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INDUSTRIAL STRATEGY AND INTERNATIONAL ENTERPRISES \*

by

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Working paper

- \* Brief summary of a study completed by ECLA in November 1970 for the Ministry of Planning and General Co-ordination of the Government of Brazil, by virtue of the agreement in force between the two institutions. A more comprehensive summary was submitted to ECLA at its fourteenth session (Santiago, Chile 27 April to 8 May 1971) in volume II, "Special studies", of the Economic Survey of Latin America 1970, (background paper E/CN.12/868/Add.2). The author is Regional Adviser on Export Development Planning, attached to ECLA.



## INDUSTRIAL STRATEGY AND INTERNATIONAL ENTERPRISES

### 1. Purpose of and reasons for the study

The purpose of this study is to analyse some aspects of the behaviour of international enterprises, with emphasis on those owned by United States residents, which are engaged in industry.

There is need for further information on the behaviour of these enterprises for the following reasons:

(i) Experience of industrial development in Latin America shows more and more clearly that the expansion of industrial activities must be oriented to fit into the framework of over-all development strategies. When these strategies are being formulated it must be possible, within certain limits, to forecast the consequences of the different policy options. The importance and accuracy of those forecasts will depend on the validity of the countries' conception of the development process that they are striving to project. The accuracy of this interpretation, in its turn, is partly dependent upon how clearly the operation of the principal agents in the process is understood. And in many Latin American States international enterprises may be said to be one of those agents nowadays.

(ii) In particular, these enterprises tend to play an important role in the most dynamic sectors of industry, which are those with the highest economic growth rates in the various countries.<sup>1/</sup>

(iii) As a general rule, the most dynamic sectors are those which expand most rapidly in the world market for manufactures. A point in common in the various countries' development programmes is the diversification of exports through the promotion of exports of manufactures. Therefore, if the above situation continues, any success achieved in this direction will depend partly on the behaviour of international enterprises; and their behaviour will in turn be determined by whatever rules of the game governments may adopt with regard to them.

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<sup>1/</sup> An analysis of the role of international enterprises in Brazil appears in Fernando Fajnzylber, "Sistema industrial y exportación de manufacturas" (ECLA/IPEA, November 1970).

(iv) With the establishment of regional integration groups, it is becoming more and more necessary to co-ordinate the positions adopted by the member countries with respect to international enterprises. It is a well-known fact that these firms are in a better position than the Latin American enterprises to take advantage of the expanded markets resulting from integration. They have the necessary flexibility to select the best location, the financial resources to establish plants of a size and specialization required by that market, and the marketing systems required to distribute their products. This means that the basic trends and prospects of regional integration are conditioned, to a very large extent, by whatever policies the countries adopt towards the activities of international enterprises in Latin America.

(v) A growing proportion of goods transactions between countries are carried out by international enterprises, which act simultaneously as exporters and importers. More and more operations hitherto conducted in the open market are now concluded outside it; thus to a certain extent enterprises avoid competing with one another. In other words, when a subsidiary company is established in a certain country it is tacitly decided to import equipment and components from other subsidiaries of the same enterprise. It is clear from the above observations that it is increasingly important to take the behaviour of international enterprises into account in the formulation of foreign trade policy.

(vi) A similar situation arises in connexion with the transfer of technical know-how. International enterprises are perhaps the most important, although not necessarily the most efficient, means of transferring technical know-how from one country to another. Each different way of transferring know-how, whether that just mentioned or any other, will affect the capacity to compete on the world market differently. Therefore, in preparing a policy for technological development, particularly when the aim is partly to make the country more competitive in the world market, it would seem essential to consider the consequences of the transfer of know-how through subsidiaries of international enterprises.

(vii) International

(vii) International enterprises also play an important part in the transfer of capital. In addition to their direct role in determining capital flows, they may have a not insignificant influence on the behaviour of other financial agents, both national and international.

