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Division on Transnational Corporations and Investment

World Investment Report 1994
Transnational Corporations, Employment and the Workplace

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NOTE

The UNCTAD Division on Transnational Corporations and Investment serves as the focal point within the United Nations Secretariat for all matters related to transnational corporations. In the past, the programme on transnational corporations was carried out by the United Nations Centre on Transnational Corporations (1975-1992) and the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992-1993). In 1993, the Programme was transferred to the United Nations Conference on Trade and Development. The objectives of the work programme include to further the understanding of the nature of transnational corporations and of their economic, legal, political and social effects on home and host countries and in international relations, particularly between developed and developing countries; to secure effective international arrangements aimed at enhancing the contribution of transnational corporations to national development and world economic growth; and to strengthen the negotiating capacity of host countries, in particular developing countries, in their dealings with transnational corporations.

The *World Investment Report* is published annually by the UNCTAD Division on Transnational Corporations and Investment to contribute to a better understanding of transnational corporations, their activities and their impact.

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A slash (/) between dates representing years, e.g., 1988/89, indicates a financial year;

Use of a hyphen (-) between dates representing years, e.g., 1985-1989, signifies the full period involved, including the beginning and end years.

Reference to "dollars" ($) means United States dollars, unless otherwise indicated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

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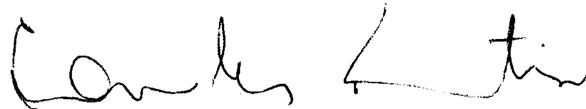
PREFACE

Greater openness in the world economy has intensified international competition and expanded the potential role of foreign direct investment. Transnational corporations have responded to these changes by adopting new structures and strategies to locate and govern their activities at the regional and global levels. For substantial sectors of the world economy, an integrated international production system is emerging. The ***World Investment Report 1993*** described these trends in some detail. But the impact of these developments is not confined to changes in corporate governance or in the nature of international economic integration. It extends to the quantity and quality of employment, human resource development and, more generally, to the organization of work. These concerns are the focus of the ***World Investment Report 1994***.

Transnational corporations directly account for nearly one-tenth of the world's paid employment in non-agricultural activities, although the share of their employment in the world's total labour force is considerably less. Because the evolution towards a more integrated world economy has coincided with slower economic growth and the steady rise of unemployment in developed countries, the short-term impact of cross-border corporate restructuring and relocation has come under even closer scrutiny in recent years. But longer-term and indirect effects on employment flowing from the activities of transnational corporations are also important. In particular, as created assets help, more and more, to shape international competitiveness, the skills profile, training schemes and industrial relations practices of transnational corporations assume greater relevance for all countries.

The new international setting is characterized by widespread liberalization, including in the area of foreign direct investment. This also involves a redefinition of the relationships of the principal actors in the market -- firms, trade unions -- with each other and with governments. As liberalization proceeds, it will be essential that greater freedom is accompanied by greater responsibility, for both transnational corporations and trade unions. There is also a growing need for cooperation among all three actors to ensure that a more open environment is also one in which the benefits from greater efficiency and growth are made available to all members of society. The analysis and evidence presented in the ***World Investment Report 1994*** seek to improve the understanding of these new roles and responsibilities.



Carlos Fortin
Officer-in-Charge
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Geneva, July 1994

The ***World Investment Report 1994*** was prepared by a team led by Karl P. Sauvant and comprising Victoria Aranda, Persephone Economou, Masataka Fujita, John Gara, Richard Kozul-Wright, Padma Mallampally, Fiorina Mugione, Lene Östergaard, Aurelio Parisotto, Paz Estrella Tolentino, Jörg Weber and Zbigniew Zimny. Specific inputs were also received from Abebe Abate, Alvaro Calderon, Duncan Campbell, Edward Dommen, Donald Lee, Michael Mortimore and James X. Zhan. Principal research assistance was provided by Mohamed Chiraz Baly. Research assistance was also provided by Richard Bolwijn, Nitinart Chartsiriwatana, Djidiack Faye, Belen Garbayo, Christopher Jaeckel, Jan Willem Plantagie, Patrick Roqas, Letizia Salvini, Martin Tiddens, Stefan Weiss and William Wiseman. Production of the ***World Investment Report 1994*** was carried out by Medy Almario, Teresita Sabico and Christiane Vertallier. It was copy-edited by Frederick Glover and desktop-published by Martin Best. The work was carried out under the direction of Roger Lawrence.

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Executive summary

Transnational corporations (TNCs) are increasingly designing their production and distribution strategies with the global economy in view, thus expanding the scope of international production. But even as the configuration of their economic activities changes, production still takes place in specific locations, with employees closely attached to their place of work. The impact of corporate strategies and international production on the workplace -- in terms of the quantity and quality of employment, human resource development and industrial relations -- is the particular theme of the *World Investment Report 1994.*

This theme needs to be seen in the context of the return of large-scale unemployment to developed countries and its persistence in developing countries. Fifty years ago, when the international community met at Bretton Woods to lay out an international agenda for a new world order, unemployment was discussed against the backdrop of the Great Depression and the economic disintegration of the inter-war period. Today, the response to unemployment must take place against the background of a more integrated world economy, and one in which TNCs are, inevitably, among the more important vehicles through which any chosen agenda for economic stability and prosperity takes effect. Although the immediate impact of TNC activity on current levels of unemployment is small, the longer-term consequences through stimulating economic growth and improving international competitiveness cannot be underestimated. Policy makers and trade union leaders must find innovative ways to respond to the ongoing changes in the international economy. This is not an easy task. Not only must they address the many new issues raised by integration at the level of production; but, in a more open and integrated world economy, policy makers must coordinate more carefully the traditional instruments for domestic economic management with policies relating to international economic relations, including, in particular, foreign direct investment (FDI) and other forms of TNC activity.

Part One of this volume examines and analyses recent global and regional trends in FDI and TNC activities and presents a longer-term perspective on these trends in the context of the globalization of economic activity. Part Two focuses on employment, human resource development and industrial relations in TNCs, against the background of the expanding volume, wider dispersion and deeper integration of the activities of TNCs. Part Three considers the changing roles of TNCs, trade unions and governments within an increasingly globalized economy, with particular reference to labour-market issues.

Global and regional trends

Recent trends in FDI and TNC activities illustrate the deep and ongoing changes occurring in the world economy. The broad picture that emerges is characterized by the recovery from the FDI recession, the outstanding -- although uneven -- performance of host developing countries, the growth in the number and reach of TNCs and the changing character of the world economy on account of the integration brought about by TNCs at the level of production.

The recovery from the FDI recession ...

After a two-year slow-down in outflows (from $232 billion in 1990 to $171 billion in 1992), FDI outflows began recovering in 1993, reaching $195 billion. Not all major home countries contributed equally to the recovery. Still, the recovery from the FDI recession is seeing a slow return to the previous configuration of major home and host countries.

This configuration had substantially changed during the FDI recession: Japan slipped from first place as a source of FDI to third place, behind the United States and France. The United Kingdom -- the largest outward investor during most of the second half of the 1980s -- moved down to fifth place, after Germany. The decline of world FDI outflows during 1991 and 1992 consisted primarily of reduced outflows from Japan and, to a lesser extent, from some Western European countries, mainly to the United States. The large decline in Japanese outflows -- accounting for 44 per cent and 65 per cent, respectively, of the total declines during these two years -- can be explained by a combination of adverse cyclical factors and some special factors. Among the latter, particularly noteworthy are the weakened financial position of many Japanese TNCs resulting from plummeting stock prices at home, compounded by underperforming investments in Europe and the United States undertaken during the investment boom of the late 1980s. The decline of FDI outflows from Western Europe was not as large as that of Japanese outflows, primarily because the differential timing of the economic recession across Europe partly mitigated the overall decline of FDI flows. In addition, the implementation of the Single Market programme continued to create intraregional opportunities for FDI by European and other TNCs. In comparison with both Japan and Western Europe, United States FDI outflows remained at a high level during the recession and increased substantially in 1993. This reflected the more diversified geographical profile of the country's outward FDI, which permitted United States TNCs to exploit FDI opportunities in some regions and countries, in spite of the recession.

