CHAPTER V
ECONOMIC EFFECTS

International Arena

(i) Effect on International Monetary System

The economic effects of the activities of the TNCs are far more important and far-reaching for not only the countries where they operate, be they home or host countries, but for the international community as a whole. Taking the vast international arena as their field of operation, the gigantic monetary operations of the TNCs, moving their funds from one country to another dictated by their own global strategies, act as an unsettling effect on the international monetary system itself. The very possession of vast amounts of liquid assets by the TNCs running to several hundred billion dollars is itself a source of potential danger.\(^1\)

A lion's share of short-term liquid assets, estimated at 268 billion dollars at the end of 1961, was under the control of private persons in a private market.

virtually uncontrolled by any sort of official jurisdiction. The bulk of this amount, more than twice the total of all international reserves held in all central banks and international monetary institutions in the world, was held by the MNCs. Only a small amount of these assets need be moved in order to develop a genuine financial crisis. In fact the monetary crisis resulting in the two devaluations of the US dollar in 1971 and 1973 was attributed partly to large-scale speculation of MNCs firms. 2

In a staff report submitted to a Senate Sub-Committee on Foreign Relations on 29 January 1975 it was estimated that a sharp increase of $1.1 billion, or 20% in accounts receivable through their subsidiaries abroad, was reported by the sample US parent companies for the close of March 1973. This shift might have helped set the stage for the third devaluation which peaked at the end of 1973. 3 Between January and March 1970, there was a massive inflow of £22 million into UK, of which a very substantial part related to inter-company accounts in the form of import credit from foreign parent companies. A movement of £6 million


3 US Congress 94, Session 1, Staff Report.

in Transnational Corporations funds from New York to Frankfurt or Zurich in early 1973 helped to spread inflation across the Atlantic, forcing Europe to pay for the last remaining costs of the war against Vietnam. As a result unemployment began to increase, welfare public expenditures were cut, and tariff protection rates raised.5

An executive of an international oil company did not exaggerate when he remarked that "when I write a cheque it is the bank that bounces".6

The massive movements of funds are undertaken not only for settling current account transactions between affiliates but also to hedge against possible devaluation of currencies and making gains on anticipated devaluation of currencies. The affiliates in under-valued currency areas may be asked to speed up collections and reduce liabilities. If a devaluation is anticipated, the affiliate may be asked to increase the borrowing locally and make advance payments to the parent company. These activities, familiarly known as 'Leads and Lags', are employed frequently. In the very act of such protective monetary devices, the TNCs bring about economic stability in the countries where leads and lags operations are employed. This has a great


6 Seminar, October 1974, p. 16.
system knitting together world-wide corporate activities of a single group, the base on which the theories of international trade and even international trade law were built, have been eroded for two major reasons:

(a) With the flexibility and facility to locate production plants in any part of the world, and producing a commodity within the jurisdiction of a country which formerly was importing the same commodity from the same corporation in another country, exports from the latter may be affected. The conventional trade barriers are thus overcome by capital and investment flows, minimising the need for trade flows.

(b) With a significant increase in intra-company transfers in intra-corporation trade, the transfer-price mechanism has been introduced under which prices are not dictated by market forces but by a central decision of the corporate board at the headquarters of the home country rendering the traditional theories ineffective and irrelevant. As has been pointed out earlier, nearly 25% of the total world trade today is accounted for by intra-company transfers. In this context the international trade is yielding place to international investment, so much so that scholars like Kindleberger have made serious suggestions for the need to have a GATT for direct investments.
**Effect on Technology Transfer**

The next area of economic effect of the activities of TNCs on the international community as a whole is that relating to technology transfer. Technology includes technical knowledge and technical know-how processes, machinery, tools and other equipment, products and their accompanying software. Technology in today's world symbolize power, prestige, prosperity and propellant for progress. This power is now concentrated in the hands of a few Transnational Enterprises. In 1964, in the USA, 28 TNCs alone, out of 2,000 firms which reported, accounted for 63% of the total expenditure on research and development activities. In France, 16 out of 440 firms spent 43% of the total research expenditure. These R & D activities are again concentrated in only one country, often the home country of the parent company. Thus nearly 94% of the total expenditure by the US corporations is spent only in the USA. Apart from owning the technology processes,

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9 n. 7, p. 49.
developed and protected by patents, the TNCs are possibly the only effective vehicles for transfer of this technology through the network of their affiliates and through collaboration agreements with non-affiliates. Thus, the TNCs have the power to decide what, when, and how to transfer technology and also dictate the price since, unlike commodities, technology, being a specialized process and skill developed for a particular product, commands a monopoly price. It is this power which is worrying the international community. Industrialized nations are worried that these TNCs may export technology too freely. The developing nations feel that third-rate technology is dumped on them for an extortionate price. Secondly, the organizational tie between the parties to the technology transfer (foreign parent and local subsidiary or foreign company and local collaborator) is causing apprehension to both the home and host nations because this tie enables the TNCs to defy the control of both the Governments. Again, in the choice of location for passing on the technology, the TNC may be guided by its aim of maximizing profits, and the national interest may be bypassed. It is this impact, coupled with the fact that

international trade in technology has almost quadrupled over
the decade 1965 to 1975 (in 1965 it was £ 2700 million and
in 1975 £ 11,000 millions), that has prompted thinkers,
economists, national and international agencies to work out
solutions for harnessing the benefits of technology and
regulating the activities of MNCs in this field. 11 A
separate code of conduct at the international level is now
being thought of as one of the major solutions to the
problems.

Economic Effects - Home Country

Turning to the economic effects on the home
countries, the problem has largely been viewed in terms of
export of jobs, increase in unemployment, lowering the
bargaining power of domestic labour by opening subsidiaries
abroad, creating deficits in the balance of payments in

11 See (a) Taji Sagati-nejad and Rudolph Belfield,
"Transnational Corporations : Technology Transfer
and Development : A Bibliography", Worldwide Institution

(b) Decision 24 of the Andean Code and UNCTAD
Resolution of 1972 (Santiago) and 1976 (Nairobi);
and UN Doc. TD/AC.1/9 of 8 August 1977, Report of
the Intergovernmental Group of Experts on the
International Code of Conduct on Transfer of Technology
on its Third Session;

(c) also "Transfer of Technology under UNCTAD and
all draft Codifications", The Journal of International
Law and Economics, vol. 12, no. 1; and "International
Licensing : Opportunities and Challenges in World-
wide Technology Management", Business International
the home country by capital outflows and reduction in the rate of exports, and export of technology abroad built up with local tax-payers' funds. All these charges have been levied and arguments about the adverse effects advanced on behalf of the 'mother country' of the TNCs, namely, the United States of America. 12 But the Tariff Commission of 1973, set up by the US Government, came to the conclusion that there was nothing to substantiate the charge of export of jobs, which varied from industry to industry, and showed that the overall net effect was positive. Insofar as the balance of payments were concerned, it was found that the operations of the TNCs had an unsettling effect on the US dollar leading to three devaluations. Further, since the technology transfer was a third-rate technology not much loss was caused to the home Government on this account. 13 Research on this subject is still being carried on by several agencies and with the rapid diversification in the modes of operation and structural changes taking place, it will take some time to assess the true effects on the economy of the home countries. However, considering that the developed

12 UN Doc. n. 7, pp. 53-59; and UN Doc. ST/ESA/15, pp. 43-52, "Summary of Hearings Before the Group of Eminent Persons...", wherein Nathaniel Goldfinger, Director, AFLCIO expressed similar views while giving evidence before the Group.

countries, the homes of the TNCs, have benefitted on the whole by increasing their share of the world trade, and that the developing host countries (except oil-producing countries) have increased their indebtedness on private account to the developed countries, the home countries have not much to complain except where State Government priorities and the TNCs' objectives come to a clash. As stated in the UN Document on MNCs:

...taking into account all the considerations, the governments and social groups of the home country, especially the U.S., are increasingly concerned with the implications of the activities of the multinational corporations...the key issue is not whether home country should hamstring or do away with multinational corporations but how their behaviour may be influenced so as to correspond more closely to a set of enlightened national and international objectives. (14)

Economic Effects - Host Countries

Insofar as economic effects on the host nations are concerned, they may be classified into two categories, namely, (1) the contribution of the TNCs to their economic development; and (2) the costs to attain the above objective. Theoretically, the contributions that are expected of a TNC may be stated as follows:

14 UN Doc. n. 7, p. 59.
(a) Filling the resources gap between a targeted investment and locally available capital;
(b) Filling in the foreign exchange and trade gaps;
(c) Making up the revenues by contributing in taxes;
(d) Filling in the management and technological gap by transferring adequate technology and skills in production, marketing, development of proper technology, research and development activities and other related expertise including entrepreneurship.