(viii) Generally speaking, international enterprises are among the most important companies in their respective countries of origin, which indicates that their activities abroad may have considerable influence on those countries' economies. It may be assumed that the attitude of the governments of those countries to the countries where the enterprises are operating partly depends upon the nature and intensity of the effects which such activities have on the home economy. This means that it is necessary to study not only the relationship between international enterprises and the countries in which they are operating, but also the repercussions which their presence in those countries may have on the home country's economy.

These observations may be summed up as follows: international enterprises play an important role in relation both to the countries of origin and to the countries in which they operate, and also to the relations between the two groups. Thus, in formulating development strategies and programmes in the Latin American countries, it is important to know something about the behaviour of this new type of decision-making centre. This applies equally to countries which are, in general, in favour of international enterprises and to those which wish to curtail their activities or even eliminate such enterprises.

## 2. Content

The study is divided into five chapters. The first discusses the main methodological problems and the criteria adopted to solve them, and explains why attention is concentrated on United States enterprises.

The second chapter analyses the differences in the behaviour of international enterprises depending on the sector or region in which they operate; compares growth rates, rates of return, and the structure of the financing required for expansion abroad; and formulates hypotheses regarding relations between these three factors.

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The third chapter attempts to show what effects the existence of foreign subsidiaries has upon the economy of the country of origin; as regards the flows of goods, technology and capital. In order to measure these effects, the growth rate of enterprises in the United States is compared with that of their subsidiaries abroad.

The fourth chapter analyses some of the effects of international enterprises upon the countries in which they are operating. The first point studied is the difference between the growth rate of the international enterprises and that of industry in the respective countries. Then a comparison is drawn between the scale of United States enterprises and that of firms in competing countries. The chapter goes on to identify the behaviour of such enterprises with regard to exports by their subsidiaries. The information in this and the preceding chapters raises the need for a general interpretation of the process of expansion of United States enterprises abroad, which is formulated and analysed in the fifth chapter.

### 3. Limitations

Some of the study's main limitations are obvious merely from this outline of its content; they are discussed below:

(i) The study deals chiefly with United States enterprises. In spite of the importance of direct United States investment abroad compared with that of other countries, it does not seem right to attempt to apply the conclusions reached concerning the behaviour of United States enterprises to all companies operating in other countries. In fact, it may be assumed that the different economic characteristics of the countries of origin are reflected in the behaviour of the enterprises concerned.

The balance-of-payments position of the country of origin is likely to affect the policy of these firms with regard to remittances, financing, exports and imports. The operational sectors of the subsidiary firms will certainly reflect the degree of specialization of the home economy and its supply of natural resources. The behaviour of these firms will also be affected by the relative position of the country of origin in the world context, and by any other links, besides economic links, which may exist between the country of origin and that in which the firms are /operating. In

operating. In other words, the conclusions that may be drawn from the analysis of the behaviour of United States firms are not necessarily applicable to enterprises of other countries.

Attention is centred on these firms only because there is a sufficiently detailed breakdown of the data available on them.<sup>2/</sup>

(ii) Only the economic repercussions of the behaviour of international enterprises are analysed. As indicated above, these enterprises play, or at least are in a position to play, an important role in relation to both the country of origin and the country of operation. This means that in addition to the economic effects deriving from their activities, it is essential to analyse the political effects that are associated with them. Quite obviously, the attitude the countries adopt towards these firms is influenced by economic and political considerations in varying proportions. Since this study deals exclusively with the former group, the conclusions to which it leads will represent only a fraction - and sometimes a very small fraction - of all the criteria that are involved in the whole decision-making process of the different countries regarding international enterprises.

