BOOK REVIEWS

Sovereignty at Bay: The Multinational Spread of U.S. Enterprises by Raymond Vernon, New York, Basic Books, 1971, x+326 pp.

The spread of international production, that is the fact that a considerable and increasing part of industrial production and extractive activities in national territories is now undertaken under foreigners' control, has recently become a topic of the hottest debate in international economic relations. The main agents of these moves which significantly interact with the pattern of world trade and factor movements have been the U.S.-based multinational corporations which have since 1965 been the subject of extensive and intensive research under the Harvard Multinational Enterprise Project. This book by its director, Raymond Vernon, which brings together the principal results of the project's studies for the first time is a unique contribution in its wide range of coverage and broad horizon of approach. Representing a skillful synthesis of wide-ranging materials made available in the course of the project, rather than a systematic treatise originating in a single analytical mind, the volume is perhaps the best introduction into the existing state of knowledge about the subject matter.

The coverage of the volume is broad and well balanced. The problems of contemporary multinational enterprises range from purely economic aspects, such as impacts on efficiency and welfare or on the balance of payments of the countries concerned, to social and political power relations implied in the growth of corporate direct foreign investment. Although the choice of the title for the book may suggest the predominance of the political point of view in the treatment of the subject, two-thirds of the pages are devoted to the analysis of relevant economic aspects, somewhat removed from the concept of "sovereignty."

The first task to which the author addresses himself is to identify the subject of the study, the nature of the multinational enterprise. Instead of starting from preconceived theoretical concepts, Vernon tries to arrive at viable generalizations through sorting out a rich assembly of characteristics pertaining to the representative U.S. enterprises with considerable productive operations abroad. They represent "a group of enterprises of extraordinary size and high profitability, committed to activities that involve the relatively heavy use of skilled manpower and of advertising outlays—in short, a group of enterprises bearing the characteristics usually associated with oligopoly." (p. 12) We find here all those elements of industrial organization which are basic to the recent theory of direct foreign investment as developed by Richard Caves. It is suggested that the examination of the typical style of behavior of oligopolistic firms with a degree of product differentiation will be of a crucial importance to any effort at systematic explanation of international production.

The major economic issues posed here, however, are related to the macroeconomic consequences of multinational corporate operations for both the investing "home" and the "host" countries. Accepting the fact that the particular form of international transmission of capital, technology, and managerial resources, so to say in a package, is more profitable at the firm level than the alternatives of transferring these resources separately, it must be asked what the implications of these operations are for growth

and efficiency, for welfare and equity, or for the balance of payments of the home and the host countries respectively. In trying to answer these questions, the microeconomic approach via theory of industrial organization will have to be supplemented by the consideration of general macroeconomic relationships, possibly along the lines of traditional international trade theory. Raymond Vernon's theory of product cycle appears to come in ideally to fill the gap.

According to Vernon's succinct restatement, the hypothesis in question depicts the cycle of growth and decline of products essentially in the following terms: "To begin with, U.S.-controlled enterprises generate new products and processes in response to the high per capita income and the relative availability of productive factors in the United States; they introduce these new products or processes abroad through exports; when their export position is threatened they establish overseas subsidiaries to exploit what remains of their advantage; they retain their oligopolistic advantage for a period of time, then lose it as the basis for the original lead is completely eroded." (p. 66) The key to the explanation of direct foreign investment in the context of the product cycle hypothesis is obviously "the perception of a threat to an established export market." (p. 71) But a threat to the export position may take very heterogeneous forms in the reality, such as the protectionist policy of tariffs and quotas introduced by host-country governments, the growth of domestic production in competition with imports, or the entry of competitive multinational enterprises into the market in question, and the response of the U.S.-controlled multinational enterprise may differ accordingly. Evidence doesn't seem to have established the necessary causal relationship between the export-threat and direct foreign investment. While in some industrial fields the threat to export position may motivate the enterprises to reinforce their export effort rather than to transfer production abroad in preference to exports, a dynamic cost-reducing policy of firms may make investing in production overseas more profitable than exporting even without their export position being seriously threatened. The entrepreneurial decisions to organize production abroad obviously depend on many more factors than the difficulty encountered in the export market. The rationale of direct overseas investment requires also to be explained in the light of the alternative of selling technology through licensing arrangements. In all these respects, the product cycle hypothesis does not give more than a partial explanation of the birth of multinational enterprises.

Moreover, the essential elements of technological superiority in the dominating power position of the U.S.-controlled multinational enterprises seem to escape the grasp of the product cycle thesis. Vernon states that "the instinct of U.S.-controlled enterprises is to locate production of relatively young sophisticated products in the United States and to move the production abroad as the U.S. oligopoly position is impaired." (p. 189) Thus, the logic of the product cycle hypothesis would be to link direct external investment with a somewhat weakened oligopoly position which may be associated with the process of diffusion of technology and progressive standardization of products. This contrasts with the actual behavior of the American multinational giants which is characterized by the concentration of manufacturing on R&D-intensive sophisticated products for local sale, rather than on standardized labor-intensive products for export to the United States. In fact, the U.S.-controlled multinational operations, intent on maintaining the technology gap as large as ever, have good reasons to avoid the production of standardized products, in which the U.S. firms may be easily displaced by local competitors.

