COUNCIL on FOREIGN RELATIONS

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Source: *Foreign Affairs*, Oct., 1974, Vol. 53, No. 1 (Oct., 1974), pp. 121-134

Published by: Council on Foreign Relations

Stable URL: http://www.jstor.com/stable/20039495

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MULTINATIONALS AND DEVELOPING COUNTRIES: MYTHS AND REALITIES

By Peter F. Drucker

FOUR assumptions are commonly made in the discussion of multinationals and the developing countries—by friends and enemies alike of the multinational company. These assumptions largely inform the policies both of the developing countries and of the multinational companies. Yet, all four assumptions are false, which explains in large measure both the acrimony of the debate and the sterility of so many development policies.

These four false but generally accepted assumptions are: (1) the developing countries are important to the multinational companies and a major source of sales, revenues, profits and growth for them, if not the mainstay of "corporate capitalism"; (2) foreign capital, whether supplied by governments or by businesses, can supply the resources, and especially the capital resources required for economic development; (3) the ability of the multinational company to integrate and allocate productive resources on a global basis and across national boundaries, and thus to substitute transnational for national economic considerations, subordinates the best national interests of the developing country to "global exploitation"; (4) the traditional nineteenth-century form of corporate organization, that is, the "parent company" with wholly owned "branches" abroad, is the form of organization for the twentieth-century multinational company.[1]

II

What are the realities?

In the first instance, extractive industries have to go wherever the petroleum, copper ore or bauxite is found, whether in a developing or in a developed country. But for the typical twentieth-century multinational, that is a manufacturing, distributing or financial company, developing countries are important neither as markets nor as producers of profits. Indeed it can be said

[1] The author acknowledges his indebtedness for advice and helpful criticism to Dr. Tore Browaldh, Chairman of Svenska Handelsbanken and recently a member of the U.S. Group of Eminent Persons studying multinationals, and to Dr. Ernst Keller, President of Adela Investment Co., S.A., Lima, Peru.

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bluntly that the major manufacturing, distributive and financial companies of the developed world would barely notice it, were the sales in and the profits from the developing countries suddenly to disappear.

Confidential inside data in my possession on about 45 manufacturers, distributors and financial institutions among the world's leading multinationals, both North American and European,[2] show that the developed two-thirds of Brazil—from Bello Horizonte southward—is an important market for some of these companies, though even Brazil ranks among the first 12 sales territories, or among major revenue producers, for only two of them. But central and southern Brazil, while still "poor," are clearly no longer "underdeveloped." And otherwise not even India or Mexico—the two "developing" countries with the largest markets—ranks for any of the multinational companies in my sample ahead even of a single major sales district in the home country, be it the Hamburg-North Germany district, the English Midlands or Kansas City.

On the worldwide monthly or quarterly sales and profit chart, which most large companies use as their most common top-management tool, practically no developing country even appears in my sample of 45 major multinationals except as part of a "region," e.g., "Latin America," or under "Others."

The profitability of the businesses of these companies in the developing countries is uniformly lower by about two percentage points than that of the businesses in the developed countries, except for the pharmaceutical industry where the rate of return, whether on sales or on invested capital, is roughly the same for both. As a rule, it takes longer—by between 18 months to three years—to make a new operation break even in a developing country. And the growth rate—again excepting the pharmaceutical industry—is distinctly slower. Indeed, in these representative 45 businesses, 75 to 85 percent of all growth, whether in sales or in profits, in the last 25 years, occurred in the developed countries. In constant dollars the business of these 45 companies in the developed world doubled—or more than doubled—in the last 10 to 15 years. But their business in the developing countries grew by no more than one-third during that period if the figures are adjusted for inflation.

[2] I have no data on Japanese-based multinationals; but in developing countries the Japanese are still mainly engaged in extractive and raw-material-producing business.

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Published data, while still scarce and inadequate, show the same facts. Only for the extractive industries have the developing countries—and then only a very few of them—been of any significance whether as a source of profits, as loci of growth, or as areas of investment.

The reason is, of course, that—contrary to the old, and again fashionable, theory of "capitalist imperialism"—sales, growth and profits are where the market and the purchasing power are.

