World Investment Report 1993: Transnational Corporations and Integrated International Production

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The most recent assessment of world investment by the UNCTAD Programme on Transnational Corporations (the former UNCTC) is a milestone. It documents, as no other research has done, the culmination of a process that has been visible over the past three decades—the ascension of international production over international trade in importance for the growth of the world economy.[1] Further, it shows the significance of the increasing *integration* of productive activities around the world, dictating the level and patterns of trade.

It records also the sea change in host government policies towards foreign direct investment (FDI), which have now become wholly supportive and welcoming, as compared to the restrictions or rejections of the 1960s and 1970s. Governments are now adopting policies to create a favourable climate for FDI—in ways in which a 1958 survey by the United States Department of Commerce showed it to be necessary (United States Department of Commerce, 1958). These early perceptions are noted here to show that the present situation has an aura of *inevitability*. It is the continuing inevitability of international economic integration *through* international production rather than trade that is the subject of this review. The *Report* stresses that the trends observed constitute a major shift in international economic relations, encouraging closer regional ties leading to "free production agreements". These changes must be considered quite carefully in the strategies of both Governments and transnational corporations (TNCs); and, as the *Report* concludes (p. 225), the resulting "negotiations suggest that a more fundamental 're-think' is required".

This re-thinking will inevitably lead (though not necessarily smoothly or promptly) to an understanding of how to establish a world economic order that is *cooperative*-competitive, rather than merely competitive. The imperatives of such integration are partly historical—reflecting the gradual expansion of the markets served and the growth of the "economic community" from families, to

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[1] See, Polk, Meister and Veit (1966). *U.S. Production Abroad and the Balance of Payments*. New York: National Industrial Conference Board.

analysis of the implications for firms, nations and regions; and an assessment of specific problems that illustrate differing objectives and underlying values of countries and regions. All of this permits an assessment by the reader of the difficulties and processes of greater economic cooperation.

Statistical evidence

WIR93 provides a multi-year record of the growth of international production among the advanced countries and, to a lesser extent, between them and the developing countries (which hold less than 10 per cent of the world's stock of FDI, with the top 10 developing countries receiving two-thirds of the total inflow to the Third World). The full record should be read by those who are involved in international strategies for Governments or TNCs. Its is the cumulative growth of FDI that is most significant, for it has caused international production (at $5.5 trillion) to surpass total exports ($4 trillion) in 1991, with half of the trade among the affiliates and parents of TNCs. All TNCs account for a high percentage of each country's GNP, exports and imports: "For Japan and the United States, between a quarter and a third of private-sector productive assets are potentially under the common governance of TNCs pursuing integrated international production. For the world as a whole, this percentage may be one-third" (p. 6). Consequently, TNCs are the predominant decision-makers in shaping the world economy and its degree of integration.

Still, the distribution of FDI remains skewed even among the advanced countries; the five major home countries are the source of over half FDI outflows to advanced countries. It is estimated that nearly 60 per cent of the parent companies in advanced countries are in manufacturing, 37 per cent in services and only 3 per cent in primary materials. The advanced countries are the hosts to some three-fourths of all inward investment. Foreign affiliates number over 170,000 worldwide; advanced countries contain just under half, indicating that the value of investment in each is larger than the average for affiliates in developing countries, for about 40 per cent of affiliates are in the developing world, with some 13 per cent in Central and Eastern Europe (over 70 per cent of which went to Hungary and the former Soviet Union). Further, there is a high concentration of FDI in the hands of the top 100 (non-financial) TNCs, which held about $3.2 trillion of global assets in 1990, of which $1.2 trillion was in foreign affiliates equalling one-third of the FDI stock. Further, cumulative flows between North America and the European Economic Area amounted to $500 billion in 1990, compared to $100 billion between Japan and North America and roughly $25 billion between Japan and the European Economic Area.

The resulting integration through TNCs is called "deep" integration in *WIR93*, since it involves integration of factors of production as well as the sale of goods; mere sale (i.e., trade) is seen as "shallow" integration. This distinction is critical for a range of policy issues. Historically, the slogan "world peace through world trade" was used to support free trade policies, but this causal relation was not proved valid in the event. Rather, it was the nations that traded most who fought most with each other, frequently over the distribution of gains and the acquisition of factors of production.

Now, the acquisition of additional factors is done through attracting the TNCs, which bring capital, management, technology, even labour and access to foreign resources. International trade was based on the assumption of factor immobility, and integration took place through trading of commodities. International production has occurred with the movement of factors and a consequent integration that dictates a new structure of trade, largely among and within TNCs. This type of integration is much more binding and much more complex in its impacts on economic policies (both domestic and foreign). It *forces* new forms of cooperation among nations, *if* they are to reap the benefits of acquiring new comparative advantages through the movement of factors.

