CHAPTER - I

THE POLITICAL ECONOMY OF TNCs IN LESS DEVELOPED COUNTRIES AND TRANSFER PRICING.

Transnational Corporations (TNCS) represent transnationalisation of production and distribution, though primarily of production. Transnationalisation of production however, does not mean the transnationalisation of ownership and control, which continues to retain its national character. A firm breaking out of its national frontiers and setting up production units in other countries does not lose its national identity, particularly with respect to ownership and control (Hymer, S. 1960). The parent company continues to have a national identity, even though the firm may be having production units in several countries, because the ownership in the parent company, continues to be in the hands of individuals (class) belonging to a particular nation. The practise of diffusing ownership in the subsidiary company, located in a country other than that of the parent is only a means of ensuring control by the parent company and thus by its owners who belong to a particular nation. Therefore, while TNCS represent transnationalisation of production, they do not represent at the same time, transnationalisation of ownership and control, which
continues to remain distinctly national in character.

The fact that the process of transnationalisation is not complete but only partial, in as much as it extends to production but not to ownership and control, has the consequence of the interests of the TNC and the nation state to be in conflict, not of the TNC and the nation state of the parent but of the TNC and the nation state in which the subsidiary is located. This is not to suggest that there is no conflict whatsoever between the TNC and the parent nation state, but that it is of a minor order. Had the subsidiary also been located in the same nation state as the parent, there would have been no conflict of interests between the firm and the nation state, but then there would have been no transnationalisation of production either. Transnationalisation of production must out of necessity, lead to a conflict between the TNC and the nation state, in particular between the TNC and the nation state in whose territory, the subsidiary production unit is located. The basis of the conflict between the TNC and the host nation state lies in the objective of the two entities not being coterminous.

Why did the transnationalisation of production, which is the essence of present day TNCs, occur? Why did in other words firms go across their national frontiers, to locate

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1 There are however exceptions to this. Unilever and Royal Dutch Shell, are the two exceptions to this rule, with ownership and control being shared by nationals of two countries, namely U.K. and Holland (see Monthly Review, October and November, 1969).
production units in other countries, a process which we have termed as the transnationalisation of production?

Competitive capitalism, gave way to monopoly capitalism, where a few firms control the national market. Unlike the firm producing in a competitive market, which by itself is not in a position to influence the market price, the monopolistic firm controls a relatively large share of the market and is in a position to influence the market price through variations in its output. In other words, the monopolistic firm must take into account the effect of a variation in its output on the market price. Having reached the monopoly stage, further growth within the national frontiers can be realized only by depressing the price and there may be limits to growth being realized through this manner (See Monthly Review, October and November 1969 and Bukharin, 1975). Price competition is also ruled out because of the possibility of retaliation by other firms. The firm must sooner or later, having reached the monopoly stage, break out of its national frontiers by producing for the world market. Transnationalisation of production is the logical outcome of the limits imposed by national boundaries on the growth of a monopolistic form. In other words, transnationalisation of production is an integral feature of World Capitalism, in its monopoly stage. Transnationalisation of production, also means producing abroad. In the post colonial situation most less Developed countries (LDCs) pursued a policy of import substituting industrialisation.
This led to tariff jumping and production abroad by TNCs in LDCs. In the colonial context, most of the foreign companies were tied to the metropolis. The post colonial situation saw the entry of new countries. In India for instance, the dominance of British capital gave way to that of American capital. Foreign investment is also of a preemptive nature, where firms from a particular country invest out of fear that if they didn't others would (Reddaway, 1967 and 1968). The motive forces of world capitalism, including the conquest policies of capitalist nation states, were ably analysed by Bukharin (1975), and even though the conquest policies in its overt form may not hold any more, the fundamental underlying features continue to be the same. These features are:

One, increased competition in the market for raw materials, which becomes particularly relevant for the LDCs since they are the source for the raw materials for TNC production; Two, increased competition in the sales market; and Three, increased competition in the spheres for capital investment.

There is a surplus of capital in the advanced countries which cannot be absorbed within the national frontiers and hence, it must be exported and translated into production across national frontiers - the transnationalisation of production. Surplus capital finds its way to profitable avenues of absorption. For this they go international. The three features mentioned above are just another expression of the conflict between the growth of productive forces and
limits imposed by national frontiers on production organisation (Bukharin, 1975).