On the inward investment side, the economic recession saw a collapse of investment flows to the United States -- the largest host country during the 1980s and early 1990s -- to 2 per cent of world inflows in 1992 (compared to over one-third in 1989). In absolute values, inflows declined from $69 billion in 1989, the peak year, to $3.4 billion in 1992. The decline of cross-border mergers and acquisitions, which play an important role in the market-entry strategies of TNCs, was substantially responsible for the fall in FDI flows into the United States and major countries in Western Europe.

With the recovery from the FDI recession, the earlier pattern of major host and home countries is beginning to re-emerge. On the inflow side, the United States has resumed its position as the largest host country, with its inflows reaching almost $32 billion in 1993. On the outflow side, the United States has strengthened its position as the largest source of FDI, investing abroad a record $50 billion. The United Kingdom regained its position as the largest home country in the European Union, lost during the FDI recession to France. The developing countries, too, contributed to the recovery of outflows. Outflows from Germany and Japan have not yet started to recover, but they stopped decreasing, signalling, perhaps, that they have reached the bottom of the cycle. Approval data for Japanese outflows for fiscal year 1993/1994, in particular, augur well.

... is being led by a vigorous expansion of FDI in developing countries ...

Even during the FDI recession in the developed countries, flows into developing countries continued to boom, one of the outstanding features of recent global FDI trends. In 1993, developing countries attracted a record $80 billion in estimated FDI, twice the amount of flows in 1991 and the same as the level of total world inflows in 1986. As a result, the share of developing countries in world FDI flows reached about 40 per cent in 1993, a share unsurpassed in decades. Foreign-direct-investment flows in 1992 were the largest component of net resource flows to developing countries, comprising one-third of the total; they constitute over one-half of total private flows to those countries. The most important factors making developing countries attractive to foreign investors were rapid economic growth, privatization programmes open to foreign investors and the liberalization of the FDI regulatory framework.

However, the growth of FDI flows to developing countries is unevenly distributed among regions and groups of developing countries. Most FDI inflows are still concentrated in 10 to 15 host countries overwhelmingly in Asia and Latin America. China has become the largest host country in the developing world, accounting for nearly three-quarters of the increase in FDI flows into developing countries in 1992 and over half of the estimated increase in 1993. Indeed, with $26 billion inflows, China has become the second largest host country in the world in 1993, after the United States, with important consequences for its external trade: the share of foreign affiliates in the country's exports increased from 9 per cent in 1989 to over one-quarter in 1993, while the total volume of exports increased from $53 billion to $92 billion.

On the other hand, the least developed countries as a group have received little FDI. Indeed, their share of total developing-country inflows declined from an annual average of 2.1 per cent in 1986-1990 to 0.6 per cent in 1992. In absolute value, the $300 million received by them in 1992 was less than the inflow received by individual developing countries, e.g., Pakistan, in that year. This unevenness is also reflected in the regional pattern of FDI. Most of the increase of FDI flows has been concentrated in East and South-East Asia, as well as in Latin America and the Caribbean. Flows to Africa -- which includes the largest concentration of least developed countries -- did not increase between the second half of the 1980s and the early 1990s; as a result, the share of Africa in developing-country inflows was halved to 6 per cent between these two periods.

The highlights for each developing country region are as follows:

- **South, East and South-East Asia** have been experiencing the fastest economic growth in the world, and remain the largest host region, accounting for 57 per cent of total developing-country FDI in 1992. China's performance has been central in this respect. Flows into the newly industrializing economies slowed down, however, as a consequence of the restructuring of FDI in response to the loss of some locational advantages and to their efforts to become attractive to high technology or skill-intensive investments. These economies continue to be significant outward investors and are moving labour-intensive

activities to other countries in Asia. As a result, intraregional FDI is growing; countries such as China, Indonesia, Malaysia, Thailand and, increasingly, Viet Nam are particularly attractive locations for such investment. Prospects are quite promising that this region will be able to sustain the present level of FDI inflows, if not improve on it, given that most principal factors determining FDI flows are favourable. Even if FDI flows into China should slow down, as latest signs suggest, there are still a number of markets in the region -- most notably India -- that have yet to be fully tapped by foreign investors.

- Average investment flows into **Latin America and the Caribbean** during the early 1990s were more than twice as high as those during the 1980s. This revival of inflows reflects the recovery of economic growth, market-oriented reforms and a liberalized FDI framework. While FDI through TNC participation in privatization and debt-equity conversion programmes is still important in some countries, others, such as Chile and Mexico, are now succeeding in attracting substantial amounts of investment outside such programmes. Prospects for sustaining the present growth of FDI flows appear to be quite favourable. Progress towards greater economic integration, both within this region and with North America, would be an additional factor generating and attracting FDI.

- Despite the widespread liberalization of FDI policies by many governments in **Africa** during the 1980s, FDI inflows did not increase between the second half of the 1980s and the early 1990s. Averaging around $3 billion a year, FDI flows to the entire region are considerably less than those received by, for example, Malaysia in the early 1990s. Small markets with low growth rates, poor infrastructure, high indebtedness, slow progress in introducing market- and private-sector-oriented economic reforms and low levels of technological capabilities all reduce the attractiveness of many African countries to foreign investors. Inflows are concentrated in oil exporting countries, especially Egypt and Nigeria. However, a number of small African countries, such as the Seychelles and Equatorial Guinea, have attracted considerable FDI inflows in relation to the size of their economies. That suggests that a differential analysis is required when assessing the investment potential of African countries. Still, although some countries are clearly more successful in attracting FDI than others, prospects for FDI in Africa as a whole and especially in sub-Saharan Africa are not so favourable. External assistance, particularly official development assistance, will therefore continue to be of great importance to create the premises for self-sustained growth, including an FDI-friendly environment.

... but only moderate FDI increases in Central and Eastern Europe.

The remarkable expansion of FDI flows to developing countries has belied the fear that the opening of **Central and Eastern Europe** -- and the efforts of the countries of that region to attract such investment -- would divert investment flows from developing countries. In fact, the growth of FDI flows to Central and Eastern Europe has fallen far short of the growth of flows to the developing countries. The modest inflows also greatly dampened expectations regarding the role of FDI in the transition from centrally planned to market economies. Flows into the region totalled an estimated $5 billion in 1993 (about the size of flows to Mexico). Cumulated FDI flows were approximately $13 billion in 1993 (barely more than the FDI stock in Thailand). Investments are unevenly distributed within the region, concentrated in those countries that have made the most progress in establishing a market-oriented economic system. Nevertheless, FDI in some key industries (such as automobiles), the establishment of new linkages with Western Europe, the transfer of modern technology and management practices to foreign affiliates and supplier firms and the provision of previously unavailable services assist in speeding the transition and fostering economic recovery. In addition, TNCs help indirectly in the transition to a market economy by exerting pressures for institution-building, privatization and competition. As regards the future, the region has a good potential to attract foreign investors: many countries are middle-income

economies with sizeable domestic markets and pent-up consumer demand for goods and services and have a large industrial base; some countries are rich in natural resources and have considerable human resource endowments and relatively low labour costs; and the proximity to the European Union market could entice TNCs to reorganize affiliate networks regionally. Even then, however, it is not likely that the result would be a large-scale transfer of production capacities from developed countries to those of Central and Eastern Europe. Rather, what is more likely is an incremental increase in production located there, partly to satisfy local markets, partly as a result of regionally integrated production.

The expanding TNC universe ...

The universe of TNCs in the early 1990s was composed of at least 37,000 parent firms that controlled over 200,000 foreign affiliates worldwide, not counting numerous non-equity links. Two-thirds of these parent firms -- 26,000 --- were from 14 major home developed countries, an increase of 19,000 since the end of the 1960s. Foreign affiliates generated sales of more than $4.8 trillion in 1991, slightly more than world exports of goods and non-factor services (some one-third of which were intra-firm) and twice the sales figure at the beginning of the 1980s. The influence of the largest TNCs on output, employment, demand patterns, technology and industrial relations should not be underestimated: the world's largest 100 TNCs, ranked by foreign assets, held $3.4 trillion in global assets in 1992, of which about 40 per cent were assets located outside their home countries. The top 100 control about one-third of the world FDI stock.

... has linked national production systems in the broader context of globalization.

Transnational corporations and their activities have not only grown in quantitative terms. They also have had a qualitative impact on the world economy, within the broader process of globalization.