The result is a clear picture of *dynamic comparative advantage*—often discussed by economists by not wholly taken into account in classical theories of trade. The ability of Governments to *attract* factors of production and to change national comparative advantages also changes the "locational advantages" offered to other, related or competitive TNCs. And many economic decisions are shifted from the market to the hierarchies within TNCs—from the market to relationships *within* and *among* TNCs. The network becomes more important than the "self-regulating market", and *WIR93* shows that the networks are complex and expanding.

Since this new form of integration requires a number of trade offs among Governments, as comparative advantages shift and industries and services relocate, there is pressure to form associations among like-minded countries so as to ease the potential conflicts. Regional rules, incentives and surveillance are established to make certain that the interests of Governments are served in this new development.

Transnational corporations are also acting at the global level, adding more complexity to policy determinations by Governments. They are inducing markets to become more similar, as consumers find similar or identical products both satisfactory and pleasing; they are moving factors worldwide, not simply within a contiguous region; they are hastening the improvement of communication and

transportation, which is both a result and a cause of continuing integration of international production; and they are tying national economies even closer together through their demands for financial and other services of the same type all around the world. As financial markets are integrated, it becomes increasingly necessary for Governments to cooperate not only in the rules for financial institutions but also on monetary and foreign exchange policies. This they are not get quite ready to do, but it will be forced upon them. The more open economies are becoming to the full range of the activities of TNCs in production, selling and servicing, the more cooperation among Governments and between them and TNCs will be necessary.

Such cooperation will lead to even greater openness, for it is quite difficult to cooperate on mutual restrictions without raising conflicts. But, again, the major unresolved issue in cooperation is the equitable distribution of benefits of a more open world economy. Not even dynamic comparative advantage, accelerated by FDI, will necessarily remove inequities that reflect an early start, former protectionist policies or the more recent industrial targeting by specific nations.

Organizational structures

The volume moves on (chapter VI) to the structures adopted by TNCs to give effect to their international strategies. This is quite a good description of the phases through which many TNCs have gone and which most newly-formed TNCs will follow—the "stand-alone" foreign affiliate, often tied to the home-country market; the "holding company" or "multi-domestic" structure serving several foreign markets from local production sites; the "integrated" (not yet "global") enterprise, tying several producing and distribution affiliates through a complex network of operational and financial ties; and the "alliance" forms, which provide for short- or longer-term integration of specific functional activities, such as marketing, purchasing, research and development, production of a specific line, mutual supply of components etc.[5] The illustrations of actual company networks will be instructive to both Governments and academics.

The lesson is that the organizational forms fit the needs of the TNCs in making their operations more efficient to meet the demands of an increasingly competi-

[5] Chapter V on TNC strategies makes the least contribution, since it draws on work of other researchers; most of this material is not new and some repeats questionable results of academic researchers. It might be better for future authors to stick with analyses of their own research and merely make reference to the studies by others. The authors of *WIR93* are often too tentative with their own conclusions, using the words "may" and "might" or "conceivably", while giving too much credence to academic research.

tive world economy. It is not possible, therefore, to predict the decision-making structures that will evolve as technology and markets change. This dynamism requires that Government decision-making be as adaptive both in its structure and its methods so that unnecessary conflicts are avoided.

The structures of TNCs will be significantly altered by the increasing number of regional associations being formed by Governments. A major question is raised of whether TNCs will respond by becoming regionally oriented or will seek also to keep strong ties across regions. The concept of a Triad world is already passé; the regions identified—North America, Pacific, and Europe—have become stretched beyond their former limits, with the rise of the "four tigers" and the claims of Central Europe; and new entrants are on the horizon in the form of China and, later, Russia and India. The economic positions within Europe are already shifting significantly, with the United Kingdom and Italy declining, and Germany taking the primary position largely by default. And the impact of the North American Free Trade Agreement (NAFTA) is not yet clear on its signatories and their TNCs, much less the rest of Latin America and the Pacific countries. What is clear, however, is that an effective NAFTA will accelerate greatly the increase of integrated production among its members, raising many of the policy problems reviewed in *WIR93*.

