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Chapter XII

A LOOK TO THE FUTURE

The world is in a period of rapid change, so much so that, as late as 1985, it would have been difficult if not impossible to predict what the world would look like by 1992. The end of the Cold War and the economic opening of Central and Eastern Europe, the unification of Germany, the rise of Japan and the relative decline of the United States as major international investors have all occurred in the past few years, and are re-defining international relations. While such rapid change makes it difficult to speculate about what the world will look like at the beginning of the twenty-first century, one thing that seems very likely is that international competition will increasingly be based on economic rather than military prowess.

Furthermore, the nature of international competition itself is being re-defined by the globalization of economic activity, such that the activities of TNCs rather than domestic firms operating within the boundaries of individual nations are likely to be key determinants of the dynamics of international competition. International production may well become one of the most, if not the most, important characteristics of the world economy in the coming years.

Not only is international production growing, it is also changing. Transnational corporations may increasingly be viewed as networks, in which intra-firm flows of capital, goods, services, training and technology play an important role, and whose major value-adding function is the integration, organization and management of those international flows. Thus, in the 1990s, the term "transnational", which describes firms whose strategies are determined more by considerations of global efficiency rather than by national borders, may become increasingly applicable to the nature of international production.

The policies that govern the world economy have not moved as quickly as have TNCs in adjusting themselves to international production. The growing role of FDI as a basis for international economic relations poses formidable challenges to policy makers. Addressing the discrepancy between the rise of international production and the policies that govern it is likely to be a key policy issue, both on the domestic and multilateral levels, in the 1990s. The increased role of TNCs in the growth and competitiveness of both home and host countries, and the role played by FDI in integrating national economies into regional and international production structures, present new issues and problems with which most national Governments have had little previous experience. Indeed, the domestic policy frameworks of most countries do not reflect the role of TNCs as integrating agents of capital, trade, technology and training flows; hence one of the first tasks of Governments in the new world economy is to adjust their policy-making structures. However, there is clearly a limit to how far domestic policies can go in addressing the international issues posed by the new world economy. In this regard, there is a risk that effective solutions to the current challenges in the international economy could be hampered by the lack of an adequate multilateral governance mechanism, since the institutions currently in place are not fully able to deal with the issues that arise in a world in which TNCs are the primary private economic actors.

A. New domestic policy issues

The emerging shape of international production poses new challenges to policy makers. First of all, the space in which TNCs act is expanding as more countries give a greater role to the private sector and market forces in their economies. The growing role of the private sector through the liberalization of FDI and trade policies, privatization and fiscal reform is likely to continue into the future. Countries face many issues in this regard, a key one being the model of public-private sector relations they choose to adopt. Very different experiences present themselves in the world economy concerning the relationship between state and market, each carrying its own set of costs and benefits. An important consideration in this respect is that the policies that Governments adopt *vis-à-vis* the private sector will influence their ability to attract investment by TNCs in a highly competitive world FDI market. Going hand-in-hand with the greater role that the private sector is meant to play are expectations that TNCs can make a significant contribution in such major tasks of the 1990s as the need to shift towards a more environmentally sustainable growth path (especially by introducing new technologies); efforts to address migration pressures (by alleviating such pressures through investment in source countries); and the transition of the countries of Central and Eastern Europe to market economies (by engaging themselves strongly in that process through FDI). Such expectations need to be examined carefully, and the limits to the role that TNCs can play in meeting them need to be recognized. Finally, the choices that countries make regarding the management of the private sector will, in an increasingly integrated world economy, become issues of not just domestic but international concern as well (see below).

The priorities of domestic policy regimes are also likely to be affected by the changing nature of international production. Rapidly-developing communications technologies are likely to increase greatly the tradability of services, especially of those that have a high information or know-how content. The nature of FDI will be further changed by that trend, allowing TNCs to create an international division of labour in the production of many services as they are already doing in the production of goods. Such a trend would affect both developed and developing countries alike, and it is likely to affect the nature of economic policy-making. With the services sector having become the largest sector in most countries by the early 1990s, its importance will be fully recognized by the end of the century. By that time, economic management policies will likely focus on the services sector, precisely to reflect the importance of this sector in the world economy and in world-wide FDI flows. Technology policy will also probably be given higher priority on national agendas. Indeed, services sector policies, technology policies and human resources policies may in the future overshadow industrial policies as the prime areas of state and market interaction. Those policies, in turn, in both home and host countries, will have to pay special attention to the role of TNCs. Indeed, countries may need to design integrated policy packages centred on FDI, but addressing simultaneously technology and trade issues in order to derive maximum benefit from the activities of TNCs.