The driving forces of technological progress and competition, combined with liberalization, have lowered barriers to international flows of goods, services and factors of production, increased the scope for international specialization and led to an unprecedented expansion in international economic transactions. Transnational corporations have played a leading role in this process -- as traders, investors, disseminators of technology and movers of people -- thus strengthening the links among national markets. Beyond that, the distinguishing role of TNCs is that they organize the production process internationally: by placing their affiliates worldwide under common governance systems, they interweave production activities located in different countries, create an international intra-firm division of labour and, in the process, internalize a range of international transactions that otherwise would have taken place in the market.

The strategies pursued by TNCs are of central importance to understanding the globalization process. The activities of parent firms and affiliates can be linked through *stand alone* strategies, in which the links are one-way, concentrating on ownership, finance and technology; *simple integration* strategies, in which affiliates, in addition, often provide inputs to their parent firms; or the linkages can take place through *complex integration strategies*, driven by the desire to exploit global economies of scale and a higher degree of functional specialization involving locating specific corporate activities in a number of locations around the world. Although all three strategies co-exist, most recently there has been a shift towards complex integration strategies, a corresponding division of the value chain into discrete functions and their location wherever they can be most effectively carried out in light of the overall needs of a firm.

Common governance is reflected in the fact that some one-third of world trade is intra-firm in nature (with its composition shifting towards intermediate goods) and that some 80 per cent of

international payments for royalties and fees (as a measure of transfer of technology) are undertaken on an intra-firm basis. Combining the domestic assets of TNCs with the assets of foreign affiliates suggests that as much as one-third of world output is under the common governance of TNCs and hence potentially part of an integrated international production system -- the productive core of the globalizing world economy.

Employment, human resource development and industrial relations

Globalization has important implications for the organization of labour markets.

Until quite recently, the world of work has been shaped by local and national factors. At least since the Second World War, the level of employment has been a major consideration influencing the policies of national governments. The quality of employment depended on the sectoral distribution of production and the behaviour of individual firms with respect to wages, working conditions and training programmes, albeit in the context of wider government policies relating to the labour market and education and training. Most people, at least in the developed countries, expected a lifetime's employment, if not in the same company, then most likely in the same locality or country. Trade union and employer organizations bargained within an established framework of national industrial relations. All that is now changing under the pressure of globalization, as the increased mobility of capital meets the more location-bound asset that is labour.

More specifically, the growth and organization of international production under the governance of TNCs has several implications for the organization of domestic labour markets:

- The conditions underlying firm-level competitiveness are changing, relying less on traditional natural assets and more on created assets, above all assets in the form of skills and knowledge. Such assets are therefore an important factor influencing the locational advantages of countries as hosts to TNCs.
- The importance of skilled human resources, as well as the proliferation of cross-border production linkages via FDI, subcontracting arrangements and strategic alliances and the adoption of complex integration strategies by TNCs create both challenges and opportunities for mutually beneficial relations between employers and employees.
- As the organizational scope of TNCs widens, both geographically and functionally, and as the mobility of capital increases, labour and governments must adapt more quickly to changes in the international competitiveness of their industries and firms.
- Increasing reliance on market forces redefines the relationships of firms, labour and governments with one another, including those in the areas related to employment and the workplace.

In addition, the recent increase in unemployment has refocused the attention of policy makers on the links between TNCs and the generation, location and upgrading of jobs. Although the fundamental factors underlying current unemployment problems relate to macroeconomic and structural imbalances in developed countries and resource constraints in developing countries, TNCs, as a major force in the internationalization of economic activities, influence the quantity and quality of jobs available worldwide. Their influence is particularly important in manufacturing and services and, within these, in certain industries and countries. In all these respects, the influence of TNCs on labour markets and workplace conditions is, of course, not independent of established industrial relations practices.

As a direct result of these changes, labour markets and industrial relations are beginning to emerge slowly from their national confines and to adapt to a world economy that, in other respects, is more integrated than at any time in its history, and is becoming progressively more so.

Quantitatively, employment in TNCs has grown more slowly than FDI worldwide...

Transnational corporations are estimated to employ some 73 million persons at home and abroad. Although this represents only around 3 per cent of the world's labour force, employment in TNCs accounts for nearly 10 per cent of paid employment in non-agricultural activities worldwide, and close to 20 per cent in developed countries considered alone. In addition, the indirect employment effects of TNC activity are at least equal to the direct effects and probably much larger. Backward linkages, such as the purchasing of raw materials, parts and components from subcontractors and external suppliers, are among the principal channels whereby TNCs can indirectly contribute to employment generation. The importance of these effects has grown in recent years, as firms have progressively focused on smaller but higher-value segments of the production process, relying increasingly on national and international outsourcing for technological, cost or flexibility reasons. An example is the footwear company Nike whose core staff consists of 9,000 persons, but, through subcontracting, employs an additional 75,000. Overall, however, it is estimated conservatively that each job in a TNC generates at least one additional job elsewhere in the economy. Thus, at a conservative estimate, the total number of jobs associated with TNCs may be placed at 150 million at the beginning of the 1990s.

As world FDI stock expanded during the 1980s and early 1990s, the total number of persons directly employed by TNCs at home and abroad increased as well, though at a considerably lower rate. The reasons include a trend towards capital deepening and labour-saving technologies, the spread of national and international subcontracting arrangements that generate employment in outside TNCs, and efforts by TNCs to reduce costs through rationalization and employment downsizing. In fact, total employment in a large sample of the top industrial TNCs at the end of the 1980s was lower than in 1980, and it is likely to have declined further since then. However, when all TNCs are considered, total employment in TNCs has grown somewhat.

... and employment in foreign affiliates rose, particularly in affiliates in developing countries, compared to that in parent firms.

Parent corporations account for nearly two-thirds of total direct employment in TNCs. However, during the 1980s and early 1990s, the limited growth that took place in direct employment in TNCs was concentrated in foreign affiliates. For example, employment in United States parent TNCs fell slightly during 1985-1990, while that in their foreign affiliates rose during the same period. In the case of Swedish manufacturing TNCs, employment at home declined sharply during 1986-1990, while that in foreign affiliates rose, resulting in an increase in the share of foreign affiliates from 41 per cent to 61 per cent of total employment. Particularly significant was the growth of employment in Japanese foreign affiliates, which more than doubled during the second half of the 1980s.

When it comes to the distribution of the growth of employment in foreign affiliates, those in developed countries are estimated to account for a somewhat smaller share of the moderate increases that took place between the mid-1980s and the early 1990s, in spite of the high absolute amounts of FDI flows to, and stocks in, these countries. One of the reasons for this is the pronounced sectoral shift of FDI towards services where one FDI dollar is associated with perhaps only half of the jobs associated with one FDI dollar in manufacturing. Furthermore, a restructuring and consolidation of corporate networks has often led to a reduction in employment. However, in spite of slow growth in foreign affiliate employment in developed countries due to

these factors, foreign affiliates account for about 3 per cent of paid employment in these countries, with this figure rising to 10 per cent or more of manufacturing employment in most developed host countries.

The greater part of the increase of employment in foreign affiliates in recent years has taken place in developing countries, rising from 7 million in 1985 to an estimated 12 million in 1992. But the picture is quite uneven with respect to the distribution of foreign affiliate employment and its growth among host developing countries, in general reflecting disparities with respect to the pattern of FDI flows. A considerable share of the increased employment was concentrated in East and South-East Asia, in particular China, and in export processing zones in that region and elsewhere. Still, the level of foreign affiliate employment remains low in most developing countries. With the exception of small countries, such as Singapore, Jamaica or Botswana, the share of employment by foreign affiliates is 2 per cent or less of total employment. However, the figures hide the fact that TNCs are concentrated in modern manufacturing industries with implications for economic growth, long-term employment generation and employment quality. Indeed, TNCs account for one-fifth or more of total paid employment in manufacturing in a number of developing countries.

Qualitatively, foreign affiliates can make a contribution ...

These figures do not say anything about the qualitative aspects of employment in foreign affiliates, be it in developed or developing countries.

... both in terms of working conditions ...

