Re-evaluating the benefits of foreign direct investment

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During the past twenty years, both the country- and firm-specific factors influencing foreign direct investment have changed significantly. For their part, countries adopted a much more welcoming stance towards inbound investment and increasingly see it as a means of upgrading the competitiveness of their indigenous resources and capabilities. Corporations, on the other hand, are increasingly taking a more systemic approach to their global activities and are pursuing more integrated production and marketing strategies. Both these developments are affecting the balance of the costs and benefits of foreign direct investment to host countries, and also the appropriate actions that Governments should take to ensure that it advances their long-term economic objectives. In considering some of these issues, this article identifies the ways in which different kinds of activities may affect domestic competitiveness, and stresses the need for Governments to reorient their macro-organizational policies so that they may best gain from being linked to the globalizing economy of the 1990s.

Introduction

Thirty-six years ago, the first comprehensive analysis of the consequences of inbound foreign direct investment (FDI) for a host country was published (Dunning, 1958). The subject of study was the United Kingdom; since that date, similar investigations have been undertaken — with varying degrees of sophistication — for almost every country in the world.[1] Hundreds of books, theses

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[1] Of the more substantive studies, those for Canada (Safarian, 1966), Australia (Brash, 1966), Norway (Stonehill, 1965), New Zealand (Deane, 1970), the Netherlands (Stubenitsky, 1970), Kenya (Langdon, 1981), Singapore (Mirza, 1986), the United States (Graham and Krugman, 1989), India (Kumar, 1990), Mexico (Peres-Nuñez, 1990) and Central and Eastern Europe (Artisien, Rojec and Svetlicic, 1993) might be mentioned.

and Government reports, and thousands of papers in academic and professional journals have been written on the topic,[2] and scarcely a day goes by without some newspaper or magazine article lauding or denigrating the globalization of business activity.

Why, then, is it needed to revisit the subject? Has not everything worthwhile already been said or written about the role of transnational corporations (TNCs) in economic development? Quite apart from its spectacular growth over the past decade,[3] two sets of reasons for the current resurgence of interest could be offered. Each reflects the changes in attitudes towards the costs and benefits of FDI that have occurred over the past twenty years; the first is by *countries* and the second by *firms* — particularly by TNCs.[4]

The changing attitudes of countries

In the early 1990s, most Governments are acclaiming FDI as "good news", after a period of being highly critical — if not downright hostile — to these investments in the 1970s and early 1980s. There are a number of possible explanations for this change of heart, some of which are set out in figure 1.

- Renewed faith of most countries in the workings of the market economy, as demonstrated, for example, by the wholesale privatization of State-owned assets and the deregulation and liberalization of markets over the past eight to ten years. While these events are being most vividly played out in Central and Eastern Europe and in China, the need to remove structural market distortions has also been acknow-

[2] In 1991, the United Nations Centre on Transnational Corporations (now the UNCTAD Division on Transnational Corporations and Investment [DTCI]) identified over 3,000 books, reports and articles published between 1988 and 1990 alone (UNCTC, 1991).

[3] As documented, for example, in the *World Investment Report* (UNCTAD, Division on Transnational Corporations and Investment, 1993, 1994a), and in the forthcoming *World Investment Directory* (1994b). Since 1981, the annual growth rate of FDI stock has consistently outstripped that of world gross domestic product, gross domestic investment and the exports of goods and non-factor services. Furthermore, it is estimated that, in 1991, foreign affiliates of TNCs generated global sales of more than $4.8 trillion compared to world exports of goods and non-factor services of $4.5 trillion ($3 trillion excluding intra-firm trade; UNCTAD, Division on Transnational Corporations and Investment, 1994a).

[4] Some of these changes in attitudes and values are reflected in the publications of the former United Nations Centre on Transnational Corporations since its inception in 1974. In particular, the initial focus on the actions of TNCs that might constrain the sovereignty of national Governments, has gradually been replaced by an examination of the ways in which host Governments and foreign direct investors can work together to promote sustainable economic development and the competitiveness of domestic resources and capabilities. The contemporary mood which stresses the complementarity between Governments, firms and markets is also echoed in several of the reports of the World Bank (see, especially, *World Bank*, 1991 and 1993).