Advantages of integrated production

The volume reviews the several advantages of these developments for longer term economic growth of participating countries. They are principally favourable, of course, as was argued for many years by all but a few researchers on the role of TNCs. The few dissidents have now vanished, for it is clear that the major advantages of greater employment, higher wages for host country workers, new technologies in *all* countries, lower costs and the stimulation of sluggish domestic markets are needed by all countries. In fact, it is the lack of adequate domestic stimuli to economic growth that has given rise to universal calls for inflows of FDI—including by Russia, China, Albania, Democratic People's Republic of Korea and Cuba—with many formerly state-owned enterprises seeking avidly (and unrealistically expecting?) a Western joint venture to be their salvation.

There is an interesting omission in the *Report* in the absence of an analysis of the effects of TNC activities on the balances of payments of home and host countries. It would be a useful service if, in future assessments, the diverse effects of integrated international production could be traced in the international balance of payments. This is difficult, because FDI often includes within it a

pattern of intra-company trade and payments that after overall balances, but this only makes FDI more significant in foreign economic policies. An analysis of these linkages will be necessary in order to grasp the issue of an equitable distribution of benefits. This issue will have to be addressed *not* at the level of the gains from trade but at the very source of the distribution of income-generating factors of production.

It is not yet fully grasped in corporate or Government policies that the world does not yet have adequate (acceptable) answers to the basic economic questions of *who* (companies) should produce *what* (goods and services), *where* (countries), *why* (social purpose), for *whom* (masses or elites), *how* (technology) and *when* (present versus future). There are no *economic laws* dictating any of the answers, save those of "supply and demand", "division of labour" and "comparative advantage"; these are the "laws" of consumer satisfaction and production efficiency and, of course, must be taken as dynamic or changing in their expression according to time and circumstance. All else is subject to determination through various policies and practices expressed in political processes, organizational hierarchies and a myriad of relationships. A resolution through these structures requires extensive cooperation; they are not well used in intensive competitive conflicts—such as seems to be the major focus through the emphasis on "international competitiveness" today.

Answers to these economic questions inherently involve not only the question of efficient production, which will be improved by the developments described in *WIR93*, but also of *equity* in the distribution of benefits, an acceptable *participation* of countries involved (regionally or globally), opportunities for *creativity* in research and development, the maintenance of desired *diversity* of culture protected by national *autonomy*, the protection of the *environment* as a concern for future generations and the creation of a *community of interest* that protects *human dignity* and elicits both individual and social *responsibility*. These are the nine criteria for an orderly and progressing world economy, as seen from the debates both in the United Nations and in other international fora and in the negotiations of regional and bilateral agreements.

Transnational corporations are themselves learning to offer many of these benefits to their own personnel and affiliates, and as well as to host countries. Thus, there is an increasing dispersion of production opportunities, of research and development laboratories and of component supply—all documented in the volume under review. These changes are in response not only to earlier governmental "performance requirements" but also to evidence that efficiency *rises* when equity and opportunity are provided. There is no necessary "trade-off between equity and efficiency", as has been argued among economists; the psy-

chologists have shown that perceived equity enhances productivity, and it would be so among the nations of the world, once they see the benefits of cooperative competition through the integrated international production of TNCs.

This recognition should be accelerated by *WIR93*, but many attitudes are so ingrained that it will probably be some years before TNCs are *used* through policy decisions as a means for creating the several "criteria of acceptability" of a new world economic order noted above. Yet, it is apparent that, with new rules, TNCs would respond to produce the very conditions necessary for greater reception of their roles *and* greater order and progress in the world economy.

Policies to attract foreign direct investment

The volume details a number of policies that Governments have adopted to attract FDI. It shows that *all* policy changes during 1992 were to liberalize the treatment of TNCs. Such policies have been adopted by many countries over the past decades, under advice from various quarters (including the World Bank, which issued "Guidelines on the Treatment of Foreign Direct Investment", urging "fair and equitable, and national and non-discriminatory treatment"). Additional inducements came from advantages of FDI noted above and reflected in the performance of joint ventures between foreign and domestic enterprises: "their record of sales, profits and foreign-currency earnings per employee has been well above that of domestically-owned enterprises" (p. 57). This record buttresses the call by the countries of Central and Eastern Europe for "more joint ventures with the West"); but they are as yet unwilling to adopt the World Bank Guidelines, and *WIR93* warns that "FDI is not a substitute for domestic-led growth". On the contrary, FDI will seldom come into a country to "kick-start" its growth; rather, it waits until it is clear that policies will be supportive of the private sector and broad economic growth, so that a dynamic domestic market will be assured.

The new policies need not be detailed here, but a few should be stressed since former communist countries are now embarking on a new phase of attracting FDI and will be competing with all other countries seeking such inflows. The major attraction to foreign investment remains a strong and vibrant *domestic* private sector, followed by access to the domestic market. These conditions show TNCs that private investment is well treated by the Government and that its investment can be profitable on a "stand-alone" basis if necessary. "National treatment" is relevant *only* if that treatment is similar to the best that is available in competing opportunities.