To begin with, the workforce directly employed by foreign affiliates typically -- but not always -- enjoys better wages, conditions of work and social security benefits relative to those prevailing in domestic firms. The explanatory factors include the size of foreign affiliates and their tendency to be concentrated in more capital- and skill-intensive industries and the importance of skills and quality of work for generating competitive advantages. Thus, TNCs have the potential to exert a positive qualitative influence on wages and working conditions in host countries. Particularly in developing countries, the higher wage levels in foreign affiliates are likely to be an influence for raising wages, at least of certain kinds of labour. When it comes to other conditions related to work, TNCs generally adopt standards that are not less favourable than those of comparable national employers and are sometimes above the national average.

... and human resource development.

Perhaps even more importantly, TNCs often provide labour with the opportunity to acquire additional knowledge and skills, and this is particularly so in the case of affiliates operating in developing countries. Indeed, the essential characteristic of TNCs is that they bring together in the workplace international knowledge and skills with the human resources present in a particular location. Accordingly, host country employees and the host economy as a whole can benefit from the upgrading of skills already possessed through employment in TNCs and, especially, the acquisition of new vocational and management skills through formal and on-the-job training in foreign affiliates.

The major role of TNCs in human resource development stems from the learning opportunities and training that they provide for their employees. The extent and nature of training varies according to the country, industry and activity in which a TNC is engaged, as well as firm-specific strategies with respect to FDI and human resource management. On the whole, TNCs provide

at least as much, if not more, training for their workers in developed and developing host countries as domestic firms. Because of their size and international character, TNCs are able to offer formal and non-formal training programmes that are, in some respects, better than those provided by many domestic firms, especially in developing host countries. Larger TNCs often establish training centres and use in-house or external expertise to provide off-the-job training for their employees. Large, as well as small and medium-sized TNCs send affiliate employees to their operations in the home country for experience and training on the job, while large TNCs also rotate managerial staff to different locations for learning. Another channel for the transfer of skills that TNCs typically use is expatriate staff. Human resource development through training is particularly important in the more sophisticated manufacturing activities and in service TNCs where training is a principal channel for the transfer of soft technologies.

The transnational structure and the large size and scope of many TNCs thus hold a distinctive potential for the development of the skills and knowledge of their employees and the further dissemination of those capabilities in an economy through backward and forward linkages. Realizing the potential depends, however, not least on the human resource capabilities that a country already has. The reason is that the ability to attract FDI, particularly into industries and activities that involve human capital investments by TNCs, depends to a significant extent upon the availability of an educated and skilled labour force ready to absorb new skills, know-how and knowledge. Countries in which the level of education and skills is sufficient to provide TNCs with the labour quality that they seek are, therefore, likely to attract such FDI inflows. In addition, as TNCs move -- either on the basis of labour-market conditions or as a result of other reasons -- towards higher skill-intensive activities, the availability of an educated and skilled labour force becomes a condition for sustaining the shift of TNCs into activities with greater potential for human resource development. A virtuous circle of interdependence can be set in motion, with positive results for labour, TNCs and the host economy.

Although industrial relations practices continue to frame workplace issues in TNCs...

Decisions affecting the quantity and quality of employment in TNCs are the responsibility of management. But these decisions are not taken in isolation. Trade unions -- in the context of national industrial relations systems -- continue to be important to articulate, explain and present workers' views to management. However, there has been, particularly over the past decade, a tendency for management to take up certain employment issues in the context of human resource management, thus removing them from the domain of collective industrial relations. The expanding influence of TNCs over domestic economic activity is accompanied by perceptible changes in industrial relations practices, both within TNCs and in industrial relations in general.

... the transnational organization of production poses special challenges for nationally organized labour ...

The central characteristic shaping the relationships between trade unions and TNCs is the difference between the international organizational scope of TNCs on the one hand and the mostly national scope of labour organizations on the other. Within this basic asymmetry, the greater flexibility of TNCs to shift productive assets assumes particular importance because the real or perceived threat to relocate production can have implications for the effectiveness of unions, first to organize themselves and then to take action. This may be further exacerbated if governments seeking to attract FDI see trade union presence as a possible deterrent to foreign investors. Another aspect of the transnational character of TNCs is that their decision-making processes are often more complex than in purely domestic firms. This makes access to information and to ultimate decision makers more difficult than in the national context. On the other hand, the

growing interdependence of national units constituting corporate networks makes them more vulnerable to disruption by union action.

While the issues that arise out of the differences in the organizational scope of TNCs and trade unions are real, it appears that they do not play a dominant role in day-to-day interactions. Industrial relations practices have, historically, been designed and implemented at the national level, often in close association with governments, although there are signs suggesting that the scope for national systems of industrial relations to determine autonomously labour practices and bargaining relationships is becoming more limited and that TNC-based industrial relations structures are becoming more important. Still, in most instances, TNCs have adapted their own practices to host country norms. Furthermore, the long-term strategies and structures of TNCs are, on the whole, not determined by considerations relating to trade unions and, hence, do not necessarily always change when there are (temporary) disagreements between management and workers. In fact, motivated by their self interest, TNCs normally recognize unions (indeed, unionization often appears to be higher in foreign affiliates than in domestic firms), invest in their workforce and deal with trade unions with a view towards establishing effective relationships.

... but also opens new avenues for cooperation.

Such relationships have become all the more important as the pressures of competition require that firms need to "reinvent" themselves continuously through the introduction of innovatory practices and corporate restructuring. Often these require the formal or at least informal cooperation of organized labour to be effective. Perhaps more profoundly, the growing importance of created assets and the adoption, by many TNCs, of flexible production methods and new organizational paradigms increases the need for workers' commitment to the performance of the firm. Such a need can be best sustained in the framework of a cooperative approach to industrial relations. As a result, employees are increasingly recognized as important stakeholders in the enterprise, with a strong interest in ensuring its success. While there may be disagreement about how this is best achieved, how the benefits of success should be shared, how unions may be involved and how national systems of industrial relations may be affected, one effect of expanding integrated international production is the recognition that all employees have much to contribute to the well-being of the enterprises in which they work. Growing acceptance of this view may permit the development of new cooperative arrangements for the conduct of industrial relations within TNCs.

Although the relocation of jobs through FDI is limited ...

Foreign direct investment is often associated with a process of structural transformation in host economies, a transformation that may be expected to generate growth and hence employment in the long term. As part of that process, the rise of international production is associated with a certain redistribution of jobs, especially at the regional level, and an increase in the speed of the broader process of industrial restructuring that is taking place on the global level. On the whole, however, the number of jobs relocated from developed to developing countries through FDI is small, compared with the size of the total labour force in developed countries.

The reasons are varied. To begin with, services account today for a substantial share of FDI flows to developing countries; given the (still) limited tradability of most services, most FDI in this sector is therefore by necessity location-bound, i.e., markets (domestic and international) cannot be served by trade. Other market-oriented FDI also typically does not lead to a relocation of jobs, e.g., when barriers to market access make it difficult, if not impossible, to serve certain markets through trade. Moreover, although labour costs are important for certain activities in certain industries, they are not, by themselves, among the most important determinants for the location

of FDI. Furthermore, differences in labour costs between developed and developing countries are, to a certain extent, offset by corresponding differences in labour productivity. Finally, despite a few notable cases, TNCs do not often close down, on account of labour-cost considerations alone, production facilities in one country to re-establish them in another country; rather, to the extent that a shift in production occurs, it typically involves an incremental process in which new production facilities are established in developing countries or countries of Central and Eastern Europe. Broader and more important macroeconomic and cyclical factors, technological change and labour-market inflexibilities are the principal influences on the growth and distribution of employment.

... governments seek to influence FDI to gain or maintain jobs.

Nevertheless, given the unemployment problems facing most countries, it is a frequent objective of governments in developed as well as developing countries to retain or attract TNC operations with a view to maintaining or adding to jobs available. In fact, competition for FDI may tempt governments to offer concessions in the social and labour fields as an incentive to attract TNCs and to create much needed jobs. This reflects a genuine policy dilemma faced, in particular, by developing countries, between the need to create jobs and the need to raise labour standards. Policy formulation in this respect should recognize the complex factors determining employment and go beyond simple measures for attracting additional FDI inflows *per se* or, in the case of home countries, discouraging outward investment. In the current context of growing global competition and integrated international production, the key policy issue is how to attract or retain value-adding activities in a way that maximizes the long-term contribution by TNCs to national production capacities while maintaining desired local employment levels.