Other contributions suggested by those who advocate the entry of transnational corporations into developing countries, are that the TNCs contribute to creating jobs and thereby raise the level of employment; and bring about a more efficient market structure within the economy as a whole reducing local monopoly profits and improving the climate of efficiency. Further, by improving the country's terms of trade, the country's dependence on foreign goods is reduced. Grant Reuber summed up these advantages by saying that foreign direct investment through TNCs leads to:

(a) a net addition to investable resources in the host country and correspondingly raise the rate of growth; and

(b) bringing in benefits of new technology, better management, superior marketing techniques and better export earnings with beneficial effects in foreign exchange position. (16)

The representatives of some of the transnational corporations who appeared before the Eminent Group of Persons also reiterated these benefits. 17

It has, however, not been possible so far for anyone to quantify precisely how far these contributions have been achieved or even the direction in which they have been made. 18 On the other hand, even theoretically it could be argued that TNCs, by providing capital, may reduce domestic savings if, for example, saving is limited by investment opportunities and these themselves are limited, or if


17 See UN Doc. ST/ESA/15, "Summary of Hearings Before the Group of Eminent Persons...";

(a) Evidence of Emilio Collado, Executive Vice President, Exxon Co., pp. 34-44;

(b) Evidence of Gilber Jones, Chairman of IBM World Trade Corporation and Jacques Maison rouge President, IBM World Trade Corporation, pp. 65-73; and

(c) Thomas Murphy, Vice-Chairman of General Motors, pp. 79-84.

18 Streeton and Lall, n. 15.
foreign investment leads to lower wages. Instead of filling the exchange gap the investment may impose a primary and secondary foreign exchange burden through capital servicing costs and drawing back from the investment incomes in the form of profits, dividends, royalties and interests. As for taxes, it is a fact that the TNCs bargain for or show tax concessions as conditions for entry into the developing countries. As regards transfer of technology, it has been a consistent complaint that generally the technology they bring is inappropriate, or even injurious, to the country both from the point of view of the cost as well as its needs and requirements. As for the provision of expertise in the form of foreign management techniques in production, marketing and administration, they may all be ill-suited to the countries' environment. The alien companies may economise by displacing the huge force of ill-nourished and uneducated labour. This may yield a private profit to the firm, but may beat a tremendous social cost to the country as a whole. These foreign managers may import a culture alien to the local culture and distort social and cultural values.

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Economic Development vs. Growth

Apart from all this, it is doubtful if TNCs, concentrating on growth of profits, are well-suited to pay attention to the real need of a less developed country, namely, the economic development as distinct from economic growth. Economic development is economic growth plus structural, social and economic change leading to social and economic justice. This may be achieved by reducing the inequalities in the distribution of income and wealth, providing improved medical services and housing, and enhancing training opportunities and greater employment. Economic growth, on the other hand, is principally concerned only with the rise in per-capita income and output. As pointed out by Jan Tinbergen and Walt Rostow, it is economic development alone which can act as an impetus for further growth and not vice versa. 20

Several studies, mostly on a theoretical basis, have been undertaken in regard to the economic effects of the operations of the TNC. 21 These studies are built on


models to prove a particular point of view. A comprehensive report, clearly bringing out the cost-benefit ratio to the developing nations which can form the basis for a clear judgement of the effects, has not yet been brought out, though an attempt towards one was made by the Commission on Transnational Corporations. Two other fairly objective studies, made by P. Streeten (an Oxford scholar), and Bos, Sanders and Secchi, are useful to follow the trends in the economic effects on the developing countries. According to Streeten's analysis, nearly 40 per cent of the 159 firms operating in six countries (viz. in Jamaica, Kenya, India, Iran, Colombia and Malaysia) taken together have negative effects on social income. For India, the effect of foreign investment by transnational corporations on the national income was only 1.3% of sales, whereas for Columbia and Malaysia, the effects were negative averaging 1.5% to 4.5% respectively. For Jamaica, the effect was worked out to 7%, and for Kenya it was 12.7%. But in all these cases the results were better if the foreign affiliate was a majority owned firm. Wherever there is a joint venture, or a minority shareholding, there

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22 See UN Doc. TD/B/C.3/111; The Flow of Financial Resources: Private Foreign Investment, UNCTAD, 23 May 1973; and also H.C. Bos, Martin Sanders and Carla Secchi, Private Foreign Investment in Developing Countries (Boston: D. Reidel, 1974).
undermining effect on the monetary policies of all the affected nations. The instability in exchange values, which in its wake also causes instability in interest rates, would certainly have a great damaging effect on the stability of the international monetary system as a whole.

**Effect on International Trade**

A second international economic effect of the transnational corporations activities relates to international trade itself. There was a time when theories of international trade used to be developed on the basis of market mechanism operating between importing and exporting countries. In transactions arrived at between independent importers and exporters, unconnected with each other, the prices were determined on "arms length" basis uninfluenced by any consideration other than purely commercial. The flow of trade was helped or hindered by State actions by removing or raising tariff and non-tariff barriers. It was in this context that the General Agreement on Tariff and Trade became relevant for the international community and theories of international trade and industrial trade law assumed importance. However, as a result of the growth of the TNC

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is a depression indicating lack on the part of the foreign company.

**Balance of Payments**

As regards the direct balance of payment effects, according to Streeton:

the overall effects are negative for the great majority of sample firms (91% of the total) by counting 8 out of 11 firms in Jamaica, 3 out of 8 in Kenya, 48 out of 53 in India, 14 out of 15 in Malaysia and all 16 in Iran and 56 firms in Columbia had negative balance of payments. (22a)

Analysing the data on the contribution to export earnings, Streetan points out:

Certainly the data do not lead us to conclude that foreign ownership was particularly conducive to exporting, except when the investment had been set up specifically to service an export market - a rare occurrence in spite of the recent publicity given to export oriented figures. (23)

Bos's study also confirms that the argument that TNC operations have helped to increase exports cannot be sustained. The "Survey of Current Business", issued by

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23 UN Doc. n. 22, pp. 8-9.
the United States Government (October 1975), shows that if fees, royalties, profit and dividend remittances are taken into account, the net effect on the balance of payment for the entire period from 1966 to 1974 is negative for both Latin American and other developing areas. For Latin America, during this period, the total capital net inflow was $2,385 million, and the total capital outflow to the United States was $2,845 million. For other developing countries, the total inflow of capital was $526 millions, whereas the total outflow by way of royalties, fees and dividends was $691 million. It must be mentioned, that account has not been taken here of reinvested earnings, which is often included as part of foreign private investment. The reason for exclusion of this is that a reinvested earning in local currency does not have effect on the balance of payment situations expressed in foreign currencies. But, a higher reinvested capital is a potential source for future increase of outflow of income thereof, including capital transfers in case of complete repatriation. This would have a greater negative effect on the balance of payments. The UN Document on MNCs (Table 42 - MNCs in World Development) gives the figure of inflow and outflow of capital in regard

24 UN Doc. n. 7, pp. 192-3.
to the various regions of Africa, Asia and Latin America. The following figures as given therein speak for themselves:

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<td>A. Inflow</td>
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<td>-467.1</td>
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<td>A. Inflow</td>
<td>436.9</td>
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<td>159.0</td>
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<td>1592.4</td>
<td>1744.2</td>
<td>1997.5</td>
<td>2138.5</td>
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<td>C. Balance</td>
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<td>-1321.2</td>
<td>-1559.2</td>
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<td>Western Hemisphere (Total)</td>
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<td>A. Inflow</td>
<td>723.3</td>
<td>780.5</td>
<td>647.5</td>
<td>1011.4</td>
<td>1083.6</td>
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Creation of Jobs

So far as role of the MNCs in the creation of jobs is concerned, in 1975, the US based manufacturing majority-owned firms employed 1.5 million persons in all the developing
countries and provided another 1 million jobs in the Latin American countries. But the question that must be considered is, whether, but for the operation of these corporations there would have been greater or less number of persons employed as a result of the local capital moving into the areas where the foreign capital had entered.

Secondly, as a result of importing components from parent or other affiliates to a considerable extent (it has been estimated that approximately 45% of the inputs are purchased from the parent or another subsidiary, 40% locally and the remaining 10% from other sources), employment opportunities within the country remain truncated to that extent. Thirdly, the techniques of production employed by the foreign company are capital intensive rather than labour intensive (except where production arrangements are made to exploit cheap labour), and this tends to lower employment opportunities. Fourthly, the craze for sophisticated technology is shown by
of India even where there was no need for such equipment leading to abandonment of areas where traditional labour was being utilized. This displacement also added to the number of the unemployed. Furthermore, wherever foreign firms take over local firms on account of their inability to compete with the foreign firms because of financial or technological weaknesses, new techniques are introduced to pull the unit up to the standard of the absorbing foreign company which retrenches several people in the name of rationalization/labour, previously employed. An instance in India of such a nature was purchase of Wazir Sultan by Indian Tobacco Company, a foreign multinational.

Net Addition to Resources

The argument that private foreign investment is a net addition to the investable resources of the country where the foreign corporation operates, has also not conclusively been borne out. For the year 1966 to 1972, only 21% of the total capital outlay of the transnational corporations, operating in all developing countries including Latin America, came as inflow. The balance 79% represented local loans, reserves, and retained earnings. Therefore, there appears to be little force

in the argument that there is a net addition to the investable resources of the developing countries. In the light of the above analysis, it may at least be stated that insofar as developing countries are concerned the beneficial effects claimed for foreign direct investment are open to question.