To the developing country, however, the multinational is both highly important and highly visible.

A plant employing 750 people and selling eight million dollars worth of goods is in most developing countries a major employer—both of rank and file and of management—and a big business. For the multinational parent company, employing altogether 97,000 people and selling close to two billion dollars worth of goods a year, that plant is, however, at best marginal. Top management in Rotterdam, Munich, London or Chicago can spend practically no time on it.

Neglect and indifference rather than "exploitation" is the justified grievance of the developing countries in respect to the multinationals. Indeed, top management people in major multinationals who are personally interested in the developing countries find themselves constantly being criticized for neglecting the important areas and for devoting too much of their time and attention to "outside interests." Given the realities of the business, its markets, growth opportunities and profit opportunities, this is a valid criticism.

The discrepancy between the relative insignificance of the affiliate in a developing country and its importance and visibility for the host country poses, however, a major problem for the multinationals as well. Within the developing country the man in charge of a business with 750 employees and eight million dollars in sales has to be an important man. While his business is minute compared to the company's business in Germany, Great Britain or the United States, it is every whit as difficult—indeed it is likely to be a good deal more difficult, risky and demanding. And he has to treat as an equal with the government leaders, the bankers and the business leaders of his country—people whom the district sales manager in Hamburg, Rotterdam or Kansas City never even sees. Yet his sales and profits are less than those of the Hamburg, Rotterdam or Kansas City sales district. And

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his growth potential is, in most cases, even lower.

This clash between two realities—the personal qualifications and competence, the position, prestige and power needed by the affiliate's top management people to do their job in the developing country, and the reality of a "sales district" in absolute, quantitative terms—the traditional corporate structure of the multinationals cannot resolve.

III

The second major assumption underlying the discussion of multinationals and developing countries is the belief that resources from abroad, and especially capital from abroad, can "develop" a country.

But in the first place no country is "underdeveloped" because it lacks resources. "Underdevelopment" is inability to obtain full performance from resources; indeed we should really be talking of countries of higher and lower productivity rather than of "developed" or "underdeveloped" countries. In particular, very few countries—Tibet and New Guinea may be exceptions—lack *capital*. Developing countries have, almost by definition, more capital than they productively employ. What "developing" countries lack is the full ability to mobilize their resources, whether human resources, capital or the physical resources. What they need are "triggers," stimuli from abroad and from the more highly developed countries, that will energize the resources of the country and will have a "multiplier impact."

The two success stories of development in the last hundred years—Japan and Canada—show this clearly. In the beginning, Japan imported practically no capital except small sums for early infrastructure investments, such as the first few miles of railroad. She organized, however, quite early, what is probably to this day the most efficient system for gathering and putting to use every drop of capital in the country. And she imported—lavishly and without restraints—technology with a very high multiplier impact and has continued to do so to this day.

Canada, in the mid-1930s, was far less "developed" a country than most American republics are today. Then the liberal governments of the 1930s decided to build an effective system for collecting domestic capital and to put it into infrastructure investments with a very high "multiplier" effect—roads, health care, ports, education and effective national and provincial administra-

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tions. Foreign capital was deliberately channeled into manufacturing and mining. Domestic capital and entrepreneurs were actually discouraged in the extractive and manufacturing sectors. But they were strongly encouraged in all tertiary activities such as distribution, banking, insurance and in local supply and finishing work in manufacturing. As a result a comparatively small supply of foreign capital—between a tenth and a twentieth of Canada's total capital formation—led to very rapid development within less than two decades.

There is a second fallacy in the conventional assumption, namely that there is unlimited absorptive capacity for money and especially for money from abroad. But in most developing countries there are actually very few big investment opportunities. There may be big hydroelectric potential; but unless there are customers with purchasing power, or industrial users nearby, there is no economic basis for a power plant. Furthermore, there is no money without strings. To service foreign capital, even at a minimal interest rate, requires foreign exchange. At that, loans or equity investments as a rule constitute a smaller (and, above all, a clearly delimited) burden than grants and other political subsidies from abroad. The latter always create heavy obligations, both in terms of foreign and domestic policy, no matter where they come from.