As has already been noted, the nation state and the TNC, not the nation state of the parent TNC and the TNC but the nation state of the subsidiary TNC and the TNC, are fundamentally in conflict with each other. This conflict of interests between the TNC and the nation state of the subsidiary TNC arises over a number of areas, the most important of which is profits or surplus transfers. Conflict arises over surplus transfers between the TNC and the host countries, because any transfer of surplus implies that the host country is denied these surpluses, which could have been used for capital formation. Since the only goal of the TNC is to ultimately make profits, all the activities of TNCs ultimately converge on this. The goal of TNCs is to make profits and therefore to have maximum freedom to search for profits. The TNCs aim for freedom for deployment of surpluses. All the points of conflict between the TNC and the host country are in the final analysis over profits or surplus. Technology or more specifically the transfer of technology is a point of conflict between the TNC and the host country. As shall be discussed later, the roots of the monopoly in production also lie in the technological monopoly which the TNC possesses. It is only natural for

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2 In China, in recent times, tax concessions have been given to those TNCS which retain a larger proportion of profits for local investment (FEER, 1986).
the host countries, in particular those which are less developed, to aspire for the acquisition of the technology used by TNCs in their own territories. TNCs resist any genuine transfer of technology, because they fear that their monopoly would be broken. Similarly, a point of conflict between the TNC and the host country is the restrictive clauses, such as those on export, that a TNC may impose on the unit with which it is collaborating in the host country. A restriction on exports, means lower earnings for the collaborating unit in the host country and lower foreign exchange earnings, for the host country. To the TNC, the restrictions on export is a means for ensuring its control over the world market.

Surplus transfers is the most important point of conflict between the TNC and the less developed countries. Further, transfer pricing, is the most important or the dominant form of surplus transfers by TNCs, in less developed countries, which is the thesis and the subject matter of the present study.

The goal of capitalist production is profits and accumulation of capital, that is translation of profits into capital in production. When national frontiers act as a limit on this process of accumulation of capital,

3 For other areas of conflict, see Monthly Review, November, 1969, pp. 8-9.
transnationalisation of production occurs. This transna-
tionalisation of production does not mean that capital loses its national identity, in particular, the parent firm, in which ownership and control of the TNC rests, does not lose its national identity. Profits made in the LDCs are remitted principally to the parent company, though in part, it may find its way either directly or indirectly through the parent company, into countries other than the home country of the TNC as investment. Transfer pricing is one of the forms, the most dominant form of remitting the surpluses, realized in LDCs.

We shall see later, why the TNC adopts this course, of remitting surpluses by transfer pricing, but it would suffice at this stage to note, that this is mainly on account of tax considerations, as transfer pricing is the cheapest means for remitting the surpluses.

Surplus transfers by the TNCs from LDCs, has the following consequences for the LDCs:
One, any transfer of surplus from the LDC, means a loss of that surplus to the LDC. If these surplus transfers had not taken place then, the LDC could have used these surpluses either for (social) consumption or investment.
Two, remitting the surplus by transfer pricing, in particular by overinvoicing of imports, has a foreign exchange cost or drain, for the LDC. Surpluses, remitted through conventional channels, such as dividends, would also have this cost, in as much as, all remittances normally
occur in foreign exchange; and Three, surplus transfers by transfer pricing means a loss in tax revenue to the governments in LDCs, since one of the important reasons why TNCs resort to this is that had they remitted the surpluses, through a conventional channel such as dividends, it would have meant a greater tax burden for the TNC.

The thesis consists of three parts. The first part which is introductory runs up to chapter three. The second part beginning with chapter four, ends with chapter five, and deals with the theory and application of transfer pricing. The last part deals with policy.
CHAPTER - II

RETAINED VALUE, OUTFLOW PAYMENTS AND SURPLUS TRANSFERS

2.1 Retained value and outflow payments.

Some recent studies have focussed attention on the transfer of surpluses by TNCs, in the industries of LDCs, with a view to minimising this transfer. Notable among them are the studies carried out by ESCAP (1978 a, 1979 a, 1979 b, 1979 c, 1979 d, 1979 e, 1979 f, and 1979 g) and Vaitsos, (1974).

TNCs could be defined as enterprises controlling assets in two or more countries (U.N. 1973). Such a definition would permit the estimation of the surplus transfers by not only the giant international corporations but the smaller foreign companies as well.

The concern in the ESCAP studies has been with estimating the distribution of gains between TNCs and host countries, in the various export commodity sectors. Towards this end in view, the notion of retained value has been introduced, which is an aggregation of local disbursements and is computed as a proportion of f.o.b. export revenues.

1 For the estimation procedure see ESCAP, 1978 a, p.24. Only one of the case studies has made detailed estimates of retained value and outflow payments (See ESCAP, 1979 a, pp. 55-60).