(iii) The study does not cover all the economic aspects of the behaviour of international enterprises. Attention is focused exclusively on those which could be analysed quantitatively on the basis of currently available data. These are not necessarily the aspects which are most relevant for evaluating the role played by international enterprises in the various countries. In particular, it has not really been possible to make a thorough study of how these firms act as catalysts on the behaviour of the different economic agents operating in both the country of origin and the countries of operation. It has been possible only to indicate some orders of magnitude which reflect the importance of these

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<sup>2/</sup> For a detailed description of the methodology used by the United States Department of Commerce in defining United States enterprises and collecting information about them, see U.S. Business Investment in Foreign Countries, 1960, pp. 76 et seq. Most of the data were taken from the monthly publication, Survey of Current Business, published by the Department of Commerce.

enterprises in the different contexts in which they are operating, but not to evaluate any effect they may have, in view of their importance, in determining the rules that will govern their behaviour. Clearly, for this type of analysis, more economic data are required than those currently available, and the analysis should also include sociological and political issues.

(iv) Most of the available data were obtained from the United States Department of Commerce. This could be a limitation inasmuch as the type of data gathered by that Department, the criteria used in processing them and the level of aggregation at which they are presented were chosen in line with objectives which are not necessarily in line with those of a study of this type.

The fact that in any attempt to evaluate the behaviour of international enterprises it is necessary to draw upon information supplied by government agencies of the country of origin of such enterprises is a clear indication of the crying need for the Latin American countries to set up a system of information on the international enterprises operating in the region, with the specific purpose of formulating the rules to be applied to these enterprises and of evaluating their actual behaviour.

#### 4. Main conclusions

As can be seen from the foregoing analysis, it is reasonable to expect that in the next few years the competition will be fiercer between United States, European and Japanese firms for the markets of their respective regions and of third countries. One of the regions in which these firms will be competing is Latin America. The principal aim of United States international enterprises will be to make up for the slower growth of the United States economy and thus maintain their share of the world market. European and Japanese firms will be trying to defend themselves against United States pressure on their own markets. It may be assumed that this pressure will increase in Japan, whose policy it has been to reserve the domestic market for its own enterprises. Expansion through their subsidiaries will guarantee them outlets for their exports of equipment and components, and will make it easier for them to export products that are not yet being manufactured by their subsidiaries abroad.



A first effect of this increasing competition between subsidiaries of international companies may possibly be to weaken the position of the individual companies in the countries in which they wish to operate. Up to now, the market for foreign investment has been characterized by the fact that international enterprises could take their pick of the countries, selecting whichever offered them the greatest tax incentives, while Governments vied with each other in finding ways of attracting more foreign investment.

Because of the growing need for firms to invest abroad, the consolidation of regional groupings in which efforts are made to equalize the conditions for the entry of foreign capital, and the Governments' increasing concern about the gradual take-over of their industries, it may well be that the balance in the foreign capital market will gradually incline in favour of the Governments of the countries in which the enterprises are operating.

The strengthening of the countries' bargaining position would force firms to adopt a more and more flexible attitude to the terms imposed by countries or regional groupings. There are already signs of greater pliability among international enterprises in both the extractive and the manufacturing sectors. Firms are agreeing to being minority shareholders and to much more restrictive conditions than in the past. They are entering into association with public, semi-public and private enterprises in countries with different economic systems (including enterprises operating under the workers' management system in Yugoslavia). This means that firms are showing more and more willingness to fulfil the functions that the countries assign them according to the development model they have adopted.

The expansion of international manufacturing companies in Latin America has hitherto been almost the decisive factor in determining the rate of growth of industry, and their diversification policy has largely dictated the structure of industrial supply. The public sector's investment policy has been influenced by the need to establish the infrastructure for the expansion of the most dynamic sectors. In addition, financial  
/mechanisms have

mechanisms have been developed for stepping up demand, even if only temporarily, for the goods produced by these sectors. In other words, international enterprises have played, and continue to play, a central role in Latin America's industrial development model. The foregoing shows, however, that they do not have to dominate the market, to be willing to invest in the Latin American countries. It is clear, for example, that when they produce certain goods in countries with partially or completely centralized economies, their role is to provide some of the items in a basket of consumer goods which are selected according to a model which they have little chance of modifying. When those countries need to have international enterprises, it is presumably because they consider the enterprises will be more efficient producers of these goods than local firms. The basic difference is therefore that in one case the type and volume of the goods to be produced are decided by the enterprises, and in the other by the country concerned. It is impossible to judge in advance the advantages or disadvantages of either method.