More positively, the contemporary multinational corporation typically plans to locate

production facilities in those countries where most favorable conditions prevail, to service the entire world market from the point of view of world strategy. Vernon himself has to admit that this world business strategy cannot be adequately explained in terms of the patterns of growth and decline of products, when he writes that his own "model is losing some of its relevance for those enterprises that have long since acquired a global scanning capacity and a global habit of mind." (p. 107) It is also obvious that Vernon's trade model does little to explain much of non-American multinational behavior. Here is a field of inquiry in which further research, perhaps combining the oligopoly thesis with analysis of changing international trade patterns, will prove most rewarding.

Vernon's approach to the controversial issues of national economic consequences of multinational corporate behavior is characterized by a high degree of caution and circumspection, which is in remarkable contrast with the sporadic expression of value judgments in favor of U.S.-based multinational corporations. The questions of impacts of multinational enterprises on efficiency and equity of national economies of the host countries, for instance, are admittedly difficult to answer in unequivocal terms, because the answers sensitively depend on the selection of yardsticks for comparison. Although the author comes very close to the arguments typically presented by the interests of multinational corporations in many respects, the discussion is generally ambiguous in its conclusions. Even as regards the effects on balance of payments of the economically advanced host countries, which crucially depend on what happens in the pattern of import substitution, evidence was, as Vernon states in his typical style, "that these investments somewhat accelerated a process of import substitution that would in any event have occurred. That statement is about as far as the systematic data can carry us." (p. 166) The lack of conclusive results may largely be a reflection of the absence of a range of special studies which are suitably designed with the assistance of a theory.

Turning to the questions of social and political power associated with U.S. multinational corporate operations, Vernon puts them into a right perspective, observing that "just at the stage when the need for national control has increased, the national ability to maintain that control has declined. The interests and responsibilities of nations . . . have . . . spread outward into the areas of other nations." (p. 231) For the United States, this outward spread has been epitomized more than by anything else by the expansion of its multinational enterprises. Hence inevitable conflicts in jurisdiction and tensions involving mounting national sentiments.

Instead of delving deeper into the substantive aspects of these conflicts and tensions, however, the author seems to prefer reducing the disputes into a clash of value systems. On the one hand, Vernon has the image of the multinational corporation as a carrier of world economic integration, accountable only to some transnational body and representing the world's interests transcending national confines. Properly interpreted, such an enterprise has a "constructive economic role" which should not be in conflict with any national economic aspiration. On the other hand, however, the national desire for control is reduced to a mere psychic phenomenon. Vernon writes: "As a rule, the tension is a manifestation of powerful psychic and social needs on the part of élite groups in host countries. These needs include the desire for control and status and the desire to avoid a sense of dependence on outsiders." (p. 249) As if there were no reason for substantive conflicts of interests and for "destructive political tension," but for the bias in the psychology of nationalist élite groups in host countries!

It is mainly in the developing countries of the South that the U.S. multinational corporate behavior is persistently subjected to suspicion and accusation of economic

dominance. Today is the time for experiments for finding a *modus vivendi* of direct foreign investment whereby the host country's need for capital, technology, and managerial resources may be harmonized with its understandable desire to avoid a sense of economic dependence. The "new forms of partnership" include proposals for combining capital transfer in the form of portfolio investment with separate arrangements for transfer of technology and managerial skills. Uppermost on the agenda for the developing countries are various schemes for sharing ownership and control in the subsidiaries of foreign-based multinational enterprises, including some forms of prearranged divestiture. Although Vernon recognizes some utility of such schemes in meeting "political and psychological needs of the host country" (p. 269), his main arguments in terms of standard economic cost-benefit calculus lead him to a position basically inimical to the divestiture proposal. Readers from the developing countries may have wished the arguments to have been conducted more properly in terms of political economy, with emphasis on the need for harmony of interests.

What are the implications of the multinational corporate behavior for the world pattern of trade and factor movements? Vernon's volume represents a rich mine of observations full of insights on the future shape of the world economy. Vernon reports that, in the course of the Harvard Project's studies, the behavioral model that has proved most useful is "one quite far removed from the classical model" of perfect competition. The environment of corporate operation is also characterized by "the pervasive presence of ignorance and uncertainty in the decision-making process." (p. 115) Because of the oligopolistic character of the market, the direction of international commodity transactions is conditioned less by cost advantage and factor endowments in specific countries than by the decision of the multinational enterprises as to the balancing of conflicting demands of different sources and markets. (p. 177) If about a quarter of all U.S. exports of manufactured goods is accounted for by parent-to-subsidiary sales, involving 264 U.S. parents and their subsidiaries (p. 16), the fact that it is entirely in the hands of multinational corporate decisions to distribute costs and benefits between the affiliate units of the enterprise through setting transfer prices must raise a fundamental question as to the theoretical foundations of international equilibrium price. These observations merit further elaboration to provide building blocks for a more realistic and dynamic theory of international trade.

To stay within the confines of the problem areas designated by the author, however, it may be worth mentioning that the world Vernon portrays in which multinational corporations play such a decisive role is highly asymmetrical in the distribution of power. (p. 112) But the nature of political and economic influence that the U.S.-controlled multinational enterprises, the heroes of this study, can and almost certainly seek to exercise in international economic policy of the present time has been deliberately placed outside the scope of the political and social discussion in this volume.

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Administration and Development in Malaysia: Institution Building and Reform in a Plural Society by Milton J. Esman, Ithaca, Cornell University Press, 1972, xi+341 pp.

This book is the result of Milton J. Esman's observations as a senior advisor to the