It has generally been admitted that the technology that is transferred to the host country is not the first line technology. The US Tariff Commission states:

...There are grounds for an inference that, as a matter of strategy, the multinational corporations do not, on balance, export their first line technology either to their own affiliates or to unrelated foreigners. Rather, this first line technology tends to be retained in plants at home to generate new exports and compete effectively with imports in the same class.... (27)

Similarly, the Hathi Committee in India noted:

...in regard to research, barring a few, other multinational corporations have been taking the line that basic innovational research for new drugs involving co-ordination between multi-disciplinary teams of scientific workers requires giant outlays and top grade research scientists. According to them, research be centered in the parent organization

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functioning abroad rather than be dissipated in many countries - foreign firms are not interested in the research on drugs for tropical diseases as a global demand for such drugs, in their view, will not be sufficiently economical.... (28)

More than the price, the restrictive clauses placed upon technology transfer are causing the greatest worry to the nations receiving technology from the transnational corporations. The Commission on Transnational Corporations has given a list of 21 such restrictive practices, namely:

1. Full or partial export restrictions;
2. Compulsory purchase of products, machinery and equipment from either the suppliers or firms indicated by them;
3. Obligation of entering into a remunerated contract of "transfer of technology" in order to obtain the possibility of acquiring products, machinery and equipment abroad;
4. Imposition of contractual secrecy in an abusive manner, tending to transform a technology not patented in the requiring country, into an industrial property right;
5. Collection of 'royalties' on patents which have entered into the public domain or which have not been patented in the demand country;

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6. Compulsory transfer of improvement and invention rights to the grantor of technology when the improvements have been made by the recipient;

7. Imposition of the use of a foreign trade mark for the acquisition or transfer of the technology;

8. The establishment of sales prices, including export prices;

9. Compulsory export through the technology supplier;

10. Total or partial limitation of production during and/or after the effective period of the technology contract;

11. Maintenance of a contractual vehicle, with or without remuneration, even after the expiration of the industrial property privileges;

12. Imposition of participation in the capital of the firm requiring the technology;

13. Limitation to the research policies and activities of the firm requiring the technology;

14. Obligation of purchasing labour from the supplier;

15. Prevention of contesting the industrial property rights alleged or secured by the technology supplier;

16. Restrictions to obtaining technology from other suppliers;

17. Practices that make it compulsory for the firm requiring the technology to accept additional remunerated technology either not desired or not needed by it;
18. Practices by the supplier which apply quality control or production standards as a means to impose upon the acquirer of technology unjustified requirements;

19. Practices requiring higher payments for technology on goods produced for export vis-a-vis goods for the domestic market;

20. Submission to foreign courts of information or judgements in law-suits regarding the interpretation or fulfilment of contracts;

21. Mandatory provisions to be held beyond the life of the contract. 29

Two reviews conducted by the Reserve Bank of India, for the period April 1960 to March 1964 and April 1964 to March 1970, brought to light various types of restrictive clauses in foreign collaboration agreements, like restriction on exports, restriction on special licenses, payment of an amount of royalty irrespective of level of production, purchase of machinery and raw-materials and components from source, return of drawings and maps after expiry of agreement, prohibition of foreign patents after expiry of agreement, foreign collaboration agreements being

subject to the laws of the foreign country etc. 30 The Committee on Public Undertakings has stated that, from the information furnished by about 50 undertakings in India which have had foreign collaborations the restrictive clauses on exports appear in 23 cases, restriction on purchases of machinery in 5 cases, restriction on passing of know-how in 13 cases and about trade mark in 2 cases. 31 Apart from payment for technology, the foreign collaboration agreements also provide for what is known as 'technical fees' under technical assistance agreements. Under this arrangement the transnational corporations engage themselves to provide technical services for executing the project, or for assisting in the manufacture of a product the licenses and drawings of which have already been obtained by payment of a lumpsum consideration under the technology transfer clause, or provide management and other consultancy services. Normally, under a foreign collaboration agreement separate fees are stipulated for technical services, royalty, and lumpsum consideration for purchase of technology and know-how. The different classifications here are adjusted taking into consideration the rates of taxation, and the facility for transfer of

30 India, Fifth Lok Sabha, Report of the 89th Committee on Public Undertakings (New Delhi, April 1976), p. 269.

31 Ibid., Chap. 8.
funds from the host to the home state under the regulations of the former. In fact, technical fees, management and consultancy fees or royalty, are very effective sources for transfer of income.

The foreign collaborations with USSR and other countries of the Soviet bloc provide for payment of technical fees which takes the place of the usually capitalistic concepts of profits, dividends and royalties. Over the years 1968-69, to 1975-76, the total amount of technical fees and royalty to the TNCs of various countries amounted to Rs. 143.6 million. It may be interesting to note that the USSR comes next only to the USA and the UK in the matter of extraction of technical fees. In the case of technical fees, the case study of Sri Lanka prepared by UNCTAD shows that in many cases no specific innovations were introduced to justify such payments.32 A well-known TNC drug firm, based in Switzerland, received technical services fees which had no relation to the actual cost for such services utilized in India since it was expressed as a specific percentage of the sale price.33 In another case, a TNC banking concern paid one of its affiliates, operating in India, a technical assistance fees for an amount almost

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33 See Commissioner of Income-Tax vs. CIBA of India Ltd., AIR 1968 SC 1131.
equal to head office expenses. This was stated to be for technical advice rendered for training programmes operating practices and credit policy administration. Obviously, a question arose whether these could be regarded as technical fees in the true sense of the term. 34

The strain on the country's economic resources is not only in the form of profits and dividends but also indirectly in the form of what is known as head office expenditure, and, more particularly, in the invisible form of transfer of pricing.

**Transfer Pricing**

One of the practices of multinational corporations, which is of particular concern to the countries in which they operate, is the fixing of prices of goods and services traded between the corporation and its affiliates located in different countries. Intra-corporate transfer pricing by a multi-regional company within a country may matter little to a national Government since all the benefits of the transactions are retained domestically. Such practice by multinational corporations, however, observed the Group of Eminent Persons in their Report, affects the

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34 Note: There are today currently in force 5,498 agreements on foreign collaboration covering transnational corporations of all nations including USSR, Poland, Hungary, Yugoslavia, UK, USA, and Federal Democratic Republic of Germany.
distribution of the benefits of their activities between countries and may stifle local competition.\textsuperscript{35} The Group found the problem to be of such a magnitude as to deserve immediate attention because "more than one quarter of the value of international trade in goods appears to be of an intra-group character".\textsuperscript{36}

"Transfer pricing" has been defined by S. Lall as "pricing of transactions, both of commodities and intangibles, such as technological services and brand names between different branches of a multinational corporation.\textsuperscript{37} It may also include transactions between a foreign company and a joint venture corporation with which the foreign company has ties either of share-holding, or managerial control, or tied collaboration agreements. It can, therefore, be termed as a clearing price entered in the books for transactions within a firm - the firm in this context meaning the entire business enterprise considered as a unit.\textsuperscript{38} The above definition refers not only to (a)

\begin{itemize}
\item \textsuperscript{36} Ibid.
\item \textsuperscript{37} Sanjay Lall, "Transfer Pricing and Multinational Corporation", \textit{Monthly Review}, December 1974, p. 36.
\item \textsuperscript{38} UN Doc. ST/ESA/18, \textit{Tax Treaties Between Developed and Developing Countries} (New York, 1975), \textit{Fifth Report}, p. 63.
\end{itemize}
transfer of goods from one part of the firm to another, but also to (b) transfer of patents or rights to use patent processes against payment of royalties, and (c) supply of technical services by one part of the firm to another part compensated by service fees or managerial fees. The advantages accruing by resorting to transfer pricing by a transnational company are:

(a) It is a device to save taxes;
(b) It is a device to get round any ceiling on profit remittances prescribed by the host state;
(c) It enables the corporation to reduce its liabilities in the country whose currency is weakening;
(d) It enables it to beat down the labour union demand for higher wages; and
(e) decrease, in case of joint venture, of the profit due to shareholders of the host country with corresponding increase of profit to home country shareholders.

Correspondingly, the harmful effects of the transfer pricing to the host country are:

(i) loss of legitimate tax revenue;
(ii) loss of higher export earnings;
(iii) loss of profits and tax thereon in regard to income of local shareholders; and where the Government is a shareholder, loss of profit due to it, and
(iv) hastening devaluation of currency in case of continuing adverse balance of payments.