Finally, the globalization of economic activity poses a whole new set of policy issues that needs to be dealt with on both national and international levels. The globalization of firms is creating international production structures that represent a new, more far-reaching level of economic integration than was previously accomplished through international trade. Host countries are faced with the prospect of a growing role for non-national firms in their economies; home countries, too, must deal with the challenges that are posed by outward FDI. Among the new issues facing policy makers in that respect is that many countries, especially small ones, may increasingly become specialized in particular stages of an industry as TNCs organize international production by locating discrete value-adding activities among several different locations according to the latters' comparative advantages in the industry in question. Thus, individual countries may become constrained in their ability to develop independent industries dominated by national firms; indeed, such a strategy may prove detrimental to national competitiveness for some countries in certain industries. National policies regarding industrial and services-sector development, trade and technology will thus increasingly have to take into account the global nature of many industries and the policies of other countries in those industries.

B. New international policy challenges

One of the greatest challenges which the policy community will face in the future is that policy-making with respect to a number of issues relating to the management and regulation of firms may be moving, at least partly, from the national to the international arena. [1] In part, that would be required by the logic of international production which weakens national policies in their ability to regulate national economic activities. In part, that will be required by the fact that the distinction between home and host countries is becoming increasingly blurred; some of the developed countries are also major hosts to FDI and some developing countries have emerged as noteworthy investors in both developed and developing countries. Potential policy areas include, in particular, competition policy and corporate law, investment incentives and technology policy, but also infrastructure-development policies and industrial, services and labour policies. More generally, larger parts of the domestic policy-making domain are likely to become increasingly subject to international policy-making, as the rise of international production could lead to more frequent systems friction, or competition between national approaches to economic management. [2] For example, the behaviour of TNCs is to a certain extent affected by the approach to private-sector management adopted by their home countries; the international activities of Japanese TNCs differ from those of United States TNCs in part because of different home-country policy frameworks. In that regard, problems may arise between countries as the level of FDI between them rises. Japanese TNCs may pursue strategies that are considered normal practice in Japan but anti-competitive in the United States, and vice versa. In another example of how domestic policies can become issues of international concern, conflicting requirements placed on TNCs by different countries can lead to disputes at the international level over basic issues of governance that extend to political, social and environmental concerns.

Such problems multiply significantly in a world in which FDI flows to many countries and integration occurs at the production level. They pose a challenge to the international community, whose task is to resolve issues that arise from different approaches to what are increasingly common problems. Consequently, multilateral mechanisms may be needed to deal with the growing interdependence of national economies at the level of production, especially to create a proper enabling framework for international production and to reconcile potential conflicts of interest between countries.

The importance of a multilateral approach is also underlined by the tendency that, as industries become more globalized simultaneously with a greater role accorded to market forces in national policy-making, a part of economic decision-making power over who gets what, when, where and how is shifting to TNCs. One important issue in that regard concerns the development of and access to new technology, which is, after all, at the heart of economic welfare and growth. Technological advances are promoting increasing globalization by shrinking economic space, as well as affecting profoundly the ways in which corporations organize their global activities. International strategic alliances among TNCs may, in some instances, lead to the formation of web-like organizations that do not clearly belong to any one country. Such networks may play a greater role in developing and disseminating new technologies. Yet, given their diffuse nature, it will be increasingly difficult to construct policies designed to promote their positive benefits for specific national economies; this issue is of concern to both home and host countries, for example, in the context of providing subsidies. The growth of multi-firm, globalized strategic alliances in high-technology industries suggests the possibility of declining bargaining power of individual countries *vis-à-vis* firms whose boundaries extend beyond national borders. It also raises the question of how to maintain competition between networks and alliances. In a separate but related issue, the further development of electronic data networks that span international borders will no doubt raise a host of issues regarding access to information (which is increasingly critical to wealth creation) and, more generally, access to the electronic highways of tomorrow's world economy. Mechanisms may be needed to deal with technology issues arising from globalization and, above all, to safeguard competition in a world of globalized firms and industries.

One way in which countries are dealing with the commonality of issues arising in a world in which FDI plays a major role is through regional economic integration. If the current trends towards a regionalization of the world economy continue, the arena for economic and regulatory activities would be increasingly defined along regional rather than national lines. Policy makers thus face a major challenge in ensuring that their countries benefit from an association in regional groupings; the harmonization of economic policies which regionalization entails is likely to be one of the key policy issues of the 1990s. Even as new institutions are being created to deal with those issues (or pre-existing ones strengthened), there is a gap in the policy framework governing interregional relations, which run the risk of being subject to increased frictions. Specifically, the inherent tension between an increasing globalization of the world economy and its simultaneous regionalization demands multilateral initiatives that ensure that efforts to promote an open, efficient and fair international system are not constrained by regional groupings.