A developing country will therefore get the most out of resources available abroad, especially capital, if it channels capital where it has the greatest "multiplier impact." Moreover, it should channel it where one dollar of imported capital will generate the largest number of domestic dollars in investment, both in the original investment itself and in impact-investment (e.g., the gas stations, motels and auto repair shops which an automobile plant calls into being), and where one job created by the original investment generates the most jobs directly and indirectly (again an automobile industry is a good example). Above all, the investment should be channcled where it will produce the largest number of local managers and entrepreneurs and generate the most managerial and entrepreneurial competence. For making resources fully effective depends on the supply and competence of the managerial and entrepreneurial resource.

According to all figures, government money has a much lower multiplier impact than private money. This is, of course, most apparent in the Communist-bloc countries; low, very low, pro-

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ductivity of capital is the major weakness of the Communist economies, whether that of Russia or of her European satellites. But it is true also of public (e.g., World Bank) money elsewhere: it generates little, if any, additional investment either from within or from without the recipient country. And "prestige" investments, such as a steel mill, tend to have a fairly low multiplier impact—both in jobs and in managerial vigor—as against, for instance, a department store which brings into existence any number of small local manufacturers and suppliers and creates a major managerial and entrepreneurial cluster around it.

For the multinational in manufacturing, distribution, or finance locating in a developing country, rapid economic development of the host country offers the best chance for growth and profitability. The multinational thus has a clear self-interest in the "multiplier" impact of its investment, products and technology. It would be well advised to look on the capital it provides as "pump priming" rather than as "fuel." The more dollars (or pesos or cruzeiros) of local capital each of its own dollars of investment generates, the greater will be the development impact of its investment, and its chance for success. For the developing country the same holds true: to maximize the development impact of each imported dollar.

The Canadian strategy was carried on too long; by the early 1950s, Canada had attained full development and should have shifted to a policy of moving its own domestic capital into "superstructure" investments. But though the Canadian strategy is certainly not applicable to many developing countries today—and though, like any strategy, it became obsolete by its very success—nevertheless it was highly successful, very cheap and resulted in rapid economic growth while at the same time ensuring a high degree of social development and social justice.

What every developing country needs is a strategy which looks upon the available foreign resources, especially of capital, as the "trigger" to set off maximum deployment of a country's own resources and to have the maximum "multiplier effect." Such a strategy sees in the multinational a means to energize domestic potential—and especially to create domestic entrepreneurial and managerial competence—rather than a substitute for domestic resources, domestic efforts and, even, domestic capital. To make the multinationals effective agents of development in the developing countries therefore requires, above all, a policy of encourag-

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ing the domestic private sector, the domestic entrepreneur and the domestic manager. If they are being discouraged the resources brought in from abroad will, inevitably, be wasted.

For by themselves multinationals cannot produce development; they can only turn the crank but not push the car. It is as futile and self-defeating to use capital from abroad as a means to frighten and cow the local business community—as the bright young men of the early days of the Alliance for Progress apparently wanted to do—as it is to mobilize the local business community against the "wicked imperialist multinational."

IV

The multinational, it is said, tends to allocate production according to global economics. This is perfectly correct, though so far very few companies actually have a global strategy. But far from being a threat to the developing country, this is potentially the developing country's one trump card in the world economy. Far from depriving the governments of the developing countries of decision-making power, the global strategy of the multinationals may be the only way these governments can obtain some effective control and bargaining leverage.

Short of attack by a foreign country the most serious threat to the economic sovereignty of developing countries, and especially of small ones, i.e., of most of them, is the shortage of foreign exchange. It is an absolute bar to freedom of decision. Realizing this, many developing countries, especially in the 1950s and early 1960s, chose a deliberate policy of "import substitution."