In the report published by UNCTAD, entitled "Major issues in Transfer of Technology to Developing Countries - A Case Study in the Pharmaceutical Industry", the unreliability of the declared profits figures in accounts, owing to existence of transfer pricing, has been well documented. The Report points out that transfer pricing is not to be regarded as one resorted to only to beat down the revenues of a developing country since it is found to exist even as between developed market-economy countries, as has been shown by the pricing policy of Roche in the UK. The firm had always declared a low profit in UK at below 5 per cent on capital employed. Yet the UK Monopolies Commission found that its real profitability, based on careful conservative estimates, was over 70% of capital employed for the period 1966-72, and that declared profits comprised only 12 per cent of the total profits. The prices charged for imports of two of its products were between 4,000 and 4,500 per cent higher than alternative

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world market prices (which already included an allowance for profit). In Colombia, it was found that drugs were similarly overpriced by 5,000-6,000 per cent. In Iran it was found that out of 72 cases of imports of drugs, 38 per cent of the cases had overpricing of intermediate drug chemical of up to 199 per cent. Another 50 per cent of the cases showed 200 to 999 per cent increase, and 6 per cent of even higher magnitude. In one case the imported chemical was overpriced by more than 10,000 per cent. In Egypt, an instance of overpricing of 159 per cent came to light in 1965. Even in Spain there was overpricing ranging up to 880 per cent in 1972. In Argentina, several examples have been found - the highest being of 1500 per cent. The United States Senate hearings have found instances of overpricing in India, Pakistan, Brazil and Turkey.41

Transfer pricing is also resorted to by excessive pricing of plant and equipment as well as raw materials. In a study relating to Sri Lanka, it was stated that raw materials had been tied to specific sources in collaboration agreements and were priced higher than market prices. A glaring example was that of importation of sulphuric acid for one of the firms manufacturing iron and steel proofing materials where the price escalation appeared to be as high

41 UN Doc. n. 39, pp. 28-30.
42 UN Doc. n. 32.
as 300 per cent. Again, in the supply of machinery and plant instances were found in Sri Lanka and India of reconditioned equipments being supplied at a high price. In Sri Lanka the equipment supplied by a Japanese collaborator to two enterprises were found to be reconditioned, and in one case it had to be replaced within a period of three years. 43 Further, in the case of such reconditioned machinery, purchase of spares from the same supply source at dictated prices is an essential element. In India, it has been found that IBM had been supplying only reconditioned data processing machines found obsolete in other countries of their operation. Here the transfer price took the form of a low value for customs by as much as 350 per cent for purposes of avoidance of import duty which was on an ad valorem basis. On the export of the re-assembled machines to its own branches outside India, a depreciated export price was shown, keeping down the export earnings to avoid income tax. 44

Economic Effects – India

In India, the activities of the foreign companies in the economic sphere could be analysed in two parts:

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43 Ibid., p. 53.

44 India, Fifth Lok Sabha, Public Accounts Committee, 221st Report (New Delhi, 1976).
(1) Direct foreign investment through a branch or through a subsidiary either with majority holdings, as in the case of tea plantations, or minority participation of 40% or less in other industries, as coming within the framework of the Industrial Policy Resolution adopted by the Government; and

(2) Foreign collaboration agreements in which the foreign direct investment plays an insignificant part, but there is technical collaboration for licensing or sale of technology, designs and drawings, processes of manufacture or for sale of machinery or plant.

In Chapter III a list has already been given showing how most of the important TNCs of the world are operating in India either through equity participation or through collaboration agreements. The total foreign investment in India has been on the increase, as pointed out in Chapter III. But the trend of late has been to lessen the risks and increase the earnings through foreign collaboration. Nearly 5,500 foreign collaborations have been approved by the Government of India for both public sector undertakings and private business during 1968-1977 covering corporations or state undertakings of more than 20 countries. According

to one estimate, 750 Indian organizations were linked in 1972-73 to foreign companies with total assets estimated at Rs.2,535 crores. It has been repeatedly asserted both by the industrialists in India and also by representatives of foreign companies that, if a proper investment climate is available there could be scope for greater investment of foreign capital which would (a) bring a net addition to investible resources, and (b) bring the package of new technology, better management, superior marketing skills, better export earnings, and beneficial effects on foreign exchange position. The position insofar as India is

46 *Patriot* (New Delhi), 30 May 1977.

47 In a meeting held in February 1978 with the Prime Minister and other important Economic Ministers of India by a group of representatives of 52 Transnational Corporation of the United States, this point was repeatedly emphasized. In a note prepared by the Task Force appointed by the American side of the Indo-US Business Council, India's rating for investment as compared to certain other countries was given as follows:

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1. Likelihood of nationalization, expropriation or forced divesture (1 - least likely)
2. Comparative magnitude of business
concerned, judged by these two tests, is that the trans-
national corporations operating in India have not been able
to achieve anything significant in these directions. There
has been really no evidence of transfer of capital in
significant proportion. The actual direct foreign investment
through multinational corporations in the form of paid up

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<td>3 Technical assistance agreements (1 - most favourable)</td>
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<td>4 Availability of local capital (1 - most favourable)</td>
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<td>5(a) Supply of skilled labour (1 - most favourable)</td>
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<td>(b) Labour Unrest (1 - least unrest)</td>
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<td>6 Repatriation of capital earnings, interest, royalties etc.</td>
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Mexico and South Korea are clearly the most favourable. India requires the most formalities and under FERA, has the potential for restricting remittances. Indonesia is satisfactory, and Brazil is satisfactory except in times of balance of payment problems.

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<td>7 Tax incentives (1 - most favourable)</td>
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capital, loans etc., is estimated to be around Rs. 1,800 crores, (Rs. 18,000 million) which is roughly about 8% of the total investment in the corporate sector, both private and public. This is also, in large part, due to result of local gearing, and retained earnings having been added to the capital. Investments have also been made in sectors which do not generate much employment or accelerate further industrial activity. If a total view is taken of the moneys brought in and moneys taken out, it would be seen that over the period 1964-65 to 1969-70, there was a net outflow of foreign exchange of Rs. 684 crores, which definitely affected the balance-of-payments position then. Imports by subsidiaries alone amounted to Rs. 749 crores against the exports of Rs. 248 crores, resulting in a net outflow of Rs. 501 crores. In the case of total exports and imports, resulting from technical or financial foreign collaborations (including both private and public sector companies), the total exports amounted to Rs. 901 crores, while imports exceeded it by Rs. 1,441 crores to Rs. 2,342 crores. While the imports by multinationals amounted to one-fifth of the total Indian imports, their exports formed only one-eighth of the total Indian exports. Examination of 53 companies by Streeton and Lall had shown that 48 foreign companies operating in India had negative impact on foreign exchange balance. It has been stated in Parliament that in the case of IBM and Coca Cola, there has been net outflow of foreign
exchange, rather than any net foreign exchange benefit to the Indian exchequer. Taking the case of some individual companies, which put out advertisements that their exports had exceeded the basic targets by 400 per cent to 500 per cent, one would note that the basic figures themselves are small fractions of the total sales and, therefore, 400 per cent of those fractions would still remain an insignificant fraction of the potential of export. For example, Metal Box with a total turnover of Rs.54.80 crores, exported only Rs.14,000 worth of goods in 1975. Pfizer reported a sale of Rs.23.02 crores, and exports accounted for only Rs.62 lakhs. Hindustan Lever had exported Rs.5.92 lakhs against a turnover of Rs.227 lakhs. A statement is attached showing the export earnings of some leading foreign companies which would show that the export earnings formed a small portion of the total sales.

Remittance on account of profits, know-how fees, technical fees, have also been considerable. Parliament's Estimates Committee reported that Burmah Shell's remittances alone amounted to Rs.30 crores up to 1966, whereas their capital investment was Rs.14.53

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48 Note: The total exports of Coca Cola Export Corporation to Denmark in the accounting year 1971 relevant for the assessment year 1972-1973 amounted to Rs.32.48 lakhs while realisations amounted to Rs.10.01 lakhs only. Reply to Unstarred Question 2362 (Lok Sabha), on 2 December 1977.

49 See Annexure 3.
Collaboration ventures, accounting for over Rs.2,000 crores worth of output, result in an outflow of more than Rs.90- Rs. 100 crores from our exchange reserves every year in the form of payment for technical know-how, royalties, profits and dividends. Besides, wholly-owned subsidiaries of foreign companies operating in India remitted Rs.211.4 crores between 1968 and 1971 by way of profits, dividends and technical fees - Rs. 105.14 crores by way of dividends, Rs. 38.80 crores as profits, Rs. 51.61 crores as technical fees and Rs. 15.81 crores as royalties. The Finance Ministry recently informed the Lok Sabha that dividend remittances by these companies had increased since 1971 by nearly Rs. 12 crores per annum. There was also a rise in other remittances.51

Disguised remittances were also made on account of what is known as head-office expenses to the extent of Rs.4.21 crores during the years 1966-71 (both years inclusive), whereas the profits remitted by way of dividends was Rs.5.88 crores. A study undertaken by the Revenue Department of the Finance Ministry in India and reproduced as Appendix II to the 176th Report of the Public Account Committee (Fifth

50 India, Fourth Lok Sabha, Estimates Committee: 50th Report (New Delhi, 1968).

51 India, Fifth Lok Sabha, Public Accounts Committee: 176th and 177th Report (New Delhi, 1975).
Lok Sabha), has disclosed that the percentage of deductions claimed by foreign companies operating in India as a charge against income covered a wide spectrum reaching up to 78 per cent in the case of a well-known international electronics data processing company, and 70 per cent in the case of a multinational bank. In fact, when the matter relating to the Head Office expenses was being probed in the case of the multinational electronics data processing company, the company itself came forward with a voluntary disclosure that there was an excess claim on account of such Head Office to the extent of US $ 450,486. Therefore, the multinationals have yet to demonstrate that their activities in India are calculated to help this nation to increase its production in the desired sectors of economy and their contribution to export earnings is significant and real.