Figure 1. The changing world of foreign direct investment

- **From a country's perspective**
  - Renaissance of the market system.
  - Globalization of economic activity.
  - Enhanced mobility of wealth-creating assets.
  - Increasing number of countries approaching the "take-off" stage in development.
  - Convergence of economic structures among developed countries and some newly industrializing economies.
  - Changing criteria by which Governments evaluate FDI.
  - Better appreciation by Governments of the costs and benefits of FDI.

- **From a firm's perspective**
  - Increasing need to exploit global markets (e.g., to cover escalating research-and-development costs).
  - Competitive pressures to procure inputs (raw materials, components etc.) from the cheapest possible sources.
  - Regional integration has prompted more efficiency-seeking investment.
  - Growing ease of trans-border communications and reduced transport costs.
  - Heightened oligopolistic competition among leading firms.
  - Opening up new territorial opportunities for FDI.
  - Need to tap into foreign sources of technology and organizational capabilities and exploit economies of agglomeration.
  - New incentives to conclude alliances with foreign firms.
  - Changes in significance of particular locational costs and benefits.
  - Need to better balance the advantages of globalization with those of localization.

At one time, firms used to engage in international transactions primarily through arm's-length exporting and importing. Today, the main vehicle is FDI and cooperative alliances. Initially, these latter forms of cross-border commerce were driven by trade; today, they largely determine trade. Outside the primary sector, upwards of two thirds of the world's exports of goods and services are accounted for by TNCs; and 30-40 per cent of these take place within these same institutions (60-70 per cent in the case of intangible assets, such as technology and organizational skills) (Dunning, 1993a; UNCTAD, DTCI, 1993).

In the 1990s, TNCs are the main producers and organizers of the knowledge-based assets that are now primarily responsible for advancing global economic prosperity; they are also the principal cross-border disseminators of the fruits of these assets. It is true that the ambience of innovatory activities, the availability of risk capital and the educational infrastructure is strongly influenced by the actions of Governments. It is true, too, that a myriad of small firms and individual entrepreneurs are significant seed-beds of new ideas and inventions. However, economic progress is being shaped increasingly by the way in which new knowledge and organizational techniques are systematized and disseminated. Sometimes, the market system is able to perform satisfactorily this task by itself. However, because many emerging innovations are both generic and multi-purpose and have to be coordinated with other assets to be fully productive, firms frequently find it beneficial to supplement or supplant external markets by their own governance systems. Sometimes, too, the efficient production and use of created assets requires firms to cooperate and even to be located in close proximity to each other.[8]

To some extent, this has always been the case. One of the earliest definitions of a business enterprise was that it was a coordinated unit of decision taking;[9] today, a firm is better described as a coordinator of a network of interrelated value-added activities (Dunning, 1993b). In the past, the boundaries of the firm were firmly determined by its ownership. Now, *de facto*, they are much fuzzier, as their capability to control the allocation of resources may be exercised through a variety of cooperative arrangements or networking agreements.[10] The more activities a firm pursues, the more it engages in coalitions with other firms and the

[8] The gains of spatial agglomeration or clustering of related industries are one of the four critical variables influencing the competitiveness of firms and countries, as identified by Michael Porter (1990).

[9] This definition was popularized in the 1930s, when the nature of the firm as an organizational unit was hotly debated among economists in the United Kingdom.

[10] These include strategic alliances and long-term contractual relations with suppliers. The widening scope of firms to at least partially control the use of resources and capabilities of other firms in which they have no ownership (and *vice versa*), is encouraging scholars to return to the idea of *groups* of related firms as the critical units of micro-economic analysis.

more countries it produces in, or trades with. In that event, its competitiveness is likely to be determined by its ability to integrate these activities systematically.