By now we have all learned that in the not-so-very-long run this creates equal or worse import-dependence and foreign-exchange problems. Now a variant of "import substitution" has become fashionable: a "domestic-content" policy which requires the foreign company to produce an increasing part of the final product in the country itself. This, predictably, will eventually have the same consequences as the now discredited "import substitution," namely, greater dependence on raw materials, equipment and supplies from abroad. And in all but the very few countries with already substantial markets (Brazil is perhaps the only one—but then Brazil is not, after all, "developing" any longer in respect to the central and southern two-thirds of the country) such a policy must, inevitably, make for a permanently high-cost industry unable to compete and to grow. The policy

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creates jobs in the very short run, to be sure; but it does so at the expense of the poor and of the country's potential to generate jobs in the future and to grow.

What developing countries need are *both*—foreign-exchange earnings and productive facilities large enough to provide economies of scale and with them substantial employment. This they can obtain only if they can integrate their emerging productive facilities—whether in manufactured goods or in such agricultural products as fruits and wine—with the largest and the fastest-growing economy around, i.e., the world market.

But exporting requires market knowledge, marketing facilities and marketing finance. It also requires political muscle to overcome strongly entrenched protectionist forces, and especially labor unions and farm blocs in the developed countries. Exporting is done most successfully, most easily and most cheaply if one has an assured "captive" market, at least for part of the production to be sold in the world market. This applies particularly to most of the developing countries, whose home market is too small to be an adequate base for an export-oriented industry.

The multinational's capacity to allocate production across national boundary lines and according to the logic of the world market should thus be a major ally of the developing countries. The more rationally and the more "globally" production is being allocated, the more they stand to gain. A multinational company, by definition, can equalize the cost of capital across national lines (to some considerable extent, at least). It can equalize to a large extent the managerial resource, that is, it can move executives, can train them, etc. The only resource it cannot freely move is labor. And that is precisely the resource in which the developing countries have the advantage.

This advantage is likely to increase. Unless there is a worldwide prolonged depression, labor in the developed countries is going to be increasingly scarce and expensive, if only because of low birthrates, while a large-scale movement of people from pre-industrial areas into developed countries, such as the mass-movement of American Blacks to the Northern cities or the mass-movement of "guest workers" to Western Europe, is politically or socially no longer possible.

But unless the multinationals are being used to integrate the productive resources of the developing countries into the productive network of the world economy—and especially into the pro-

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duction and marketing systems of the multinationals themselves—it is most unlikely that major export markets for the production of the developing countries will actually emerge very quickly.

Thus, the most advantageous strategy for the developing countries would seem to be to replace—or, at least to supplement—the policy of "domestic content" by a policy that uses the multinationals' integrating ability to develop large productive facilities with access to markets in the developed world. A good idea might be to encourage investment by multinationals with definite plans—and eventually firm commitments—to produce for export, especially within their own multinational system. As Taiwan and Singapore have demonstrated, it can make much more sense to become the most efficient large supplier worldwide of one model or one component than to be a high-cost small producer of the entire product or line. This would create more jobs and provide the final product at lower prices to the country's own consumers. And it should result in large foreign-exchange earnings.

I would suggest a second integration requirement. That developing countries want to limit the number of foreigners a company brings in is understandable. But the multinational can be expected to do that anyhow as much as possible—moving people around is expensive and presents all sorts of problems and troubles. Far more important would be a requirement by the developing country that the multinational integrate the managerial and professional people it employs in the country within its worldwide management development plans. Most especially it should assign an adequate number of the younger, abler people from its affiliate in the developing country for from three to five years of managerial and professional work in one of the developed countries. So far, to my knowledge, this is being done systematically only by some of the major American banks, by Alcan, and by Nestle. Yet it is people and their competence who propel development; and the most important competence needed is not technical, i.e., what one can learn in a course, but management of people, marketing and finance, and first-hand knowledge of developed countries.

In sum, from the point of view of the developing countries the best cross-national use of resources which the multinational is—or should be—capable of may well be the most positive element in the present world economy. A policy of self-sufficiency

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is not possible even for the best-endowed country today. Development, even of modest proportions, cannot be based on uneconomically small, permanently high-cost facilities, either in manufacturing or in farming. Nor is it likely to occur, let alone rapidly, under the restraint of a continental balance-of-payments crisis. The integration of the productive capacities and advantages of developing countries into the world economy is the only way out. And the multinational's capacity for productive integration across national boundaries would seem the most promising tool for this.