Diffusion of technology and training people in modern managerial skills is claimed to be the second advantage of multinational operations. Here again, the operations of multinationals in India have shown that they extract a high price for transfer of technology, which moreover is only a third-line technology. Even that transfer is not the appropriate technology suited to the needs and requirements of this country. Adoption of borrowed technology

52 Public Accounts Committee, n. 44, p. 234.
creates a dependence on the foreign source for maintenance or modifications. The National Committee on Science of Technology in its report of May 1973 observed:

Foreign equity participation is not essential for procurement of technology. Equity participation brings dependence and has the possibility of influencing management policy directly or indirectly. Foreign equity participation should not be permitted unless some exceptional circumstances arise where it is seen that no other source exists for the technology or comparable technology and that the only mode left for acquiring such technology is through foreign collaboration. (53)

Even in such cases, according to the Committee, equity participation should be avoided. As regards technical collaboration, they have argued that it should be permitted in such cases and only on such terms that the management policy is not influenced and technical self-reliance is achieved. The terms of collaboration agreements for technological transfers have been analysed by the Reserve Bank of India which has found that in many cases restrictive clauses have been imposed in regard to use of technology, production processes, and export of commodities. 54


It is argued in some quarters that there really is no dependence after the expiry of the period of agreement, or when the period of patent expires. But it is forgotten that by the time the Indian collaborator acquires ownership of the know-how, foreign technology advances much further, leaving India back in square one. Thus, this introduces a continuous dependence which must be cut at the root, and indigenous attempt should be made to set up a chain of research and development laboratories and a technology bank to store processes and designs suited to the needs and requirements of India, and free the country from foreign technological dependence. As it is, according to a survey made by the National Committee on Science and Technology, R & D expenditure for the whole of India comes to only 0.4 per cent of the GNP, which is one of the lowest of the 21 countries compared. 55 The total expenditure on scientific and technological activities was Rs. 246 crores in 1973-74, and about 92% of this was financed by Central and State Governments and the balance of 8% by the private sector. To be precise, the private sector's share was Rs. 23.51 crores out of Rs.246 crores. 56 Even of this pitiful small percentage, the expenditure on technology by transnationals

55 See V. Gaurishankar, "The Performance of Transnational Corporations in India", India Quarterly (New Delhi), April-June 1977, p. 190.

56 Ibid.
comes to a fraction. Of the 197 subsidiaries of foreign companies operating in India, only 80 units are reported to be having their own research departments. It is further reported that no new technology is developed and that the Indian technicians are not allowed to know the processes and formulae which are held as closely guarded secrets in the foreign Head Office of the Indian subsidiary. In regard to companies in which foreign interests had collaborations, only one-third of 400 such units had research departments. No innovations have been made, but only brand names were introduced with or without modifications. This abuse was noticed in the case of the drugs and chemicals industry and the Hathi Committee had drawn pointed attention to this in its report. For the research carried on in the foreign country, the host country has to pay heavily. This is well illustrated by the fact that payment by the developing countries for patents, licenses, know-how and trade marks etc. amounts to 7% of their combined exports and the total cost for such payments for 13 developing countries, representing 65% of the world population, is estimated at 1.5 million US dollars, which amounts to half of the flow of direct foreign private

57 Ibid.
58 Ibid., p. 191.
59 Hathi Committee Report, n. 23.
investment to developing countries. By 1985 this amount is estimated to amount to US$ 6,000 million.

As regards labour relations, the International Labour Organization (ILO) has been repeatedly pointing out the disparity in strength between transnational corporations, with an integrated financial and managerial control, and the labour unions dispersed over many countries. In a recent paper submitted to the ILO, it has been found that a majority of the millions of the workers, who produce the most widely used products, such as rubber, sugar, tea, cotton or coffee, earn less than one US dollar a day in the developing countries which supply these products to the industrialized countries. It has been stated that the daily wage of a US farm worker is 18 US dollars against just 0.71 US dollar for a worker on Indian tea plantation. Besides paying them low wages, overcharging for company supplied products between 25% and 60% above city prices has also been reported, and their children have remained undernourished, uneducated and potential victims of all kinds of diseases.

It was stated earlier that very little capital is actually brought into the economy by the foreign companies.


61 The Statesman (New Delhi), 8 December 1976.
when they enter the developing countries and a very significant part of the direct foreign investment consists of retained earnings. In India this is most pronounced.

Taking the two years - 1972-1973 and 1973-1974 - the net equity brought in was only about 5.6 crores for the subsidiaries and for the branches, whereas in 1972-73, Rs. 6.4 crores were taken out of the country. For 1973-74, Rs. 17 crores were brought in as against the total of Rs. 16.2 crores. The net investment brought in the retained earnings in India for the above two years amounted to Rs. 70 crores. It has been reported that, whereas the gross inflow was Rs. 227.8 crores (this includes not only equity on loan and other credit facilities given for import and raw materials, machinery etc.), the net in-flow amounted to only Rs. 59 crores for 1973-74. This means that nearly Rs. 170 crores had been taken out of the country.

The foreign companies have been concentrating only on plantations, manufactures and service industry. Even in the manufacturing industry the concentration has been in Chemicals, Drugs and Processing, and manufacture of metals, in which 93 subsidiaries were engaged in 1973-74 with a total turnover of Rs. 1142.04 crores. The next


profitable item for the foreign subsidiaries in India is processing and manufacturing of foodstuffs, textile leather and products thereof - Rs. 486.64 crores (in 1973-74).\textsuperscript{64} Consumer industries and drugs have always had the highest attraction for the transnational corporations because of low outlay and high profits. Investment in consumer items, such as perfumes, cigarettes, food-products, tea etc., came to about Rs.835 crores. The profit percentage was highest in perfumes, i.e. 44.6%, followed by tea which was 15.5%, thread and thread-balls, making 20.7%, medical and pharmaceuticals 21.3%, and cigarettes 12%.\textsuperscript{65} An idea of profitability in these items can be had if one takes up one of the well-known consumer products manufactured by Chessborough Ponds. Chessborough Ponds, with a paid-up capital of Rs. 150,000, earned a gross dividend of Rs. 73.91 lakhs in 1969 (4.927.33%), Rs. 80 lakhs in 1970 (5333.33%), Rs. 70 lakhs in 1971 (4666.66%), and Rs. 122 lakhs in 1972 (8121%).

The country-wise breakup of the data indicates that the UK remained a dominant source of foreign capital even in 1973-74 amounting to 639 crores rupees or 35%; US capital rose from Rs. 16 crores during this period

\textsuperscript{64} Ibid.
\textsuperscript{65} Ibid., Table 14, p. 15.
touching Rs. 530 crores. UK, USA, West Germany and Italy accounted for three-fourths of India's outstanding long-term foreign corporate liability in 1973-1974. 66

**TNCs Dominating Certain Sectors**

**Matches - Wimco**

Within the industries mentioned above, certain companies have had dominating influence so as to command a major portion of production market within the country and strength to beat off all competition, stifle local production, and pre-empt possible competitors. Wimco, a Swedish multinational, is the only corporation producing matches for the whole of India in the power operated sector. It produces 50% or more of the matches produced by all the other companies in India, and its total sales alone exceeds 33.3% of the total combined sales of all match manufacturers. Apart from this, Wimco has also been licensed to produce Potassium Cholorate, an important chemical ingredient for matches, but which is


67 Note: For 1973-74, manufacture of matches by Wimco was 3313,000 gross boxes as against 39,613,000 boxes by all others. For 1974-75 it was 29,541,000 gross boxes as against 46,967,000 gross boxes. For 1975-76, it was 25,268,000 gross boxes for Wimco and 52,772,000 gross boxes for all others. /See India, Sixth Lok Sabha, Public Accounts Committee: 55th Report - 1977-78 (New Delhi), December 1977, pp. 1-53/
also an important ingredient for explosive. Wimco's production accounts for one-third of the total production of Potassium Chlorate in India. The economic domination by Wimco of the match market has been graphically brought out by the PAC in its 55th Report to the Sixth Lok Sabha in 1977-78. Referring to Wimco exploiting the market and restricting production of this vital consumer product, the Committee observes:

While on the one hand Wimco has been exploiting the small scale producers, the Committee found that they have not been producing to the full capacity themselves as would be evident from the following figures:

(total capacity 5,000 million boxes, utilized 1973-74 - 4368 million boxes, 1975 - 3734 million boxes).