The systemic view of TNCs implies very different governance structures than those implemented by traditional foreign investors. Rather than acting as an owner of a number of fairly autonomous, or "stand-alone", foreign affiliates, each of which is expected to earn the maximum economic rent on the resources invested in it, the systemic TNC aims at managing its portfolio of spatially diffused human and physical assets — including those owned by other firms over which it has some property rights — as a holistic production, financial and marketing system. Of course, there are costs of coordinating intra- and inter-firm cross-border activities, and these will ultimately determine the extent of a firm's territorial expansion. But recent advances in international transport and telecommunication technologies have pushed out these limits. In the cases in which corporations have shed some of their foreign assets, this has been mainly done to reduce the scope or diversity of their activities, rather than the geography of their international transactions.

A final feature of the FDI in the 1980s and 1990s, which accords with the systemic view of TNC activity, is that, probably, as much as 90 per cent of that activity is currently undertaken by established TNCs, that is, it is *sequential* rather than *initial* investment. This is not to deny that new TNCs are emerging all the time — probably at a rate of 4,000 to 5,000 a year,[11] and increasingly, from developing countries, notably China; but, as yet, the total foreign capital stake of these companies is quite small. Research has established that sequential FDI — which, as far as a particular country is concerned, might be a first-time investment — is not only likely to be more geared to the interests of the investing company's value activities, but is also likely to generate its own unique costs and benefits, that is, over and above those generated by the initial investment (Kogut, 1983; Buckley and Casson, 1985). These essentially arise from the consequences of transnationality *per se*. They include gains such as those arising from the diversification of exchange risk and economic uncertainty, the spreading of environmental volatility and the opportunity to exploit better the economies of geographical scope and specialization. They also include the costs of coordinating the activities and markets of foreign affiliates in widely different business cultures and political regimes (Kogut and Kulatihala, 1988) and those associated with the setting-up and sustaining of cross-border networks of intra- and inter-firm relationships.

[11] Estimates of the universe of TNCs and their affiliates are constantly being revised upwards. The latest estimates by UNCTAD, DTCI (1994a), are at least 37,000 parent firms and 200,000 foreign affiliates in the early 1990s.

Types of foreign direct investment and countries

Global economic events of the past decade or so, particularly those driven by technological advances, regional integration and the realignment of economic systems and policies, have altered fundamentally the perception of Governments of host countries of how FDI can contribute towards their economic and social goals. These same events have also caused a reappraisal by firms of *why* and *how* — and, indeed, *where* — they need to engage in international transactions. It is for these reasons that the current generation of scholars — not to mention Governments and firms — continues to want to know more about the benefits (and costs) of FDI. To what extent and in what way is the global economy causing these to change? What may national and regional administrations do to ensure that inward TNC activity contributes the maximum benefits to their economic and social needs and aspirations?[12]

With these introductory remarks in mind, I will make two very simple statements, which are as timely today as they were twenty years ago and which policy makers concerned with assessing the benefits of FDI would do well to constantly bear in mind:

- History and geography matter. Policy makers should seek to learn from their successes and failures of the past and from those of other countries; but they should not be slaves to those successes and failures. In light of the perceived contribution of FDI to economic development, they should devise and implement the macro-organizational strategies most suited to their own unique situations and needs.
- Policy makers should be cautious about expecting easy generalizations about the consequences of FDI. Not only will its effects vary according to the kind of FDI undertaken, but these effects will also depend on the economic and other objectives set by Governments, the economic policies pursued by them and the alternatives to FDI open to them.

In order to focus better the remainder of this article, it is assumed that the principal criteria by which national administrations evaluate inbound FDI in the 1990s is by *its perceived contribution to the improvement of the competitiveness or the productivity of the resources and asset-creating capabilities located with-*

[12] While this article concentrates on the benefits of inbound FDI, an increasing number of Governments are also reassessing the benefits of outbound FDI. Indeed, as it has been stressed frequently — notably in Dunning (1993b) — the globalizing economy is forcing Governments to take a more integrated view of outward and inward TNC activity in exactly the way they do of international trade.

in their areas of jurisdiction.[13] This, indeed, is probably the single most important medium- to long-term economic objective of the great majority of nations, particularly of those that are most dependent on foreign sources of supply and foreign markets for their prosperity.