Apart from these conditions, there are a number of macro conditions—

appropriate infrastructure, financial and other services—and micro conditions permitting flexibility in TNC decisions on employment, pricing, remittances etc. which attract FDI. These are well-known by now, save in the newly emerging markets; *WIR93* will be highly instructive to them, since it shows the treatment of FDI not only by certain nations but also in NAFTA (pp. 51-52).

Special problems

As a result of the new patterns of ownership and production through the spread of TNCs, several special problems have arisen. They have been discussed in the literature on TNCs previously, but *WIR93* summarizes and presents the issues in a clear and useful fashion for policy makers. The issues addressed include that of the "nationality" of a TNC and its affiliates, criteria of taxation of its multi-country activities, responsibility to generate and support sustainable economies in the countries where it operates, and the potential protectionism arising from regional groupings.

The last is not really a TNC-caused issue, for TNCs would be satisfied with open regional associations. They are concerned, however, as are "outsider" Governments, with a potential "fortress" mentality arising from new regional groupings.

It is, however, more likely that the pressures of TNCs and the advantages of integrated international production will induce the opening of "free-trade corridors" between regional groups on a sectoral basis. This concept was proposed during the Kennedy Round of the GATT negotiations in the early 1960s, but it was not then seen as reciprocal in its effect, since Europe had not yet placed much FDI in the United States. Now, however, with cross-national investment in the same industries at high levels between the major (potential) regional groups—detailed for both manufacturing and services in chapter III—it is quite likely that free-trade corridors will be opened in specific industries, such as automobiles, electronics, chemicals and maybe pharmaceuticals. The dangers of regionalism arise only for those who cannot envision more cooperative solutions.

The responsibility for sustainable economies is a question of the present use of available resources and the recycling of those used. Transnational corporations will readily cooperate in this if Government policies are clear and are applicable equally to all participants—domestic and international. Here, again, therefore, cooperation is the fundamental requirement, rather than competition.

The question of the "nationality" of a TNC is a matter of the application of national policies to a segment (affiliate or parent) of the TNC and not to the

whole. It is also a question of the "rights and privileges" provided by incorporation in one or more countries. The volume examines the issue quite well, concluding that it is a problem only for Governments that wish to impose differential restraints on "foreign companies" or offer differential incentives to "national companies". Such differences can create frictions; so, again, the answer lies in the harmonization of different approaches through cooperative agreements.

The most difficult of these four issues is that of taxation, for TNCs have the ability to shift incomes or activities so as to change the tax base, including through the re-location of production. The different taxation criteria are examined without a resolution as to the most appropriate among them, because this is a matter for Governments to decide by agreement. Competitive taxation will *not* work, for TNCs would be taxed doubly or more and would simply decide to move out of certain jurisdictions. California, in trying to apply its unitary tax laws, found that it was diminishing the tax base and losing other advantages of investment in the state; it has since modified its position.

Future problems

Several problems, besides the special ones just discussed, are on the horizon. They include:

- The harmonization of Government and TNC strategies for entry or expansion into and growth of the world economy, particularly through the new regional groupings;
- differential treatment of specific industries;
- attainment of a more equitable distribution of benefits, especially between advanced and developing countries;
- the accommodation of different socio-economic systems with the transformation of the former socialist economies;
- the role of TNCs in the formation of a future world economic order.

The *harmonization* of strategies will proceed at a pace with which Governments perceive and pursue the advantages of international economic integration. Such integration is inevitable; it is occurring, as amply illustrated in *WIR93*, both at the hands of TNCs and through regional associations. And it will accelerate, for it is the *only* means by which poverty and conflict in the world can be relieved (without a complete re-ordering of priorities and a change in human nature).

Transnational corporations find such integration not only comfortable, but profitable, as detailed in the volume. They will, therefore, be the catalyst that pushes Governments in the necessary direction. The next move should be the formation of more extensive dialogues between TNCs and Governments on the entire range of TNC activities, treating the TNC as a unit rather than as a collection of independent functions—such as taxation, licensing of technology, production, exporting/importing, funds transfers etc.. For the TNC, all of these are part of the same strategy. Governments have not yet come to this realization.