Another international policy issue that arises from regionalization is that this trend appears to be evolving in such a manner as to draw selected developing countries into economic groupings with a Triad member, which serves as the pole of economic activity for those countries. Transnational corporations from the Triad are at the forefront of that development by making the investments that integrate home and host countries which, in turn, encourage economic integration initiatives at the policy level. Many developing countries, however, are isolated from that process, either because of their geographical distance from a Triad member or because they are not able to attract the investment from TNCs that promote deep economic integration. Thus, a key issue raised in the current phase of regional economic integration is whether it will lead to the increasing marginalization of a large number of developing countries, and hence to deepening economic inequality in the world economy. Against this, a question that needs to be addressed is what active role the new regional groupings can play in promoting the economic development of non-member countries through increased flows of FDI, both from developed- as well as developing-country members of the regional grouping. Such issues are likely to require the attention of the international community with a view to promoting development in an equitable fashion, while taking into account the realities of emerging regional groupings.

C. The need for new policy initiatives

As any look into the future, the present effort, too, is entirely speculative. But it seems quite clear that, whatever the specific configurations, a new world economy is in the making. And, unless current trends change significantly, international production will be the principal characteristic of the world economy at the beginning of the next century, with TNCs at its centre.

Such a prospect makes it not only possible, but necessary, to look at the world economy from the perspective of FDI and, more specifically, international production. Equally important, the paradigm of international economic relations will have to change and the mechanisms governing those relations will have to be adjusted. In other words, the international public policy framework has to catch up with the globalization of firms and industries, the rise of international production and the new policy issues that are emerging into the international arena by this deeper form of international integration. In short, there is a growing need to arrive at an international governance framework for international production. The various mechanisms outlined in chapter XI can contribute to it. But, by the beginning of the next century, something more comprehensive may be required.

One possibility would be to elaborate international principles and standards and to consolidate them in a global, comprehensive and balanced instrument with a view to ensuring the stability, predictability and transparency of the international investment environment, which would have to deal with the main aspects of the treatment of TNCs by Governments, on the one hand, and issues related to their behaviour on the other hand. Indeed, the intensified normative activity of recent years in a number of international forums—including the Uruguay Round (chapter III), the United Nations, the World Bank and OECD—suggests that the need for a comprehensive, balanced and universal framework which addresses the various concepts, issues, principles and standards affecting transnational investment and operations is becoming increasingly recognized.

Another possibility would be to establish an international framework focusing on global competition and restrictive business practices. In a sense, the creation of such a framework is imperative if one wants to preserve the operation of the market in a world of globalizing firms and industries. This could be achieved through a web of bilateral arrangements (the agreement between the United States and the European Community mentioned in chapter III may be indicative for such a possibility), or through a multilateral agreement. A multilateral undertaking may appear logical if one looks at the world economy from an FDI perspective; but, given the interrelationships between FDI and trade, it may well be that an international governance mechanism dealing with competition and restrictive business practices could also be reached through future negotiations in the framework of GATT, particularly if that organization should pay more attention to FDI matters in the future. It is interesting to note in this context that elements of a paradigm change are already occurring in GATT in the context of the Uruguay Round. There, in the course of the negotiations on services, the discussions began with efforts to adapt the trade rules of GATT to the services sector. In the end, as described in chapter III, the rules that emerged apply to trade *and* transnational production in the services sector. It may well be that, in the next GATT round, this new paradigm will become the basis of negotiations and will be extended to the goods sector. In that event, FDI matters and competition policies would be one logical focus of negotiations.

While an international governance mechanism for competition and restrictive business practices would be a step in the right direction, the issues outlined earlier in this section point to the need for a more far-reaching multilateral framework to meet the challenges of globalization. Specifically, an institution may be needed that would bring the principal forms of international economic transactions (and their interactions) within its purview. The mandate of such an institution would have to be more comprehensive than that of existing multilateral institutions such as the IMF or GATT.

Such an organization could, indeed, serve as a multilateral focal point for issues stemming from the growth of international production. Its mandate would thus encompass not only FDI issues, but also trade and technology issues, along with other policy issues that arise directly from the spread of international production, including competition and restrictive business practices. Among its functions, such an organization could also serve as a forum to resolve international disputes relating to FDI and related issues, and to monitor the policies and actions of both Governments and TNCs that significantly affect the functioning of the international production system. As a multilateral agency, such an organization could be concerned with the role of *all* countries in the international production system, both home and host, and could also be entrusted with the responsibility of meeting the concerns of countries that receive little FDI and risk marginalization and constrained development options. Such an organization could be the focal point for a rules-based system to promote a smooth and equitable process of economic integration brought about through the rise of international production. The constellation of circumstances is currently such that a window of opportunity may exist for taking bold steps in the direction of a comprehensive framework for foreign direct investment.

Notes

[1]See on this point Sylvia Ostry, "The domestic domain: the new international policy arena", *Transnational Corporations,* vol. 1, No. 1 (February 1992), pp. 7-26.

[2]Ibid.