The Ministry of Industry have given some reasons for under-utilisation. The Committee, however, do not feel convinced of those explanations. It requires to be explained how despite the claim of Wimco to have stopped utilization of small-scale producers for manufacture of their products, their capacity utilisation instead of showing increase has shown decrease after 1973.

This is also clear from the comparative statement of production of power operated sector vis-a-vis non-power operated sector (Wimco are the only unit in power operator sector). The Committee, therefore, like a thorough probe in the matter.
The Committee are perturbed to note that a foreign monopoly concern like Wimco has been able to promote its interest at the cost of small scale units by purchasing matches manufactured by the latter. The Committee feel that some rectificatory steps should be taken by Government to curb such practices in future. During evidence, the Chairman, C.B.E. & C. had assured the Committee that "probably we will like this matter to be further looked into and I would like to bring it to the notice of our Secretary as well as Minister". The Committee desire this matter to be examined speedily and the outcome reported to the Committee. (68)

Tea

As regards tea, the Sterling Companies are controlling 40% of the tea production in India. Most of the tea exported by them -- which rose from 48% in 1970-71 to 75% in 1975-76 -- was in loose tea, the value of which was far less than the packed tea or other processed tea. Further, the prices reported on exports by these companies were far less than the prices reported for tea from other countries, namely, Kenya, Sri Lanka. The correctness of the export earnings reported by these companies was also doubted by the Public Accounts Committee which came to the conclusion

68 Lok Sabha, Public Accounts Committee Report, ibid., pp. 52-53.

69 Note: They are now in the process of being converted into rupee companies but with substantial British interests not falling below 74 per cent.
that the activities of the foreign companies have not only deprived the country of its legitimate foreign exchange earnings but has also deprived the exchequer of its taxation.

**Diamonds**

The third industry under the domain of transnationals is diamond. India's diamond trade is again in the grip of a transnational corporation which has a number of subsidiaries of all over the world. This company, the Diamond Trading Company, has almost a monopoly of the world trade in diamonds and it owns diamond mines in several countries. Diamond is a sensitive item insofar as foreign exchange earnings are concerned and the helpless state in which India has been placed by the Diamond Trading Company is summed up in the following paragraphs of the Public Accounts Committee's (Sixth Lok Sabha) 54th Report:

From the evidence given by the representative of the Ministry of Commerce as well as the written statements the Committee gather the impression that the Diamond Trading Company has a near monopoly position in regard to the supply of rough diamonds and Government does not have any say on the D.T.C. in nominating the sight holders

or in determining the price.... It was also brought out during the evidence that efforts of the Government to locate alternate sources of supply failed.

The resulting picture seems to be that Government is helpless in regulating the flow of imports or their prices and has to depend on the mercy of the D.T.C. In the circumstances, it is not clear to the Committee why the D.T.C. sends a delegation to India half-yearly for discussion with Government and why the Central Selling Organization (an affiliate of the D.T.C. maintains a retired Major General in India presumably for purposes of liaison with the Government. Obviously, the D.T.C. looks for some favours from Government. It may be that D.T.C. is anxious to avail of the skills and facilities available cheaply in India for cutting and polishing small sized diamonds as such facilities are reported to be not available elsewhere.... In other words, the D.T.C. would like to exploit for their own ends the professional expertise available in India, in respect of these small sized diamonds. If so, Government does not seem to be as helpless as is made out.

The Committee note that Government have the power to grant licences and make available bank credits through the regulation of the export policy. The Committee would like to be assured that the exercise of these powers has not had the effect of benefiting the Company in expanding its market in this country and increasing our dependence on it. (71)

Tobacco

In the case of manufactured tobacco, the Indian

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Tobacco Co. (an affiliate of the British American Tobacco Co. and one of the 50 companies figuring in Fortune list) is controlling more than 60% of the country's total cigarette production. This Company has also put its affiliate, the Indian Leaf Tobacco Development Co. Ltd., to corner the raw material purchases of tobacco within India. As it happened in the case of tea, more of manufactured tobacco was exported to the British parent at a lower price than the manufactured tobacco, thereby decreasing our export earnings. Out of 367,885 tons of tobacco produced during 1970-75 in India, only 15,392 tons were processed and manufactured in India. Bulk of the rest of the 252,493 tons of unmanufactured tobacco was exported. The unit value realized for Indian manufactured tobacco was only 40 pence per lb. in 1974 as compared to 55-69 pence fetched from Zambia, Malawi, Canada and USA. The Indian Tobacco Co. has been found to have been indulging in restrictive trade practices, like price cutting, thereby harming rival Indian manufacturing units. Manipulation of price could be seen when the unit value of imported tobacco in India had increased from Rs. 1.44 per kg. in 1970-71 to 21.27 per kg. in 1974-75, whereas the unit value of tobacco exported rose only from Rs. 6.61 per kg. to Rs. 10.72 per kg. The Parliamentary Committee on Public
Accounts was constrained to observe that the foreign sector in Indian tobacco industry, which controlled 78% of the country’s total cigarette production, indulged in restrictive trade practices like price cutting of its brands of cigarettes, thereby unfairly harming the rival Indian manufacturing companies.  

The case of the fourth company, namely, IBM, which ruled the field of electronics unchallenged all these years will be dealt with separately, as its operations revealed more distinctly than the operations of any other company.

These instances would show that it is a fallacy to compare the total investment in foreign companies in a country with the total investment in the industrial and commerce sector by local capital and feel complacent that the percentage being small no harm would come to the economy. It is the sector where the foreign capital is concentrated and is in a dominant position that is of significance.

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THE IBM AND INDIA

The reason for singling out IBM for a separate case study, particularly with reference to its entry, operations in and exit from India, is that it is a typical example of the technological and oligopolistic domination exercised by a transnational corporation. Its operations are spread over nearly to 129 countries and its bargaining power is more than most of the Governments where it operates. Its market power and rate of earning is possibly the highest, next only to the oil majors. Out of the 500 leading largest industrial giants of the world, the IBM has taken the eleventh rank.

With a turnover of $16.30 billions in 1976, which was almost double than its turnover of $82 billion dollars in 1971,74 the growth rate of IBM is so phenomenal that one can well agree with William Rodgers that, "In all the world, one corporation dominates the shape of the future with an annual budget greater than of many nations and a share value worth far more than all the gold ever hoarded in the Fort Knox."75 The IBM's world sale of 16.30 billion

dollars is higher than the GNP of Thailand, Algeria, Colombia, Israel, New Zealand, Peru, Pakistan, Chile, Malaysia, Egypt, and more than dozen other countries. In reaching this growth it adopted all the familiar practices that had come to be associated with transnational corporation activities, namely, high pressure salesmanship, charging unconscionable monopoly profits for sales and service of its electronic data processing systems, squeezing out competitors both in the home country and in the host countries, and building up a most sophisticated technological secret process and know-how in the electronic industry which has made nations where it operate completely dependent upon it. In almost every walk of life where speed, accuracy, width and range of communication is of high priority, the electronic data processing system is an essential indispensable equipment and in this field IBM rules supreme. "Since the industrial revolution, perhaps no single technological innovation has influenced and even transformed the way of life and attitudes of mankind to the extent computers and other allied aids to data processing have done."

Two important factors have helped the computer industry, particularly IBM, to achieve this pre-eminence.

76 See Annexure II to Chapter I.

first, the rapidity of the obsolescence of the computer machines, and secondly, extension of the areas where these machines are being increasingly demanded. Computers are becoming obsolete within a range between 3 and 10 years. The 1951 UNIVAC, the first computer to be commercially available, was handed over to the Smithsonian Institute for its historical value in 1964. It is common place in the computer world to talk of the generations of computers such as the first generation computer; the second generation computer, the third generation, and so on. While generation gap in point of time is very little, the gap in efficiency and technological advancement is unbridgeably great.

A majority of computers we have in India is almost primitive compared to the IBM machines now operating in the rest of the world. The IBM 360 model is supposed to be the new system for India, but it is obsolete by world standards. "You will find an IBM model 30 on the pavements of the Champs-Elysee - which prints your horoscope for 20 francs while you wait", says one of the computer hardware engineer in India.78

In the international arena, there has almost been a population explosion of computers. In the United States of America, the number of computers increased from a handful

in 1950 to 6,000 in 1960, and nearly 77,000 in 1970. Japan had over 4,500 computers in 1960 and it was expected to reach 13,000 by 1972. 79

Thanks to the aggressive salesmanship employed by the IBM, carried out by a set of dedicated IBM workers who have been so well trained in the IBM culture through IBM's extraordinary training system, the IBM machines have found berth in several parts of the world and in all walks of life. Thomas J. Watson, the maker of the IBM Empire, was justified when he said that "everywhere he stops there will be IBM machines in use. The sun never sets on IBM". 80

The story of IBM and the part played by Watson and his family in building it up has been told at great length by William Rodgers in his book Think, and by Nancy Foy in The IBM World. Earlier, the history, policy and the organization of the IBM was explained by John E. Brent, its Vice President and General Manager, in a case study contributed to the International Management Association Inc. 81

81 Case Studies in Foreign Operations (Special Report), AMA Inc., 1957.
Starting his career with National Cash Register, Thomas John Watson soon found that he and the company had to face an anti-trust law suit in 1912. He left the company, after having been convicted in February 1913 for violations of Anti-trust Act, and joined Charles Flint in 1914 as a General Manager to put the Computing Tabulating Recording Company (CTR) on its feet. It was the CTR company which was first to put up in the market a tabulating machine (named after Herman Hollerith), which was the precursor of the computers as we know them today.