The only way to judge would be to see how far the results obtained through the method it decides to adopt are consistent with the country's economic and political objectives. The important point is that international enterprises are willing to accept much more restrictive rules of the game than has hitherto been believed.

Even if it is thought that over the next few years the behaviour of international enterprises may change in some respects and in certain circumstances, it is important to know what general trend they have so far followed before deciding what ground rules to adopt for them.

As regards the relationship between the activity of United States subsidiaries abroad and domestic economy of the United States, the following points have been shown: (i) the subsidiaries are expanding much faster than the United States economy; (ii) they have already attained a relatively substantial volume of activity; (iii) they are becoming an increasingly important outlet for United States exports of manufactures and for the transfer of technology to the rest of the world; (iv) in terms of capital flow, it has been found that, in extractive sectors, remittances of profits

/abroad have

abroad have been considerably greater than the inflow of investment to the subsidiaries. In the manufacturing sector, on the other hand, profits remitted were less than the flow of capital from the United States. This applies most of all to enterprises established in Europe. Remittances by United States industrial enterprises in Latin America are roughly of the same magnitude as the capital inflow to them from the United States.

Looking to the future, the probable outlook is as follows:

(i) continuing high growth rates of investment in manufacturing;  
(ii) low growth rates in the extractive sectors, particularly in Latin America; (iii) a drop in the yield on investment in the extractive sectors of Latin America, Asia and Africa as a result of the growing role of the countries in the marketing of their natural resources; and (iv), a growing participation of residents of other countries in the ownership of United States enterprises operating abroad, owing probably to the way the expansion is financed and to increasing pressure from Governments.

All in all, these hypotheses suggest that, in the medium and long term, the United States' favourable balance will tend to diminish. In other words, from the point of view of the availability of additional capital, having firms in other countries will gradually become less and less important for the United States. Although this does not mean that, in the short term and in view of that country's precarious balance-of-payments situation, this net inflow of foreign exchange will cease to be a valuable asset.

By and large, it would seem reasonable to state that there is probably a tendency for the centre of gravity of the biggest United States enterprises to shift abroad. Bearing in mind that these firms play a significant role in the orientation and growth of the United States economy, it can be argued that there are sufficient grounds for the main decision-making authorities in the United States to become more sensitive to economic events in the rest of the world.

One of the first points to consider is the structure of the financing used for the expansion of these companies abroad. As shown earlier, 83 per cent of the funds used by United States manufacturing firms abroad were generated in the countries in which they were operating. Accordingly,

/the growth

the growth of these enterprises mainly depends upon what use they make of the profits generated in the country and what access they have to the local capital market. Thus, if the countries wish to stimulate or restrict or reorient the expansion of international enterprises, they should focus their attention on the ways in which the locally generated savings are utilized.

As regards the know-how introduced by international enterprises, the developing countries should remember that, up to now, this has consisted in introducing techniques that are already widely known in the developed countries and not in developing the ability to improve them or to create new processes and products. This is perfectly all right as long as the enterprises are producing goods to replace former imports on the domestic market, but if Latin America wishes to attain high enough standards of quality in certain sectors to enable it to compete on the world market for manufactures, the know-how thus acquired will be completely inadequate. International enterprises do no technological research in the less developed countries, and even if they did, there would be no guarantee that these countries would be in a better position to compete on the world market. On the contrary, it is more than likely that any innovations that might be made would be transferred to the parent companies, thus improving the competitive position of the country of origin.

Although international enterprises may be an efficient means of transferring know-how to meet domestic consumption requirements, they can hardly be considered as a basis for any industry that aims at competing on the developed countries' market for manufactures.