How, then, might competitiveness of a country be advanced? Figure 2 identifies five main ways:

- By a country's firms producing more efficiently whatever they are currently producing, for example, by reducing organizational costs and/or raising labour or capital productivity.
- By the innovation of new, or improvements in the quality of existing, products, production processes and organization structures.
- By a reallocation of resources and capabilities to produce goods and services that are in better accord with the country's comparative dynamic advantage.
- By capturing new foreign markets — provided this is cost effective.
- By reducing the costs, or speeding up the process, of structural adjustment to changes in global demand and supply conditions.

The potential contribution of inbound FDI to each of these ways or vectors of upgrading competitiveness is fairly self-evident. It may provide resources or capabilities otherwise unattainable, or only attainable at a higher cost. It may steer economic activity towards the production of goods and services deemed most appropriate by domestic and international markets. It may boost research and development and introduce new organizational techniques. It may accelerate the learning process of indigenous firms. It may stimulate the efficiency of suppliers and competitors, raise quality standards, introduce new working practices and open up new and cheaper sources of procurement. It may provide additional markets. It may better enable a host country to tap into, or monitor, the competitive advantages of other nations. It may inject new management talent and entrepreneurial initiatives and work cultures. It may encourage the formation of cross-border cooperative alliances, technological systems and inter-firm networking. It may foster the geographical clustering of related activities that generate their own agglomerative economies. In short, it may interact with the *existing* competitive advantages of host nations and affect their *future* competitive advantages in a variety of ways.

[13] As, for example, usually measured by the gross national product (GNP) per head or rate of increase of GNP.

strategies of Governments of other countries whose firms are competing for the same resources and markets (Dunning, 1992).

In table 2, the attributes of each type of inbound FDI that are most likely to enhance the competitive advantages of recipient countries are identified. In practice, the precise contribution of each type of investment will be both activity- and firm-specific. It is also likely to vary according to the age of the investment; generally speaking, the local value added of a foreign affiliate is positively correlated with its age — and, perhaps most important of all, it will depend on the organizational strategies and economic policies adopted by host Governments. Some of these strategies and policies are examined later in this article, but, in compiling table 2, it is assumed that these are broadly consistent with the dictates of the international market-place and that they are primarily directed towards enhancing the dynamic competitive and comparative advantages of the resources and capabilities within their jurisdiction.

The conclusions of the tables summarizing the research findings of scholars[16] and the experience of national authorities are self-evident. Each type of FDI has its own particular contribution to make to the five ways of upgrading competitiveness identified in figure 2 and the four facets of Porter's diamond illustrated in figure 3. For example, through the transfer of resources and capabilities, and transactions with domestic firms, both market- and resource-seeking TNCs have the potential to raise the productivity of indigenous resources and capabilities, improve quality standards and stimulate economic growth. In the right circumstances, efficiency-seeking FDI can assist host countries to restructure their economic activities more in line with their dynamic comparative advantages; reduce the costs of structural adjustment; and foster more demanding purchasing standards by firms and consumers. Strategic asset-seeking investment may help integrate the competitive advantages of the acquired firm with those of the acquiring firm and increase competition between domestic firms. However, this type of FDI, unlike the other types, may be undertaken with the specific purpose of transferring the assets acquired from the host to the home country, and this may work to the disadvantage of the competitiveness of the former country.[17]

The contribution of each type of FDI also varies according to the part (or parts) of the value chain in which it is undertaken. Investment in each part may be motivated differently. For example, some kinds of foreign-owned research-and-development activities are truncated replicas of those of the parent companies;

[16] For a summary of these, see Dunning (1993a).

[17] Though not necessarily, as much would depend on how the owners of the acquired firm spend the proceeds of the transaction; and how the location-bound resources released by the acquired firm are subsequently deployed.

Table 2. Some likely contributions of different types of foreign direct investment to the upgrading of competitiveness of host countries

1. Natural resource-seeking

(a) Provides complementary assets (technology, management and organizational competence).

(b) Provides access to foreign markets.

(c) May or may not lead to local spin-off effects on industrial customers, e.g., secondary processing activities.

(d) Raises standards of product quality.

(e) May or may not foster clusters of resource-based related activities.

2. Market-seeking

(a) As 1 (a) above.

(b) Fosters backward supply linkages and clusters of specialized labour markets and agglomerative economies.