In 1924, Watson got complete control over the CTR and renamed it "International Business Machines". The actual credit for suggesting the name by using the word "international" before "Business Machines", it is stated, belongs to a Canadian, Larry Hubbard, who had the Canadian Agency for the CTR.

The "CTR" had already entered the international field in 1914. Hollerith had obtained a German patent for manufacturing his machine abroad. In 1904, an Englishman named C. Everard Greene formed a syndicate, called British Tabulating Machine Company (BTM), for use of Hollerith machines. "BTM" which was having a wary relationship continued between BTM and CTR with mutual discomfort and distrust until it parted in 1949, when IBM World Trade was formed. "BTM" then became 'the progenitor' of the
corporate company known as the International Computer Ltd. (ICL). In 1922 CTR, which was operating in Germany, took over Dehomag company set up by Hollerith in 1910 for manufacturing and distributing his patented Hollerith Machine and was absorbed by CTR. This absorption came about because Dehomag could not pay the royalties and licence fees it owed.

It was thence a continuous march for IBM over the rest of the parts of the world. In 1924, a separate plant was opened in Germany followed by a Paris plant in 1925. In 1926, Otto Braitmayer, the then President of IBM, went to China, the Philippines, Australia, and New Zealand. IBM soon found that the foreign business was just a fraction of what it could have been, and "international business was not developing in proportion to the possibilities of the market". Import restrictions and dollar shortages in the European countries gave a new solution to IBM viz. that it would be far better to have expanding manufacturing operations outside the US instead of importing machines manufactured in the US. To take over the manufacturing operations outside United States, a subsidiary of IBM was floated as the IBM World Trade Corporation, "with the aim of sales, service and production throughout world". In 1950, IBM was doing business in 65 countries, including Canada, France, Italy and Germany. It was assembling and re-building machines.
After 1950, it expanded its activities into 19 additional countries, having 18 manufacturing locations, and concentrating major production operations in Netherlands and the United Kingdom. It soon spread out to Argentina, Australia, Belgium, Brazil, Japan, Norway, Sweden and Switzerland. Laboratories were built in Germany and France and smaller laboratories were also started in United Kingdom and the Netherlands. All these laboratories were co-ordinated with headquarters in the United States. These laboratories had to follow closely the programme laid down by the IBM headquarters in the US which meant that they could not do any independent research but had to follow the directions of the decision of the headquarters in the US in regard to research and development activities.

The next stage was international division of manufacturing operations under what is called the interchange plan which continues to this day. Under this plan, IBM divided the manufacture of a product of a machine in several countries. For example, in the case of the electoral typewriter, the manufacture of the various components of the typewriter is divided among nine countries, viz., the United Kingdom, Sweden, Switzerland, the Netherlands, Belgium, France, Germany, Italy and Canada. Each country makes the total overall requirements for certain parts and supplies them to all countries, getting
in return the parts made by the other countries. For example, the Netherlands makes the platens which is sent out to other countries and, in return, receives parts required to assemble a complete electric typewriter in the Netherlands. It is this inter-linking manufacturing operation which enables IBM to make maximum advantage of transfer pricing, thereby minimising tax burden, overcoming exchange restrictions, and maximising profits. The position, as revealed in the Annual Report for 1974 issued to IBM's shareholders, was that the total gross income from sales and rental machines exceeded 12.67 billion dollars in that year, of which 5.94 billion dollars came from sales and rentals and services in foreign countries. The total net assets at the end of 1974 of this company was 14 billion dollars.

In these days of high sophisticated technology in the communication system, IBM, with its power, strength, and initiative gained in high pressure salesmanship in almost all the countries of the world, has been able to beat down all its rivals, and has practically sapped the ability of the countries where they operate to develop indigenously an effective and cheaper computer system suited for local needs and requirements. So much so that even President de Gaulle's favourite, "The Machines Bull", which he wanted to be the pride of France, knuckled under the pressure of
competition from IBM and had to rely on American Financial participation of GEC for its survival. The world operations today are so vast and varied that to conduct them, the IBM is organised into 12 divisions and three wholly owned subsidiaries, viz. IBM World Trade America/Far East Corporation, IBM World Trade Europe/Middle East Corporation and Scientific Research Associates.

**IBM's Entry in India**

In the data processing system, there are three stages of development which it is necessary to know to appreciate the contribution made by the computer systems. The digital computer comes first for its speed, accuracy, and versatility. The United Record Machine (URM) comes next but is much inferior to the electronic computer, though is useful for routine work. At the lowest level comes calculating machines and other allied electronic devices which do not require much of expertise in handling. Some of these are card punches, collectors, sorters, accounting machines, reproducing machines, electronic calculators, tape devices and card data records.

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82 Rodgers, n. 75, p. 272.

In India, the United Recording Machine was introduced in the twenties. By 1970, India had one thousand of such systems in use in different parts of the country. The first digital computer was installed in 1956 at the Indian Statistical Institute, Calcutta, and the first commercial computer was installed by Esso in 1961. Between 1962 and 1964, 14 computers were installed, but majority of them were in research and development organisations. The pace of computerisation quickened only from 1965 while IBM had already entered the scene in 1953, seeking and obtaining a recognition for a branch of IBM World Trade Corporation, a 'company' for the purpose of the IT Act. At the beginning of 1965, there were 235 computers in Government organisation and, of these, IBM accounted for the largest, namely, 66% computers, i.e. 143. ICL came next with 28, and Honeywell with 10. IBM-1401 accounted for 104, followed by IBM-1620. Explaining how this dominant position was achieved, Prince Azariah, an ex-IBM industrial engineer, says: "It had nothing to do with the quality of the computers themselves. In fact, the 1401—even today, numerically, the most important computer in India—was developed and marketed from the late 50s. By the mid-60s the 1401 had already started to become obsolete. Its book value was close to zero. Fully depreciated and universally rejected, second-hand 1401's

84 Report, n. 77, p. 225.
were imported into India in a knocked-down condition, 'manufactured' and then leased at the original rates as if they were brand new," Professor M.G.K. Menon, Chairman of the Electronics Commission pointed out, "the 1401s were rather like battered used cars in the US - to junk which you have to pay money." 85

The Public Accounts Committee of Parliament, in an investigation into the reasons for the whip-hand the IBM had on the Indian corporate scene, found that the choice of the system was a result of the "discipline of spoon-feeding" to which the Government departments fell a prey. The task of designing the system was left to IBM engineers whose main thrust had been in the area of business operations rather than the purposes aimed at by Government. They were repeated instances by Government departments, going in for equipment which was readily available but they were lured as it were by the ready-made packet of hardware and software by the foreign controlled companies operating in India. Thus the system acquired had not been designed to suit our individual requirements but whatever was readily available with the manufacturers were virtually thrust on this country on account of the sophisticated and alluringly aggressive salesmanship of the IBM in particular. This appears to be particularly true in the case of the IBM-1401 series (of which there is a

85 See Business India, 4, 73, p. 36.
peculiar proliferation in government departments), which, by the time they were brought into India on an "AS IS" basis and refurnished for being supplied to various users, were entirely obsolete and had outlived their utility elsewhere in the world. 86

An Inter-Ministerial Working Group, which was constituted by the Government of India to go into the question of costs of IBM, has reported that-

it is revealed that thousands of machines having no book values are in circulation earning machine rentals at fixed rates. It is further revealed that while IBM recovers, for most of the machines, depreciation based on 4-year life, such machines last for years and years and repair charges and parts consumed on such rental machines are almost insignificant. (87)

The report further adds:

another interesting feature of these rental machines is that most of them has already served elsewhere in other developed countries - the best part of their useful lives. When they became obsolete in those countries and, therefore, scrapped, such machines were being imported in India on the basis of 'AS IS' machines refurnished and circulated, as rental machines earning revenues at fantastic rates. Thus obsolete equipments in developed countries provide a

Report, n. 77, p. 49.

very profitable source of revenue to IBM for use as rental machines in countries like India.