V

That 100-percent ownership on the part of the "parent company" is *the* one and only corporate structure for the multinational, while widely believed, has never been true. In so important a country as Japan it has always been the rather rare exception, with most non-Japanese companies operating through joint ventures. Sears, Roebuck is in partnership throughout Canada with a leading local retail chain, Simpson's. The Chase Manhattan Bank operates in many countries as a minority partner in and with local banks. Adela, the multinational venture-capital firm in Latin America, and by far the most successful of all development institutions in the world today, has confined itself from its start, ten years ago, to minority participation in its ventures, and so on.

But it is true that, historically, 100-percent ownership has been considered the preferred form, and anything else as likely to make unity of action, vision and strategy rather difficult. Indeed, restriction of the foreign investor to less than 100-percent control or to a minority participation, e.g., in the Andean Pact agreements or in Mexico's legislation regarding foreign investments, is clearly intended as restraint on the foreigner, if not as punitive action.

But increasingly the pendulum is likely to swing the other way. (Indeed, it may not be too far-fetched to anticipate that, a few years hence, "anti-foreign" sentiment may take the form of demanding 100-percent foreign-capital investment in the national company in the developing country, and moving toward outlawing partnerships or joint ventures with local capital as a drain on a country's slender capital resources.) The multinational will find it increasingly to its advantage to structure ownership in a va-

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riety of ways, and especially in ways that make it possible for it to gain access to both local capital and local talent.

Capital markets are rapidly becoming "polycentric." The multinationals will have to learn so to structure their businesses as to be able to tap any capital market—whether in the United States, Western Europe, Japan, Brazil, Beirut or wherever. This the monolithic "parent company" with wholly-owned branches is not easily capable of. When companies, for example the West Europeans, raise money abroad, they often prefer financial instruments such as convertible debentures, which their own home capital markets, or the United States, do not particularly like and cannot easily handle. There is also more and more evidence that the capital-raising capacity of a huge multinational, especially for medium-term working capital, can be substantially increased by making major segments of the system capable of financing themselves largely in their own capital markets and with their own investing public and financial institutions.

But capital is also likely to be in short supply for years to come, barring a major global depression. And this might well mean that the multinationals will only be willing and able to invest in small, less profitable and more slowly growing markets, i.e., in developing countries if these countries supply a major share of the needed capital rather than have the foreign investor put up all of it.

That this is already happening, the example of Japan shows. Lifting restrictions on foreign investment was expected to bring a massive rush of take-over bids and 100 percent foreign-owned ventures. Instead it is now increasingly the Western investor, American as well as European, who presses for joint ventures in Japan and expects the Japanese partner to supply the capital while he supplies technology and product knowledge.

Perhaps more important will be the need to structure for other than 100-percent ownership to obtain the needed managerial talent in the developing country. If the affiliate in the developing country is not a "branch" but a separate company with substantial outside capital investment, the role and position of its executives become manageable. They are then what they have to be, namely, truly "top management," even though in employment and sales their company may still be insignificant within the giant concern.

And if the multinational truly attempts to integrate pro-

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duction across national boundaries, a "top management" of considerable stature becomes even more necessary. For then, the managers of the affiliate in a developing country have to balance both a national business and a global strategy. They have to be "top management" in their own country and handle on the local level highly complex economic, financial, political and labor relations as well as play as full members on a worldwide "system management" team.[3] To do this as a "subordinate" is almost impossible. One has to be an "equal," with one's own truly autonomous command.

VI

Domestically, we long ago learned that "control" has been divorced from "ownership" and, indeed, is rapidly becoming quite independent of "ownership." There is no reason why the same development should not be taking place internationally—and for the same two reasons: (1) "ownership" does not have enough capital to finance the scope of modern large businesses; and (2) management, i.e., "control," has to have professional competence, authority and standing of its own. Domestically the divorce of "control" from "ownership" has not undermined "control." On the contrary, it has made managerial control and direction more powerful, more purposeful, more cohesive.