Home countries need to recognize that, barring a major reversal of policies, globalization is a firmly entrenched process which, to an increasing extent, is becoming a parameter of national economic development. Foreign direct investment is an integral part of this process and is often a precondition for firms to preserve or expand international markets; not to undertake it could, therefore, lead to a loss of competitiveness. Today, the capacity to organize activities in an integrated way across different countries is a critical element in ensuring the efficiency and competitiveness of firms and, hence, their capacity to generate employment. The implication is that it may be better for home countries to ensure the competitiveness and eventual survival of their TNCs by encouraging them to focus on higher value-added activities than risking that they become less efficient producers. To be sure, the structural adjustments that this implies may be socially disruptive and entail substantial costs, especially for less-skilled labour. Governments will wish to ensure that these costs are minimized. Human resource development policies, especially retraining, have an important role to play in this respect. Policies designed to slow the pace of the adjustment process may facilitate the transition but, at the same time, may create other hidden or overt costs; efforts to steer the adjustment process require therefore a careful analysis of the costs and benefits involved.

The employment effects of globalization make themselves felt not only at the aggregate level but also at the firm level. In particular, complex strategies have implications for the quantity, quality and location of the jobs generated by TNCs and the relations of these firms with trade unions. While the shift to complex strategies may lead to some decline in direct employment within the TNCs concerned, it also increases the opportunities for host countries to receive more and higher value-added FDI. Furthermore, as TNCs locate higher value-added and more specialized activities in their foreign affiliates, training requirements to improve the quality of host country personnel increase. The trend towards complex strategies, therefore, suggests that integrated international production reinforces the higher wage/high skill profile of foreign affiliates. Thus, important employment effects of FDI derive from the way in which value-adding

activities are structured and integrated within the production networks of TNCs. Growing recognition of these positive effects has contributed to increased competition among governments for FDI.

In this respect, enhancing the quality of the labour force is likely to be a main avenue for policy action by developing and developed host countries to attract FDI. Human resource development is, indeed, within the realm of influence of local or national policy makers. It should be noted, however, that this may be a necessary, but not a sufficient condition to attract FDI, among other reasons, because the supply of highly skilled human resources is growing across locations. Moreover, TNCs are most likely to be attracted by a combination of an educated labour force and a social and physical infrastructure capable of generating high productivity, especially in large and expanding markets.

Policy challenges

The essence of the policy challenges in a more integrated international production system is how best to ensure that the forces of international competition and cooperation work in a complementary manner to enhance global economic welfare and contribute to a more equitable distribution of the resulting benefits. Two broad tendencies underpin this challenge: on the one hand, the ongoing process of liberalization implies a greater reliance on market forces; on the other hand, private economic actors need to take on new responsibilities in relation to the social implications of their expanded opportunities. As a result, the relationships among the principal actors -- firms, trade unions, governments -- are being redefined. This raises specific problems in the context of TNCs and FDI policy, illustrated here in relation to issues related to employment, human resource development and industrial relations.

The widespread liberalization of FDI policies ...

In the FDI area, liberalization is the most important policy trend of the 1990s, as part of broad-based efforts to attract foreign investors. This trend is embedded in a broader liberalization movement -- covering international trade in goods, external financial transactions, transfer of technology and, more recently, services and some aspects of labour movement -- that seeks to enhance economic efficiency through the elimination of market distortions caused by restrictive or discriminatory governmental measures. These policies are interrelated and mutually supportive. Together, they are one of the preconditions for, and allow the further development of, the emerging integrated international production system, while receiving additional impetus from it.

A number of important multilateral and regional agreements bearing on FDI issues (in particular, the Uruguay Round of Multilateral Trade Negotiations, the North American Free Trade Agreement and the Single European Market) and the increasing number of bilateral investment treaties (64 of them were concluded in 1993) have provided further momentum to unilateral FDI liberalization drives at the national level. These efforts are leading to a level of convergence of government approaches towards FDI never before achieved. Yet this process of liberalization has been far from homogeneous, and there are still considerable differences in the nature, breadth and depth of the measures taken. As the normative frameworks for FDI around the world become increasingly similar, these differences become more important for attracting foreign investors, and there is a real possibility that efforts to attract FDI can lead to increased "policy competition" among governments. Such competition could potentially be carried into more policy areas than in the past, since the increasingly integrated nature of international production elevates more and more policies from the domestic to the regional and international domains.

The liberalization of FDI policies involves the following main elements:

- First, the tempering or removal of market distortions resulting from restrictions applied specifically (and hence discriminatorily) to foreign investors; and the granting or withholding of incentives and subsidies that discriminate in favour or against TNCs. The most significant liberalization steps taken relate to restrictions on the entry and establishment of foreign investors, although all countries still keep some activities closed to FDI. In the developed world, restrictions are mainly found in the natural resources and services sectors. In developing countries, the picture is more complex. There, liberalization has had a tendency to focus mainly on export-oriented manufacturing industries, or projects involving advanced technology; more recently, the liberalization drive in these countries has expanded to services and natural resources. But, in general, it has not yet reached the levels typically found in developed countries. Similarly, although compulsory and minority shareholdings have declined in importance over the years as a means of restricting entry of FDI generally, ownership restrictions continue to be used as a tool for controlling FDI in specific industries and activities. In particular, this and other forms of local control over foreign affiliates' decision-making are used in large investments in strategically important industries or in cases of privatization of public monopolies. Operational restrictions, for example on the employment of non-nationals, are still being used. However, performance requirements have in recent years shown a tendency to lose their compulsory character and, instead, tend to be related to positive inducements. General authorization procedures have been abolished in most developed countries and are tending to disappear gradually in developing countries as well (except for TNCs operating in certain specific industries), and are being replaced by requirements for registration or notification. Recent incentive programmes appear to discriminate less in favour of foreign affiliates. When they do, it is to attract them to certain industries, or to link them to exports, training or the introduction of advanced technology.
- The second category of measures involves the establishment of standards for the treatment of foreign investors. National treatment is central in this respect. Most developed countries grant national treatment to foreign investors, and an increasing number of developing countries are embracing that standard as well. The same applies to fair and equitable treatment. Similarly, developing countries have strengthened legal protection provided to foreign investors, including the possibility of recourse to international dispute-settlement mechanisms. Finally, in recent years, governments have made considerable efforts to publicize and disseminate information on their policy, normative and administrative frameworks relating to FDI and to ensure that this information reaches potential foreign investors, thus increasing the transparency of their FDI frameworks.
- Thirdly, the liberalization process requires regulations aimed at ensuring the proper functioning of the market and promoting broader economic and social concerns. These include, for example, competition rules, prudential supervision of banking and financial services, the protection of intellectual property rights, appropriate health, consumer and environmental standards and an effective system of accounting and reporting. More and more countries around the world are strengthening their frameworks in these areas.

In addition to liberalization measures, other policies of host countries are also important for a favourable investment climate; and, as liberalization progresses, they become increasingly so. Thus, the existence of a reasonably comprehensive legal framework for business activities and a properly functioning legal order are required to provide predictability and stability. In addition, well functioning administrative infrastructures are necessary to ensure the effective implementation of the legal framework. Moreover, the close interlinkages between FDI, trade and technology imply that their respective policy frameworks need to be consistent to achieve maximum results. Still other important aspects of a favourable investment climate include such things as political and

economic stability, the establishment of a sound macroeconomic framework, the upgrading of a country's human resources and the strengthening of its physical infrastructure. These objectives are not easy to achieve immediately. But a number of promotional measures such as, for example, entering into bilateral and multilateral commitments to guarantee foreign investors against non-commercial risks, can help to attract investors in the short term. In sum, the process of liberalization of FDI regimes does not imply a weakening of the role of Government but rather a redefinition of some of its functions and the strengthening of others. In particular, internal policies that are aimed at facilitating the integration of the local economy in the international production system are becoming increasingly important.

... means that TNCs are given more freedom and, hence, need to assume greater responsibility ...

The liberalization of FDI policies and related international transactions means that TNCs are given more freedom to shape their strategies and structures. With this increased freedom comes also a greater ability to influence national and international economic activity and, hence, more responsibility, particularly social responsibility. This is recognized by firms, for instance, when they adopt codes of corporate ethics, and by shareholder and other groups, for instance, when they advocate the social responsibility of firms.