No wonder that an investment of 100 dollars in 1974 produced 126 dollars in world operations; 156 dollars in foreign operation, and 156 dollars in India operation. On shareholders' equity (par value $5 per share), it produced 36.3 dollars on world operations, and 57.4 dollars on Indian operations. On an overall basis, the IBM earned rates of return amounting to 49 per cent, 53 per cent, 59 per cent, 74 per cent and 83 per cent on capital employed respectively for the 5 years - 1968 to 1972.88

Machine rental is the main source of income, followed by export sales and data processing for customers. In the export sales, a peculiar system of accounting is followed by taking the manufacturing cost, as export value, excluding freight, insurance, casing and packing and export handling items from the export invoice, which are separately recovered from the importing country where IBM equipment is imported by IBM affiliates. It has been found that there has been regular undervoicing on exports, resulting in losses to India operations corresponding again to foreign affiliates of IBM.89

88 Ibid., p. 180.
89 Ibid., p. 177.
On imports also, IBM had been found to have indulged in manipulation of price with a view to reducing the import duty. In evidence before the Public Accounts Committee, the Chairman of Customs Department stated:

It may be pertinent to mention here that the IBM having relationship with their foreign associates were in a better position to import such machines by under-invoicing them and charging high margin of profits by selling those machines in India and this problem has been catching the attention of the Customs Department since 1972 and with a view to put an end to this malpractice of I.B.M., their method of invoicing has been completely reviewed. As a result of the review completed by the Bombay Custom House, Special Valuation Branch, the value of the goods imported by M/s. I.B.M. India, will be determined w.e.f. 25th August 1973 after loading the invoice Inter Company Billing Price by 350 for assessment purposes....

In another place, the department has referred to the non-cooperative attitude of IBM and stated:

even if at this stage, the I.B.M. are requested to indicate the actual value of these machines, it is very likely that they may not furnish the correct amount since they have vested interest in not furnishing the correct figures. (90)

It was stated that the main revenue from rental charges and in the matter of rental charges, IBM has been insisting on customers in India executing the contract in IBM's own standard form with terms heavily loaded in favour

90 Ibid., p. 200.
of the IBM. It turned out on investigation that the total rental paid was higher than the purchase price itself in many instances, and the consumer did not have the option to purchase the machine. The hiring agreement provided for payment of installation plus monthly rental for each of the peripheral equipment. Monthly rental was based upon use of the computer for 176 hours per month beyond which additional time was billed at 30 per cent of the hourly rate derived from the monthly rental. Further, if it was not utilised fully for 176 hours, a minimum rental of Rs. 101.18 lakhs annually was payable. It was actually found on evidence that these computers were capable of processing programmes for 400 meter hours per month. This means, that the IBM had advantage both the ways. If a machine worked for more than 176 hours in a month because its capacity was really higher it got extra billing charges @ 30 per cent per hour for the difference. If the machine was underutilized or unutilized, the minimum rental of more than a crore of rupees per year was payable. Thus fantastic profits were made on rentals and these were also allowed to be remitted. The Public Accounts Committee remarked:

In view of the foregoing, the Committee hold that hiring of the computers and other equipments were wholly unjustified and motivated and the terms and conditions under which they were hired were absolutely one-sided. In fact it seems it was done to benefit the multinational corporations. They are positive that all the
details were not carefully worked out and the interest of Government were trampled by entering into such commitments. This is a unique business deal where the supplier dictates for everything and the Government accept it without any objection. (91)

Apart from these instances, the IBM Corporation was also found to have evaded income tax by charging to the Indian branch account huge amounts on account of "head office expenditure when no such expenditure could be related to the Indian branch". When the matter was being raised by the Comptroller & Auditor General of India, the company came forward with a voluntary disclosure that between the years 1966 and 1970, they had charged the Indian branch head office expenses in excess by US $450,498. (It would be interesting to note that the remittances on account of head office expenditure for the IBM case came to US $60.25 millions during the period 1967-1972.)

Nancy Foy in her book *The IBM World* affirms that IBM never dodges taxes and "that both the IBM people and Government believe that IBM is paying its fair share of taxes" - India perhaps is an exception! For not only income-tax was dodged, but also Central Excise and Customs. Apart from voluntary disclosure of over-charging in head office

expenses, a number of other tax evasion and avoidance techniques adopted by the IBM have been disclosed, as explained by the Chairman of Indian Customs.

In regard to effect on India's foreign exchange resources, the IBM's activities had resulted in a net outflow of foreign exchange in every one of the years from 1969 to 1974. The total net outflow of foreign exchange came to Rs. 109.389 million for the years 1969-74. Thus the contribution of IBM to the Indian economy has been negative.

Regarding efforts to assist in development of technology in India and train the locally available talent, the findings of the PAC are that -

India has an abundance of skilled manpower, and if IBM really meant to assist in the technological or industrial growth of this country, they could have had a more meaningful programme for manufacture. They have made no effort, either to sub-contract their export requirements to indigenous units, help them with technology and know-how and to secure a meaningful participation in export effort. Assistance from such quarters as IBM cannot, however, be expected for such tasks as the development of a research and development programme which would truly facilitate the attainment of self-reliance and the upgrading of our technology to an internationally competitive status. (93)

92 Report, n. 77, Table : Appendix VII, p. 353.
93 Ibid., p. 246.
An important aspect of the impact of IBM operations in India relates to national security. IBM data processing machines have been installed in every Defence and Home Affairs department. With the sophisticated remote controlled instruments the IBM has developed, or with components which can store information several times more than the normal human brain can, the dangers to data-security have become far-reaching and almost frightful. 94

The Secretary, Department of Space, told the PAC significantly that "the overall possibility of the espionage or intelligence gathering without the knowledge of other people is really fantastic in electronics; there is a large electronic-magnetic spectrum from which you can gather this information", 95 and added that "in the last 5 years or so we have been fairly aware of the different position in which the IBM has been able to place the various parts of the world." 96 A spokesman of Department of Communications, supplementing this, stated that -

regarding any international organisation of this type which is foreign without mentioning anything specific it can be said that we would not be surprised if we come to know that some

94 Ibid., pp. 172-3.
95 Ibid.
96 Ibid.
foreign multinational corporations which are operating in our country adopt certain methods which are not in our national interest. (97)

With all these revelations, it is only natural that the PAC, the Parliament, and almost all the Ministries of the Government of India, became concerned about the activities of IBM and the need to control its activities. The question was the methods that must be adopted for effecting this control. As a first step, the Government chose to ask the IBM trust to convert itself into Indian subsidiary with a reduced equity capital not exceeding 40%. A letter to this effect was issued in 1975 by the Reserve Bank of India to IBM and a time limit of two years was given from that date. But IBM was able to get an extension till 1978, only to finally inform the Reserve Bank of India that it would not be agreeable to the proposal of converting itself into an Indian subsidiary. Referring to the winding up of IBM in India, the Minister of Finance stated, in a reply to a question in Parliament, that IBM had decided to wind up its operations in keeping with their global corporate policy, viz. inability to associate Indian equity. He further added that IBM was not directed to wind up their activities and that the decision to wind up

97 Ibid.

98 Letter reproduced as Appendix IX to the Report, ibid., p. 355.
99 was taken by them.

The question however is "What after IBM"? To IBM, the challenge of being asked to associate with local affiliates or get out of the country is not a new experience. Earlier, the Japanese Government demanded that the wholly-owned IBM subsidiary should dilute its equity and have Japanese majority. IBM surveyed the situation, felt that the Japanese manufactures were not comparable machines, and customers if properly tutored would continue to deal with IBM. Accordingly, it refused to comply with the Japanese directive and the Government yielded for a trade-off, by which IBM agreed to increase manufacture operation and enlarge education facilities in Japan.

Burma was another country to try to evict IBM. When IBM was told that the local subsidiary would be taken over, the IBM's representative, Mr. Williamson, responded: "Go ahead", but do not forget what happened to Castro when he did that. Burma did not go ahead because it came to know that when Castro nationalised IBM, the company refused to give spare parts.

India has acted firmly. IBM has withdrawn but the story is not yet over. IBM is still there indirectly through

99 Lok Sabha Question No. 4940 of 29 December 1977.

100 Hitachi Ltd. Japan, is on the threshold of introducing a new model which is 60% more powerful than the top model in IBM line. But IBM is not nervous. The Japanese look IBM's resources and sales-service still more. Newsweek, 2 October 1978, p. 47.

101 Nancy Foy, n. 80, p. 158.
a collaboration contract signed with Computer Maintenance Corporation of India for supply of spare parts. 102 Secondly, most of the IBM business has been taken over by IDM (International Data Machine), a company floated by ex-employers of IBM. As Nancy Foy states, "some of the best IBMers are the ex-IBMers". 103 Trading in IBM-type machines, there is a likelihood of the country's dependence on IBM technology being increased paving the way for IBM's reentry. The Information, Planning and Analysis group of Electronics Commission of Government of India has expressed the view that IBM's technological philosophy is in the context of appropriate technology for India is a significant mismatch. It would, perhaps, be in the fitness of things that a comprehensive policy for self-reliance is made in the computer field especially of a type suited to the needs and requirements of this country. In this context, the efforts undertaken by the Department of Electronics in developing a mini-computer system should be encouraged.

102 See *Business India*, n. 78, p. 40.
103 See Nancy Foy, n. 80, p. 145.