Nevertheless, international enterprises might play quite an important role in the export of Latin America's manufactured products. The points raised in chapter IV indicate that there is every likelihood that manufacturing subsidiaries abroad will step up their exports in the next few years. Specifically, the following trends in respect of exports of manufactures are characteristic of the international enterprises:

/(i) Establishment

(i) Establishment of factories to supply the regional market to which the country concerned belongs. This market might be the British Commonwealth for firms established in Canada and the United Kingdom, and possibly the European Common Market for the United Kingdom; the Latin American Free Trade Association (ALALC) for firms in Argentina, Brazil and Mexico; south-east Asia for firms in India, and the European Common Market for the numerous firms established in the countries of the Six;<sup>3/</sup>

(ii) Establishment of enterprises in countries with abundant and cheap labour. As the factories would supply the market of the country of origin and other traditional markets of the international enterprise, the size of the local market and the extent of its industrialization would not matter. This has happened in South Korea, Hong Kong, Taiwan, India, and the less developed countries of Europe (Portugal, Spain, Greece and Turkey) and may happen in Latin America. The international enterprises have not yet, in practice, adopted this approach in Latin America. In south-east Asia, they appear to have concentrated on electronic and optical products and clothing;<sup>4/</sup>

(iii) Establishment of factories in neighbouring countries to the country of origin. This would appear to be a real process of industrial integration in which equal attention is given to such factors as manpower, tax legislation, distance, and transport costs. This is apparently the case of Canada and, to a much smaller extent, Mexico, for United States

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<sup>3/</sup> In Brazil, Olivetti, Mercedes Benz, Pirelli, IBM, Burroughs, Singer, Bosch and other firms supply the ALALC market. A large proportion of the enterprises that are parties to ALALC sectoral complementarity agreements are international.

<sup>4/</sup> In the last four years, forty Japanese firms have been established in Taiwan, and Rollei-Werke (West Germany) is investing 12.6 million dollars in Singapore. A subsidiary of Corning Works sends components to Korea where they are made into integrated circuits. The Società Generale Semiconduttori - the largest Italian manufacturer of electronic components - is building a factory in Singapore, and so are Philips and Plessey, the largest English electronics firm. Generators and compressors for Ford cars will be manufactured by Tokyo Shibaura Electronic and Diesel Kiki, both Japanese firms.

firms, and of Spain, Portugal, Yugoslavia, Greece and Turkey for European firms. In addition to the traditional labour-intensive sectors, this process also seems to be under way in the automotive industry;<sup>5/</sup>

(iv) Installation of plants in countries that have important natural resources that are difficult to find on the world market and which show a decided interest in processing these materials locally before exporting them. The most obvious example is the iron and steel industry and many international firms, for instance, are showing interest in establishing iron and steel plants in countries like Australia and Brazil,<sup>6/</sup> to produce for export to the markets of the countries of origin and to world markets. It can be expected that other mineral and vegetable raw materials industries will soon follow this trend;

(v) Establishment of factories in developing countries with a large domestic market and some industrial development to supply the local market and part of the world market with products that are no longer being manufactured by the parent company or subsidiaries in the developed countries. These would be the simplest types of product manufactured by the international firm or products which, as a result of technological development, have been rendered partially obsolete but for which there is a guaranteed demand on the spare-parts market;<sup>7/</sup>

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<sup>5/</sup> For instance, the agreement between Canada and the United States on the automobile industry; programme for the integration of the production of engines between Chrysler subsidiaries in Mexico and the United States, and the Daimler-Benz factory in Yugoslavia, which exports parts and components to West Germany.

<sup>6/</sup> U.S. Steel, August Thyssen-Hutte (West Germany) and Yawatta Iron-Steel (Japan). In semi-manufactures of copper, this is the case of Phelps-Dodge, which has projects in Thailand and Zambia. In aluminium, the Canadian firm of Alcan is considering a project in Guyana.

<sup>7/</sup> Electronic valves and punching machines, exported from Brazil by Philips and IBM, respectively; certain castings purchased by Volvo in Portugal; injection pumps exported by subsidiaries in India to West Germany; agreements for the exchange of components for railway carriages and trucks between Egypt and the Italian firm of Fiat.