The concept of corporate social responsibility helps firms to define and organize their relations with society. It first assumes that an enterprise is a distinct, identifiable entity with the capacity both to act and assume responsibility for its actions. Secondly, it describes the nature of a corporation's relationship with society which includes not only following narrow legal requirements but also includes broader actions as defined by a firm's social charter. Finally, the concept helps to determine which social groups fall within a corporation's circle of social responsibility and why.

General concepts of corporate social responsibility pertain equally to both domestic and transnational enterprises. However, applying these concepts to TNCs established in a diverse global setting raises special considerations and issues that may modify a firm's specific definition of its social responsibilities. In fact, it gives rise to a tension -- and an interactive dynamic -- that is specific to TNCs: on the one hand, the duty to behave as good corporate citizens in the host countries in which they are established; and, on the other hand, the duty of adhering to broader self-imposed social responsibility standards formulated to apply to their corporate systems as a whole.

In its application to TNCs, the concept of social responsibility relies on, among other things, the notion of appropriate roles as ordered by the subsidiarity principle, according to which social responsibility is best exercised by actors closest to a given situation. Societies are administered by governments, which bear primary rights and responsibilities regarding the welfare of their people. By contrast, corporations are principally responsible for matters most directly related to their own economic purpose and function, operating within prevailing legal frameworks. However, voluntary corporate actions pursuing broader social goals can derive from business capabilities and impacts. In exceptional circumstances, TNCs may even need to assume added responsibilities where other actors, including governments, do not or cannot carry out critical duties. In this sense, the role of TNC social responsibility appears broadest in developing countries and countries with economies in transition, and where governmental or free-market regulating mechanisms are not yet fully formed or effective.

Operating international production systems in different national and cultural settings raises difficult issues as to how to determine the content and scope of a TNC's social responsibility and apply it throughout its corporate network. The growing number of international strategic

alliances and the expansion of low- or non-equity forms of investment also increase the difficulty in maintaining a corporate identity that can support social responsibility actions through a consistent set of policies implemented over widely dispersed and perhaps only partially controlled foreign affiliates. Historically, many TNCs exhibited ethnocentric tendencies flowing from a heavy reliance on directives from centralized headquarters in the parent firm's home country. As the emerging integrated international production system introduces more dispersed operational authority, it could enhance a TNC's learning experiences, thus improving its responsiveness to the needs of its host societies. A TNC will still require a common core of values if it is to maintain a unified corporate identity, but its internal norms might evolve more from a dynamic interaction between corporate and host country values, eventually matching more closely public expectations regarding how corporations should behave in relation to evolving international standards.

A number of initiatives by the business community to establish voluntary standards -- and by individual firms to adopt their own corporate codes of conduct -- show that there is widespread awareness among TNCs of their social responsibility, as part of a broadly defined notion of self interest that includes a corporation's stakeholders. A review of these standards and codes suggests a range of topics relevant to TNC social responsibility. Among them, those relating to employment and human resource development are particularly pronounced. Many TNCs have set forth their policies in this respect in their corporate codes, ranging from brief statements of principle to detailed policy manuals.

... and that trade unions can count less on government and, hence, need to rely more on their own efforts ...

Trade unions represent another group with a direct stake in shaping the broader policy framework concerning employment and workplace issues. As trade unions must deal more and more with TNCs, one would expect them to seek ways to match the organizational scope of TNCs by transnationalizing their own structures. However, because of many obstacles, including differences in labour market legislation, the problem of defining mutual interest among differently organized national groups of workers and the difficulties of organizing workers arising from the increasingly fluid relations within TNC networks, this approach is of only limited significance for the time being. For these and other reasons, trade unions internationalize some of their actions, as a means of strengthening their leverage in their relations with TNCs. Thus, while the social responsibility of TNCs is grounded internationally but implemented locally, the approach of trade unions is grounded locally but implemented internationally.

Trade unions are taking two broad approaches to international action. On the one hand, efforts to strengthen cross-border trade-union solidarity and cooperation have led to the establishment of international bodies, among other things, to monitor TNC industrial relations and coordinate responses whenever and wherever appropriate. On the other hand, trade unions have looked to international normative frameworks to influence directly the behaviour of TNCs. The two approaches are not mutually exclusive, as is apparent from the Western European context. The combination of the two is likely to strengthen trade-union leverage in the face of international production.

As to cross-border trade-union solidarity, international trade-union organizations are of two types -- alliances of national trade-unions centres or confederations and organizations established at the industry level in the form of international trade secretariats. In many respects, the functions of these organizations overlap. However, the former have a stronger representational role in dealing with other international agencies, whilst the latter deal primarily with issues arising at the firm and industry levels.

On a day-to-day basis, both of these types of organizations collect information and exchange it among affiliated members. In the case of some international trade secretariats, priority has been given to bringing together workers from the same TNCs, but employed in different countries, to form world councils. These councils have been important in creating a network of relationships among unions, but most TNCs have resisted accepting them as more formal negotiating partners, and the financial and organizational pressures on them are enormous.

Beyond this informational role, international solidarity takes place through a series of increasingly intensive stages: the simple voicing of support for union action within a particular TNC; the provision of financial assistance and advice; direct pressures on headquarters; and full-scale corporate campaigns dealing with fundamental issues of trade-union organization. A high degree of planning and sophistication is required for more strategic responses.

At the national level, industrial relations are most often conducted through a body of formal rules and regulations framed by governments. Trade-union efforts to replicate at least part of this framework at the international level have helped to establish various standards and guidelines, a number of which directly address the activities of TNCs, including some in the area of industrial relations. The two most important are the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy of the International Labour Organization and the Guidelines for Multinational Enterprises of the Organisation for Economic Co-operation and Development. They include general provisions on industrial relations, in particular, concerning locational flexibility, union recognition, effectiveness of action, access to decision makers and information, and consultation. Despite widespread initial enthusiasm for these instruments from the international labour movement, experience with them has led to a declining interest reflecting, in part, the slow and complex implementation mechanisms of these instruments. But, primarily, it is their voluntary nature that appears to have constrained their more widespread use.

Despite the somewhat disappointing experience with international guidelines, trade unions have begun to renew their interest in international efforts, this time focusing on minimum labour standards. Issues raised regarding international labour standards have generally been associated with increased trade linkages. Deeper integration at the level of production through TNCs complicates this issue further. Although the greater mobility of TNCs has been seen as a potential threat to labour standards in developed countries, the worldwide affiliate networks of TNCs open up new possibilities to influence labour standards globally. However, care has to be taken that this approach is not misused for protectionist purposes.

Particularly in light of the experience gained with international regulatory approaches, as well as the broad-based reach of the liberalization movement, a new realism has characterized the efforts of the international trade-union movement over the past decade. One important manifestation of this has been a refocusing on efforts at the regional level. Developments in Western Europe -- in the face of corporate restructuring to meet the opportunities of the enlarged Single Market and widespread efforts at policy harmonization -- have placed great pressures on traditional industrial relations practices. That region has also seen the most innovatory responses from trade unions. In many respects, they represent a coming together of the two main approaches described earlier. During the 1980s, European voluntary works councils were established in a number of TNCs. Although largely informational, in some cases they have begun to take a more substantive consultative role. These initiatives at the corporate level have been complemented by legislative efforts through the European Union to extend information and consultation procedures in TNCs established in the European Union, most importantly, through a draft Directive on the formation of European Work Councils. If and when this Directive is implemented, perhaps as many as 1,000 Councils may be established. Although a purely regional initiative, the Directive is likely to have relevance beyond the European Union.

... while governments need to be pro-active in human resource development policies.

Despite the general trend towards a greater role of markets, the role of national governments in education and human resource development remains undisputed. If anything, in fact, this role has become more important, especially in developing countries, although the manner in which it is being pursued is changing. As competitiveness and economic growth are increasingly determined by created assets, it is important that governments coordinate their policies for human resource development with measures to promote FDI and channel it into priority areas for human resource development. Since TNCs must balance their competing requirements of globally efficient operations and locally responsive strategies, government policies for harnessing the capabilities of TNCs for human resource development must also strike the right balance in terms of supporting national goals while taking into account the needs of TNCs to be competitive in global markets.

