available to MNCs can be highly mobile, and they can **take advantage of lower tax regimes** in certain countries, and relocate their production facilities to those places. If this occurs, then some countries MNCs shift production between countries so as to benefit from lower tax arrangements in certain countries. This helps them **minimise how much tax they pay**, and at the same time reduces the amount of tax received by governments of countries where their operations are based.

- MNCs can also engage in manipulating **transfer pricing**. Transfer pricing occurs when two related companies - for example a parent company and a subsidiary, or two subsidiaries controlled by the same parent company – trade with each other, usually across international borders. A very large proportion of international trade (some estimate up to 60%) happens *within* rather than *between* multinationals. The companies need to set a price for the product. If a company operates across a number of different locations, it may have different elements of the production of its product, or more likely products, located in different countries. For example, it may extract the mineral commodity iron ore in one country, and then transport it to a different country to have value added by transforming it into, for example, steel. It may then transport that steel to a third company in another country where it is again transformed into, for example, consumer durables like refrigerators or microwave ovens. At each stage of the production, the subsidiaries of the MNC will sell their product to the “customer”, which is, in fact, another subsidiary of the same company. If this sale was taking place between two completely unrelated companies, we would expect that the price charged for the product would be set at the market price. However, since these two subsidiaries of the company are trading, effectively, within the one company, prices can be manipulated so that higher profits are earned in locations where lower tax rates are applicable. This might help it, for example, to **make as much of its profit as possible in a country that collects little or no tax**. Critics of MNCs claim manipulation of transfer pricing results in billions of dollars of lost tax revenue annually.