(vi) Enterprises intended mainly to supply the local market. They would be established in countries that are not in a good position to act as regional distribution centres and have neither plentiful and cheap labour nor abundant natural resources.

The direction and speed of these types of development and the way in which the profits from exports are distributed between the countries and the enterprises will depend on how decisively and clear-sightedly Governments act, whether separately or in the context of regional groupings.<sup>8/</sup>

Looking at the content and the growth prospects of these products, it must be concluded that they will not necessarily guarantee the complete attainment of the objectives generally assigned to exports of manufactures, i.e., ensuring that exports grow at a steady and increasing rate, promoting local industrial technology and improving the efficiency of industry and giving the countries more freedom of action in handling their foreign trade.

If past trends continue unchanged in the next few years, exports of the Latin American regional groupings will grow more slowly than the developed countries' trade in manufactures. In the case of the simpler products or spare parts and replacements, the growth target could perhaps be attained in quantitative terms, but their manufacture would not provide much incentive to improve technology. As regards items or components produced by labour-intensive methods, Latin America seems to be losing ground to the countries of south-east Asia. Moreover, if the aim is to achieve a substantial increase in productivity, and therefore in wages, the export strategy could scarcely be based on the lower cost of labour in Latin America. Nor would there be any significant spread of technology to other industrial sectors from the manufacture of these types of products.

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<sup>8/</sup> The above cases are drawn from various sources: inquiries made among the principal international enterprises operating in Brazil; Jack Baranson, Automobile industries in developing countries, International Bank for Reconstruction and Development, 1969; Jack Baranson, The export of manufactures from developing countries. An interim Report, International Bank for Reconstruction and Development, 1969; Time, 21 September 1970; Le Monde, economic supplement, 11 August 1970; and "Japan, Special Survey", The Economist, 27 May and 3 June 1967.

Exports of highly-processed natural resources possibly hold out the best prospects as regards volume; but this is just where there is most chance of replacing international by national enterprises, although some of their know-how would come from foreign sources.

For a country to base its exports of manufactures - i.e., that part of its exports that is assumed to be most dynamic - on decisions adopted by international enterprises does not seem to be the best way for it to achieve more independence and stability in the handling of its foreign trade. The export strategy of international firms takes into account production and demand conditions in all the different countries in which they operate. That being so, if most of a country's industrial exports are produced by international enterprises, the country's position cannot be described as stable, nor can it be said to reflect an independent policy for the handling of foreign trade.

This should not mean that countries cannot and should not do all they can to promote the export activities of international enterprises. There are some circumstances which favour the expansion of the enterprises' exports. The contention is, however, that if they delegate the main responsibility for increasing and diversifying exports of finished products to international enterprises, the countries will not be able to reap all the benefits they hope to obtain from changes in the structure of their exports.

Another question examined in previous sections which should be borne in mind is the relationship between the foreign take-over of industry on the one hand, and the difference between the inflow of capital to international firms and their remittances of profits, on the other. The more they invest, the more likely it is that they will take over industry. At the same time, once an acceptable rate of return has been established for these companies, the faster investment grows, the more likely it will be that new capital investment will equal or even exceed remittances of profits. In other words, the effect on the balance of payments may not be so unfavourable, and may even be favourable. If the take-over process continues indefinitely, there

/will come



will come a time when the international enterprises will have practically no opportunity to reinvest in the country. If this were to happen the balance-of-payments position would deteriorate considerably, since the companies would have no alternative but to remit all their profits abroad.

The over-all effect on the balance of payments will depend on the international firms' attitude to exports, which, as mentioned above, will be influenced by the ground rules adopted by countries for them.

The present study has been confined to an analysis of the behaviour of international enterprises and no specific suggestions have been made regarding what are the most advantageous ground rules for countries to adopt, since whether or not they are advantageous will depend exclusively on the economic, political and social objectives pursued by their Governments.