All national policies that are directly or indirectly related to human resource development have some impact on the appeal of a country to foreign investors. A literate human resource pool with basic education and skills; matching national education programmes with the needs of the private sector; and, particularly, implementing educational programmes that lead to the development of a workforce that is flexible and well adjusted to the evolving requirements of participation in a global economy are likely to add to the ability of a country to attract FDI. To achieve a competitive edge in international production, some countries or regions go further and match training programmes to specific needs of TNCs. This enhances their chances to attract foreign investors, but the costs of such programmes must be carefully evaluated in relation to their benefits.

Since the main impact of TNCs on human resource development takes place through the training they provide to their employees in skills related to their production operations, as well as through training provided in the context of forward and backward linkages, government policies aimed at maximizing human resource development benefits should encourage FDI in industries and activities that offer the greatest potential for training as well as skill intensive local linkages. Assuming that the initial human resource base of a country provides sufficient absorptive capacity, fiscal or other incentives could be offered to FDI in industries or functional activities that are considered most promising in this regard.

Host countries can also implement initiatives and policies that are directly targeted towards maximizing the human resource development contributions of TNCs that are already established in these countries. Thus, many countries have stipulated legal or administrative requirements for the provision of training for employees by foreign affiliates, under policies aiming at an overall improvement in skills acquired by the country's labour force. Often, they involve a mandatory contribution by TNCs, for instance, as part of payroll levies. Another focus of policies in this respect are localization programmes regarding staff in foreign affiliates. At the same time, policies may link investments by TNCs in education and training to incentives provided to those firms. Collaborative schemes between governments and TNCs to implement training programmes are another means whereby host countries can mobilize foreign affiliates for human resource development.

Investment in, and the effective use and management of, human resources are critical for countries as well as TNCs in today's competitive global economy. Education, therefore, needs to adapt to changing requirements, including those of the private sector in a globalizing world economy. At the same time, if countries wish to tap the potential of TNCs in technologically sophisticated activities for human resource development, they must pursue policies that ensure adequate domestic absorptive capacity for skills and knowledge. Finally, governments need to ensure that the results obtained in terms of human resource development by TNCs are commensurate with the resources spent, whether from public or private sources. Perhaps the greatest

potential that international production offers for human resource development lies in closer cooperative relationships between TNCs, trade unions and governments in the identification of skill shortages, training priorities and appropriate policy initiatives.

* * *

The process of liberalization of international economic transactions in general and FDI policies in particular -- and, more broadly, the worldwide acceptance of the market as the principal allocator of resources -- is redefining the relations of the principal actors in the market with each other. The new freedom created for firms by liberalization means that they need to shoulder more responsibility, and social responsibility in particular. Trade unions, still largely rooted in their national environments, can count less on governments than in the past and, therefore, need to rely more on their own efforts, being confronted, as they are, with a globalizing world economy. Governments, finally, need more than ever to ensure that the principal assets of their countries -- their people -- are as qualified as possible to be able to deal with the fast-changing demands of the emerging integrated international production system. The network of micro-economic connections at the firm level is now so woven into the cross-border fabric of internalized and externalized patterns of producing and distributing goods and services that policy makers have few options but to recognize the new landscape of international production and international competitiveness.

PART ONE

RECENT TRENDS

Chapter II

Regional trends

Introduction

This chapter examines in greater detail recent trends in foreign direct investment (FDI) within groups of countries and regions, focusing on issues of particular importance to each group and region.

A. Developed countries

1. A new pattern of investment flows?

The declining flows of FDI from and to developed countries in 1991 and 1992 were unevenly distributed among major home and host countries, leading to substantial shifts in the relative positions of these countries and changing the pattern that had emerged during the second half of the 1980s. The main shifts were:

- The United States resumed its place as the largest home country, a position held until the mid-1980s and then lost to the United Kingdom and later on to Japan (table I.6). Japan fell to third place, behind France, and the United Kingdom to fifth place, behind Germany. While the United States has maintained a high level of outflows, despite the recession, both Japan and the United Kingdom experienced large declines in their outflows. The United

Table I.1. Number of parent transnational corporations and foreign affiliates, by area and country, early 1990s

Area economy	Parent corporations based in country (Number)	Foreign affiliates located in country [a] (Number)	Year
Developed countries	34 280	87 831	
Australia	1 036	695	1992
Austria	716	2 172	1991
Belgium and Luxembourg	96	1 121	1978
Canada	1 396 [b]	6 328	1992
Denmark	800	647 [c]	1992
Finland	1 300	1 300	1993
France	2 218	7 610	1991
Germany	7 560 [d]	12 566 [e]	1991
Greece	..	798	1981
Iceland	14 [f]	28	1991
Ireland	36	1 007	1993
Italy	263	1 438	1992
Japan	3 640 [g]	3 125 [h]	1992
Netherlands	1 608 [i]	2 259 [i]	1993
New Zealand	201	1 078	1991
Norway	1 000	2 700	1992
Portugal	684	6 680	1992
South Africa	..	1 884	1978
Spain	744	6 232	1992
Sweden	3 529	2 400	1991
Switzerland	3 000	4 000	1985
Turkey	..	2 528 [j]	1993
United Kingdom [k]	1 467 [l]	3 894 [m]	1992
United States	2 972 [n]	15 341 [o]	1991
Developing economies	2 850	97 330	
Brazil	566	8 576	1992
China	379 [f]	45 000	1993
Colombia	..	1 041	1987
Hong Kong	500	2 828	1991
India	187	926 [p]	1991
Indonesia	..	1 064	1988
Mexico	..	8 420	1993
Oman	..	1 489	1989
Pakistan	57	560 [q]	1988
Philippines	..	1 952	1987
Republic of Korea	1 049	3 671	1991
Saudi Arabia	..	1 461	1989
Singapore	..	10 709	1986
Taiwan Province of China	..	5 733	1990
Former Yugoslavia	112	3 900	1991
Central and Eastern Europe [r]	400	21 800	
Bulgaria	26	114 [s]	1991
Commonwealth of Independent States [t]	68 [h]	3 900	1992
Former Czechoslovakia	26 [h]	800	1992
Hungary	66 [h]	2 400	1992
Poland	58 [h]	3 800	1992
Romania	20 [h]	6 900	1992
Others	136	3 886	1992
World	37 530	206 961	

Source: UNCTAD, Division on Transnational Corporations and Investment, based on UNCTC, 1992a; UNTCMD, 1993a; UNCTAD-DTCI, 1994a, 1994b; and national official and secondary sources.

a Represents the number of foreign affiliates in the country shown.

b For 1991.

c For 1986.

d Does not include holding companies abroad that are dependent on German-owned capital and which, in turn, hold participating interests of more than 20 per cent abroad (indirect German participating interests).

e Does not include the number of foreign-owned holding companies in Germany which, in turn, hold participating interests in Germany (indirect foreign participating interests).

f For 1989.

g As of October 1992.

h As of November 1992.

i As of October 1993.

j As of 30 November 1993.

k Data on the number of parent companies based in the United Kingdom, and the number of foreign affiliates in the United Kingdom are based on the register of companies held for inquiries into United Kingdom FDI and FDI into the United Kingdom conducted by the Central Statistical Office. On that basis, the numbers are probably understated because of lags in identifying investment in greenfield sites and because some companies with small presences in the United Kingdom and abroad have not yet been identified.

l Represents a total of 24 bank parent firms and 1,443 nonbank parent firms in 1991.

m Represents 518 foreign affiliates in banking in 1992 and 3,376 nonbank foreign affiliates in 1991.

n Represents a total of 2,160 nonbank parent firms in 1991 and 89 bank parent firms in 1989 with at least one foreign affiliate whose assets, sales or net income exceeded $3 million, and 723 nonbank and bank parent corporations in 1989 whose affiliate(s) had assets, sales and net income under $3 million.

o Represents a total of 10,538 nonbank affiliates in 1991 and 467 bank affiliates in 1987 whose assets, sales or net income exceeded $1 million, and 4,336 bank and nonbank affiliates in 1987 with assets, sales and net income under $1 million. Each affiliate represents a fully consolidated Unites States business enterprise, which may consist of a number of individual companies.

p For 1988.

q For 1987.

r Data for affiliates are estimated using the number of joint-venture registrations and available information on the number of registrations that are operational.

s For 1990.

t Relates to the whole of the economic territory of the former Soviet Union.