(c) As 1 (d) above; also raises domestic consumer expectations of indigenous competitors.

(d) Stimulates local entrepreneurship and domestic rivalry.

3. Efficiency-seeking

(a) Improves international division of labour and cross-border networking; entices comparative advantages of host countries.

(b) Provides access to foreign markets and/or sources of supply.

(c) As 2 (b) above.

(d) As 1 (d) and 2 (e) above.

(e) Aids structural adjustment.

4. Strategic asset-seeking

(a) Provides new finance capital and complementary assets.

(b) As 1 (b) above.

(c) As 2 (d) above.

(d) As 3 (a) above.

And their significance as inbound FDI determinants will also depend on the attributes of particular host countries, such as size, stage of economic development, industrial structure, degree of economic interdependence with the rest of the world and physical and psychic distances from the main investing countries.

Most of the spatial characteristics, as well as the industry, firm- and country-specific contextual variables that influence them, are well known both to scholars and business enterprises alike. Yet, in the past, the expectations of Governments — and particularly Governments of low-income countries — have been shattered because they have not taken into account sufficiently the unique characteristics of their resources and organizational capabilities. The benefits of inward FDI for Nigeria or Taiwan Province of China are unlikely to be the same as those for India; those now experienced by Chile and Viet Nam are quite different from those of ten to fifteen years ago; those currently gained in Malaysia and Botswana from efficiency-seeking FDI are scarcely comparable with each other; and those that result from market- and resource-seeking FDI are likely to be highly dependent on the development and macro-organizational policies of host Governments relative to those implemented by other Governments competing for the same type of FDI.

With respect to the second question, the significance of the spatially related variables set out in table 3 has changed considerably over the past two decades. As their share of total production costs declined, so did the drawing power of natural resources and unskilled labour, while that of created assets and the opportunities of networking with local firms rose.[22] As the unique competitive advantages of TNCs became both more mobile and systemic, these firms have increasingly chosen to locate their value-added activities in countries that can offer the most cost-effective complementary assets and the quality of infrastructural support that an integrated international production or marketing strategy requires. In this connection, intending investors usually place their need for state-of-the-art facilities for the cross-border transmission of information, technology and finance at the top of their locational priorities. An effective and trustworthy legal framework — particularly in its ability to enforce property rights and resolve contractual disputes — comes a close second. At higher levels of economic development, the quality of a country's educational and technological infrastructure becomes more critical.

More generally, as the organizational and transaction costs of economic activity have become relatively more important — and there is some evidence (Stiglitz, 1989; Wallis and North, 1986) that these are also positively related to

[22] Exceptions include some resource-seeking and manufacturing assembling investments in the poorer developing countries.

the complexity of a nation's industrial structure — countries that can offer a business environment that is conducive to minimizing these costs are, *ceteris paribus*, likely to gain an increasing share of inbound investment. Recently, two surveys were conducted, one on the determinants of Japanese FDI in the United Kingdom's manufacturing sector, and the other on the location of international offices (Dunning, 1991). In both surveys, transaction and coordinating-cost variables (such as those related to inter-personal relations, information asymmetries, language and culture, searching for and dealing with sub-contractors, learning about the quality of communications and adapting to local business practices and customer needs and bureaucratic controls) were ranked considerably higher as investment determinants than were traditional production-cost-related variables.

Host Government policies

Elsewhere (including in this journal), I have written extensively on the ways in which the actions of Governments affect — for good or bad — the location and structure of TNC activities (Dunning, 1991, 1992, 1993b and 1994). In this article, I focus on the main changes in host Government organizational strategies over the past two decades that have affected the most the level and distribution of FDI.

Foremost among these changes has been a softening in the attitudes towards FDI. This has resulted in a widespread liberalization of policies that previously constrained these investments. In addition, as has already been mentioned, the criteria by which most countries evaluate inbound TNC activity has shifted from its direct contribution to local value added to its longer-term consequences for the competitiveness of indigenous resources and capabilities.[23] This reassessment has occurred at a time when Governments of both developed and developing countries have been rethinking their own economic functions in light of political changes and the globalization of the world economy. The most obvious manifestation of this rethinking has been a widespread deregulation and liberalization of markets, the privatization of many State-owned industries and the removal (or reduction of) a wide range of Government-imposed market imperfections (e.g., subsidies, tariff and non-tariff barriers, price controls and certain rules and regulations).