The United States has yet—despite its initiatives with NAFTA—to come to the realization that regional associations are a necessary next step in the formation of a cooperative-competitive world economy. It is simply too difficult to achieve global agreement on the "rules of the game", as shown by the interminable negotiations under the Uruguay Round of GATT, and these issues are not the most excruciating ones faced by the world economy. There are too many countries involved in global negotiations; too many diverse objectives; too much interdependence among major issues of trade, aid, technology transfer, FDI, environmental protection, exchange rates, national growth policies and support for science and technology; and too much political instability to permit the reconvening of such a conference as that at Bretton Woods, or even the one forming GATT. It is imperative, therefore, that we take "partial steps" through regional associations to achieve the necessary harmonization of policies and strategies. It will then be easier to identify ways of linking these regions by more open trade and investment. Again, this linking will lead to a system of cooperative-competition, rather than the conflicts envisioned by several observers.[6]

This inter-regional linking is best done through industry agreements, focusing on the patterns of investment and trade, as was done under the United States-Canada Auto Agreement. Under such bilateral (i.e., between regions) agreements, the rules for the movement of FDI and the resulting patterns of trade (with their impacts on the balance of payments) can be more readily worked out. The fact that cross-national investment in the same industry already exists, with companies in both regions having established alliances, will make such agreements still easier. They need not and should not be anti-competitive;

[6] The latest warnings come from Lester Thurow (1992). There are others focusing on the bilateral conflict between Japan and the United States. Many of these, as with Thurow, see the developments of regional blocs clearly enough, but they draw the wrong conclusions. The intricate ties of the TNCs, as shown in *WIR93* will strengthen cooperation, for there is no advantage to TNCs from inter-regional conflicts.

rather, they should avoid managing trade and instead balance off the flows of investment and the benefits in each region from integrated production.[7]

The volume reviewed here shows that there is ample room for such negotiation at least among the advanced countries, and that is where the potential for "regional fortresses" could be the most damaging to future growth of the world economy. Transnational corporations have no interest in strident conflicts over trade or investment; rather, they seek "reasonable competition" with a "level playing field", which enables planning with less uncertainty. The world economy also needs such an approach if it is to reach sustainable growth.

The attainment of a more *equitable distribution of benefits* among the advanced countries and regions would come with the formation of the rules within and among them covering trade and investment. The existence of cross-national investment by TNCs in major regions and in major man and service industries provides ample room for balancing the trade-offs to achieve equitable benefits with maximum efficiency in the use of resources.

The difficult problem in equity at present is that between the advanced and developing countries. There is as yet not enough FDI to integrate significantly the international production that exists among them. Thus, it will be some time before balanced trade-offs can be made in either investment or trade. Consequently, the advanced countries will need to substitute trade concessions and incentives to FDI in developing countries for direct aid, building the ties necessary to generate opportunities for harmonization and the achievement of greater equity in benefits. Trade should be seen as the most effective means of increasing productivity around the world, and thereby encouraged in an open fashion. The balancing of gains should be done through the location of international production—which is relatively easily sited in multiple countries—and on an industry-by-industry basis.

The *accommodation* of different socio-economic systems as the former socialist countries join the world economy poses a new challenge. These countries are unlikely to remove state ownership completely from the major companies presently held, and these, in turn, will not be permitted to operate as Western state-owned enterprises have been, without significant Government intervention. Their integration into international production will, therefore, require a new relationship. Their entry will be eased if the partial moves towards regional and industry agreements are focused on FDI rather than trade. The strongest pressure should be brought to bear to avoid *managed trade*, for

[7] See Jack N. Behrman (1984) where a design for inter-regional and intra-regional cooperative competition is described.

this reduces competition and the gains from trade for all. The benefits of freer trade should be sought and urged on a regional and global basis; it is the movement of factors and the guidance of dynamic comparative advantage that should be managed. There is little economic basis for extreme specialization among industries, and there is strong justification for specialization within and among industries, permitting a wide variety of trade-offs among national interests and structures of ownership and control.

The *role of TNCs* in the formation of a future world economic order should be evident from *WIR93*—it is that of binding the world's economies into "deep" integration so that it is progressively more difficult to discriminate against the foreigner, more difficult to determine *a priori* the impacts of changes in exchange rates on the patterns of trade and the flow of FDI, more difficult to manage economies through national monetary policies and more difficult to control the flow of funds among countries.

These changes mean that Governments will be forced to cooperate in the formation of intergovernmental rules on investment and trade, creating an appropriate cooperative-competitive economy in which the benefits to all are transparent and therefore subject to adjustment through negotiation and trade-offs. All this is as it "should be", for it is through closer economic ties—not through trade but through "deep integration" that the economic basis for international conflicts will atrophy. In this realm the world is moving in a hopeful direction, and strong efforts should be made by both Governments and TNCs to achieve a new order (harmonization and equity) without a reduction in efficiency and progress. ■