There is no inherent reason why moving away from "100-percent ownership" in developing countries should make impossible maintenance of common cohesion and central control. On the contrary, both because it extends the capital base of the multinational in a period of worldwide capital shortage and because it creates local partners, whether businessmen or government agencies, the divorce between control and direction may well strengthen cohesion, and may indeed even be a prerequisite to a true global strategy.[4]

At the same time such partnership may heighten the development impact of multinational investment by mobilizing domestic capital for productive investment and by speeding up the development of local entrepreneurs and managers.

[3] For a full discussion of this organization design, see my recent book *Management: Tasks; Responsibilities; Practices*, New York: Harper & Row, 1974, especially Chapter 47.

[4] On very different grounds, Professor Jack N. Behrman, former Assistant Secretary of Commerce in the Kennedy Administration and a man with encyclopedic knowledge of how the multinational economy works, reached similar conclusions. See his *Decision Criteria for Foreign Direct Investment in Latin America*, New York: Council of the Americas, 1974.

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Admittedly, mixed ownership has serious problems; but they do not seem insurmountable, as the Japanese joint-venture proves. It also has advantages; and in a period of worldwide shortage of capital it is the multinational that would seem to be the main beneficiary. Indeed one could well argue that developing countries, if they want to attract foreign investment in such a period, may have to *offer* co-investment capital, and that provisions for the participation of local investment in ownership will come to be seen (and predictably to be criticized) as favoring the foreign investor rather than as limiting him.

VII

The multinational, while the most important and most visible innovation of the postwar period in the economic field, is primarily a symptom of a much greater change. It is a response to the emergence of a genuine world economy. This world economy is not an agglomeration of national economies as was the "international economy" of nineteenth-century international trade theory. It is fundamentally autonomous, has its own dynamics, its own demand patterns, its own institutions—and in the Special Drawing Rights (SDR) even its own money and credit system in embryonic form. For the first time in 400 years—since the end of the sixteenth century when the word "sovereignty" was first coined—the territorial political unit and the economic unit are no longer congruent.

This, understandably, appears as a threat to national governments. The threat is aggravated by the fact that no one so far has a workable theory of the world economy. As a result there is today no proven, effective, predictable economic policy: witness the impotence of governments in the face of worldwide inflation.

The multinationals are but a symptom. Suppressing them, predictably, can only aggravate the disease. But to fight the symptoms in lieu of a cure has aways been tempting. It is therefore entirely possible that the multinationals will be severely damaged and perhaps even destroyed within the next decade. If so, this will be done by the governments of the developed countries, and especially by the governments of the multinationals' *home* countries, the United States, Britain, Germany, France, Japan, Sweden, Holland and Switzerland—the countries where 95 percent of the world's multinationals are domiciled and which together account for at least three-quarters of the

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multinationals' business and profits. The developing nations can contribute emotionalism and rhetoric to the decisions, but very little else. They are simply not important enough to the multinationals (or to the world economy) to have a major impact.

But at the same time the emergence of a genuine world economy is the one real hope for most of the developing countries, especially for the great majority which by themselves are too small to be viable as "national economies" under present technologies, present research requirements, present capital requirements and present transportation and communications facilities. The next ten years are the years in which they will both most need the multinationals and have the greatest opportunity of benefiting from them. For these will be the years when the developing countries will have to find jobs and incomes for the largest number of new entrants into the labor force in their history while, at the same time, the developed countries will experience a sharp contraction of the number of new entrants into their labor force—a contraction that is already quite far advanced in Japan and in parts of Western Europe and will reach the United States by the late 1970s. And the jobs that the developing countries will need so desperately for the next ten years will to a very large extent require the presence of the multinationals—their investment, their technology, their managerial competence, and above all their marketing and export capabilities.

The best hope for developing countries, both to attain political and cultural nationhood and to obtain the employment opportunities and export earnings they need, is through the integrative power of the world economy. And their tool, if only they are willing to use it, is, above all, the multinational company—precisely because it represents a global economy and cuts across national boundaries.

The multinational, if it survives, will surely look different tomorrow, will have a different structure, and will be "transnational" rather than "multinational." But even the multinational of today is—or at least should be—a most effective means to constructive nationhood for the developing world.

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