However, the fact that Governments have lessened their direct intervention in markets does not mean that they have abdicated — or, indeed, should abdicate — their responsibility as *enablers* and *steerers* of wealth-creating activities, or as *facilitators* of the private enterprise system. Indeed, as firm-specific assets

[23] What might be thought of as a shift from a "micro-income" to a "macro-asset" perspective.

Table 4. Some possible contributions of inbound foreign direct investment to the upgrading of the competitive advantages of host countries

Positive contributions	Negative contributions	Host country characteristics that favour positive contributions
1. By providing additional resources and capabilities, viz. capital, technology management skills, access to markets.	May provide too few, or wrong kind of resources and assets. Can cut off foreign markets compared with those serviced by domestic firms. Can fail to adjust to localized capabilities and needs.	Availability of local resources at low real cost, particularly those complementary to those provided by foreign firms. Minimal structural distortions or institutional impediments to upgrading of indigenous assets. Development strategies that help promote dynamic comparative advantage.
2. By injecting new entrepreneurship, management styles, work cultures and more dynamic competitive practices.	An inability of foreign entrepreneurship, management styles and working practices to accommodate or, where appropriate, change local business cultures. The introduction of foreign industrial-relations procedures may lead to industrial unrest. The pursuance of anti-competitive practices may lead to an unacceptable degree of market concentration.	The policies pursued by host Governments to- promote local entrepreneurship and a keen and customer-driven work ethic; the character and efficiency of capital markets; the effectiveness of appropriate market-facilitating policies. Larger countries may find it easier to introduce some of these conditions than smaller countries.
3. By a more efficient resource allocation, competitive stimulus and spill-over effects on suppliers and/or customers, FDI can help upgrade domestic resources and capabilities, as well as the productivity of indigenous firms and foster clusters of related activities to the benefit of the participating firms.	Can limit the upgrading of indigenous resources and capabilities by restricting local production to low value-added activities and importing the major proportion of higher value-added intermediate products. May also reduce the opportunities for domestic agglomerative economies by confining its linkages to foreign suppliers and industrial customers.	The form and efficiency of macro-organizational policies and administrative regimes. In particular, the benefits likely to be derived from FDI rest on host Governments providing an adequate legal, commercial and assigning priority to policies that help upgrade human and technological capabilities and encouraging regional clusters of related activities, e.g., science and industrial parks.
4. By adding to the host nations' gross domestic product (GDP), via 1-3 above, and by providing additional tax revenue to Governments.	By restricting the growth of GDP via 1-3 above. By transfer pricing or other devices to lower taxes paid to host Governments.	See 1-3 above. Suitable policies of the tax authorities of host Governments to minimize transfer pricing abuse. Countries that have the most to offer TNCs are likely to be the most successful in implementing these policies.

Table 4. *(continued)*

Positive contributions	Negative contributions	Host country characteristics that favour positive contributions
5. By improving the balance of payments, through import substitution, export generating or efficiency-seeking investments.	By worsening the balance of payments, through limiting exports and promoting imports and out-competing indigenous firms that export more and import less.	Need to take a long view of importing and exporting behaviour of foreign affiliates. The key issue is not the balance of payments per se, but the contribution of FDI to economic efficiency, growth and stability. However, countries with a chronic balance-of-payment deficit may find it difficult to completely liberalize their balance-of-payments policies.
6. By linking better the host economy with the global market-place and helping to advance economic growth by fostering a more efficient international division of labour.	By promoting a division of labour based on what the investing firm perceives to be in its global interests, but which may be inconsistent with dynamic comparative advantage as perceived by the host country.	As 3 above - and, in particular, the extent to which host country Governments can pursue policies that encourage investing firms to upgrade their value-adding activities and invest in activities that enhance the dynamic comparative advantage of indigenous resources. The gains from 6 are particularly important for smaller countries.
7. By more directly exposing the host economy to the political and economic systems of other countries; the values and demand structures of foreign households; attitudes to work practices; incentives; industrial relations and foreign workers; and many different customs and behavioural norms of foreign societies.	By causing political, social and cultural unrest or divisiveness; by the introduction of unacceptable values (e.g., with respect to advertising, business customs, labour practices and environmental standards); and by the direct interference of foreign companies in the political regime or electoral process of the host country.	The extent to which a society is strong and stable enough to smoothly adjust to technological and political change. Also, the strength and quality of Government regulations and norms; the nature of the host country's goals and its perceived trade-off between, for instance, economic growth, political sovereignty and cultural autonomy. The difficulties in optimizing the benefits of the openness induced by FDI will be greatest in countries which are the most culturally distinct from their trading or investing partners.

Among the most important of these changes has been the emergence of the global economy and the structural integration of the world's markets and production systems. This new international division of labour, an integral part of which is the growing mobility of intra-firm intermediate products between countries, is demanding a reappraisal of the economic philosophies and policies of national Governments. In particular, the widening locational options of TNCs and the convergence of industrial structures and trade patterns of advanced countries is forcing national administrations to pay more attention to ensuring that the quality of their location-bound resources and capabilities do not fall behind those of their competitors.

In pursuance of these goals, Governments have other critical roles to play, including the elimination of structural and institutional impediments to efficient resource usage; the active implementation of market-facilitating measures; and the encouragement of an ethos of competitiveness among their constituents. The administrations that have gone the furthest in implementing those changes have been the most successful, not only in attracting inbound FDI, but also — much more importantly — in using those investments in a way that best advances their national interests in a globalizing economy.

I would, however, like to conclude by offering a number of caveats. The first caveat refers back to some of the possible costs of FDI as a competitiveness-enhancing vehicle. There is a saying, much beloved by Western economists, that there is no such thing as a free lunch. That means all good things have to be paid for. That is certainly true of FDI; the only question is whether the price attached to it is a fair and reasonable one. One difficulty faced by many Governments in formulating and implementing policies that affect the costs and benefits of inbound FDI is that they either do not have the knowledge, or are uncertain, about what those costs and benefits actually are. This is partly because most decisions, the outcome of which affects the behaviour of foreign affiliates, are taken by their parent companies on the basis of information and expectations known only to them. This is not to say that these globally oriented decisions necessarily work against the interests of host countries; but it does make life more difficult for Governments seeking to optimize the level and pattern of inward FDI and its effects on domestic competitiveness.

The main points made in this article may be summarized by reference to table 4, which sets out the main costs and benefits of FDI as have been experienced by host countries over the past two or three decades. The balance between the costs and benefits of each kind of contribution varies according to the type of investment (identified in figure 1), a variety of firm- and industry-specific features (some of which have been identified in this article), and the

age and nationality of FDI. It will also depend on the characteristics of host countries, especially the policies of host Governments. (Some of these latter characteristics are set out in column 3 of table 4.)

A second caveat relates to the nature of a country's competitiveness. The term "competitiveness" is a relative concept and it is used by analysts to compare the economic performance of firms, industries or countries (or, that of the same firm, industry or country) over time. However, whether a country whose firms are uncompetitive in the production of a particular range of goods or services should encourage inbound FDI to improve its competitiveness is debatable. Very rarely, if ever, can a country expect to be competitive in the production of all goods and services. Obvious examples include growing bananas in Iceland and producing sophisticated electronic equipment in Chad. One of the tasks of the international market-place — backed by the appropriate Government policies — is to allocate resources and capabilities in such a way that each country engages in the kind of economic activities to which it is *comparatively* best suited. Foreign direct investment can play a useful — and sometimes a decisive — part in that process. What, however, it should not be used for is to "prop-up" activities that can never become internationally competitive. Resources must be directed to where they can be most productively used. After all, one of the functions of trade is to allow a country to import products that it is relatively unsuited to produce for itself and pay for these with products which other countries are relatively unsuited to produce. The success of FDI in upgrading the *competitive* advantage of a country's resources and its *comparative* advantage in the international market-place should be judged by those criteria. ■

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