Note: Cross-country comparisons based on data reported in this table should be made with caution given differences in years and coverage across countries and that many countries report as parent firms or foreign affiliates only those companies with significant investments.

significantly higher than their share of worldwide investment inflows or inward stock, apparently because the average size of stock of FDI per affiliate in developed countries ($17.3 million) is higher than in developing countries ($4.3 million).

Despite the proliferation of companies with investments outside their home countries, the top 100 TNCs continue to account for a considerable proportion of the worldwide activities of the universe of TNCs. The world's largest 100 TNCs (not including those in banking and finance), ranked by foreign assets, had about $3.4 trillion in global assets in 1992, of which about $1.3 trillion were held outside their respective home countries (table I.2). These firms are estimated to account for about one-third of the combined outward FDI of their countries of origin. Controlling such a pool of assets and stock of investment, the largest TNCs exercise a considerable impact on home

Table I.2. The top 100 transnational corporations ranked by foreign assets, 1992

Rank	Corporation	Country	Industry [a]	Foreign assets	Total assets	Foreign sales	Total sales	Foreign employment	Total employment
				(Billions of dollars)				(Thousands of employees)	
1	Royal Dutch/Shell b	United Kingdom/ Netherlands	Petroleum refining	69.4	100.8	45.5	96.6	91.0	127.0
2	Exxon	United States	Petroleum refining	48.2	85.0	93.1	115.7	59.0	95.0
3	IBM	United States	Computers	45.7	86.7	39.9	64.5	143.9	301.5
4	General Motors	United States	Motor vehicles and parts	41.8	191.0	42.3	132.4	272.0	750.0
5	Hitachi c	Japan	Electronics	..	66.6	13.9	58.4	..	324.2
6	Matsushita Electric c	Japan	Electronics	..	74.4	29.9	60.8	94.8	252.1
7	Nestlé	Switzerland	Food	28.7	31.3	37.7	38.4	211.3	218.0
8	Ford	United States	Automobiles	28.0	180.5	33.2	100.1	167.0	325.3
9	Alcatel Alsthom c	France	Electronics	..	44.4	18.0	30.7	106.3	203.0
10	General Electric	United States	Electronics	24.2	192.9	8.4	57.1	58.0	231.0
11	Philips Electronics	Netherlands	Electronics	22.9	28.6	31.0	33.3	225.8	257.7
12	Mobil	United States	Petroleum refining	22.6	40.6	49.7	64.1	28.2	63.7
13	Asea Brown Boveri d	Switzerland	Electronics, electrical equipment	22.4	25.9	26.3	29.6	198.8	213.4
14	Elf Aquitaine c	France	Petroleum refining	..	45.1	13.2	36.2	..	87.9
15	Volkswagen c	Germany	Motor vehicles and parts	..	46.6	29.4	54.7	109.0	273.0
16	Toyota Motor Co.	Japan	Motor vehicles and parts	20.7	76.7	22.0	81.3	16.3	108.2
17	Siemens c	Germany	Electronics	..	44.6	27.0	50.3	160.0	413.0
18	Daimler - Benz c	Germany	Transport and communication	..	52.5	35.8	63.1	74.0	376.5
19	British Petroleum c	United Kingdom	Petroleum refining	..	31.5	34.0	58.6	71.7	97.7
20	Unilever c	United Kingdom/ Netherlands	Food	19.4	24.2	35.0	43.7	247.9	283.2
21	Fiat	Italy	Motor vehicles and parts	19.2	58.0	20.3	40.1	82.6	285.5
22	Sony	Japan	Electronics	19.0	39.1	13.4	34.4	71.1	126.0
23	Hanson	United Kingdom	Building materials	17.5	36.6	8.2	15.7	54.0	75.0
24	ENI c	Italy	Petroleum refining	..	54.9	12.9	33.8	25.2	124.0
25	Du Pont	United States	Chemicals	16.0	38.9	17.5	37.8	36.9	128.7
26	B.A.T. Industries	United Kingdom	Tobacco	14.2	43.6	24.1	31.2	183.0	198.0
27	Philip Morris	United States	Food	13.8	50.0	20.0	59.1	70.0	161.0
28	Nissho Iwai c	Japan	Trading	..	40.7	35.0	91.6	2.1	7.3
29	Grand Metropolitan	United Kingdom	Food	13.0	16.7	11.2	79.8		102.4
30	Bayer	Germany	Chemicals	12.8	23.7	20.7	26.4	79.0	156.4
31	Chrysler c	United States	Motor vehicles and parts	..	40.7	4.3	36.9	35.1	113.0
32	Lyonnaise des Eaux c	France	Construction	..	24.3	7.4	16.4	83.9	161.1
33	Total c	France	Petroleum refining	..	20.9	14.9	25.9	28.5	51.1
34	Seagram	Canada	Beverages	11.3	11.8	5.9	6.1	9.3	15.8
35	Saint - Gobain c	France	Building materials	..	17.2	9.1	14.1	66.9	100.4
36	Dow Chemical	United States	Chemicals	10.8	25.4	9.4	18.9	28.2	61.4
37	Xerox c	United States	Scientific and photo. equipment	..	34.1	9.1	18.3	..	107.5
38	Toshiba c	Japan	Electronics	..	45.0	11.0	37.0	29.0	173.0
39	Ciba - Geigy	Switzerland	Chemicals	10.4	21.0	10.5	15.9	68.4	90.6
40	Procter & Gamble	United States	Soaps and cosmetics	10.2	24.9	15.9	30.4	59.4	103.5
41	BASF c	Germany	Chemicals	..	24.7	18.2	28.1	41.9	112.0
42	Chevron	United States	Petroleum refining	10.1	34.0	13.2	41.4	10.1	49.3
43	Michelin	France	Rubber and plastics	9.7	14.2	10.4	12.7	..	130.7
44	Petrofina c	Belgium	Petroleum industry	..	10.7	..	16.7	10.5	15.5
45	Honda c	Japan	Motor vehicles and parts	..	24.1	19.5	29.3	..	90.9
46	Sandoz	Switzerland	Pharmaceuticals	9.3	12.7	9.8	10.2	45.8	53.4
47	Bridgestone c	Japan	Rubber and plastics	..	14.8	7.5	14.0	54.0	85.8
48	Texaco	United States	Petroleum refining	9.2	26.0	17.2	36.8	13.1	38.0
49	Hoechst c	Germany	Chemicals	..	22.9	22.1	29.4	90.3	177.7
50	Electrolux c	Sweden	Electronics	..	11.5	12.4	14.2	104.9	121.1
51	Pepsico	United States	Beverage	9.0	21.0	5.4	22.0	82.0	372.0
52	Nissan Motor	Japan	Motor vehicles and parts	8.9	62.9	..	50.2	..	143.7

Rank	Corporation	Country	Industry [a]	Foreign assets	Total assets	Foreign sales	Total sales	Foreign employment	Total employment
				(Billions of dollars)				(Thousands of employees)	
53	Rhône - Poulenc	France	Chemicals	8.8	20.4	12.1	14.8	42.5	83.3
54	Itochu Corporation	Japan	Trading	8.7	61.4	5.2	165.8	3.3	7.4
55	Sharp c	Japan	Electronics	..	18.2	6.6	12.8	29.0	63.0
56	Amoco	United States	Petroleum refining	8.4	28.5	7.5	25.3	8.4	47.0
57	Marubeni c	Japan	Trading	..	69.5	34.0	149.4	..	9.6
58	Eastman Kodak c	United States	Scientific and photo. equipment	..	23.1	6.2	20.6	55.4	132.6
59	Renault	France	Motor vehicles and parts	8.3	24.0	15.2	34.1	42.4	146.6
60	Roche Holdings	Switzerland	Pharmaceuticals	8.2	18.9	8.9	9.2	45.7	56.3
61	ICI	United Kingdom	Chemicals	8.0	19.1	17.2	21.2	72.5	117.5
62	Holderbank	Switzerland	Building materials	7.6	8.2	5.0	5.6	33.0	35.2
63	Volvo c	Sweden	Motor vehicles and parts	..	16.0	9.9	11.4	21.2	60.6
64	ITT e	United States	Diversified services	7.5	49.0	6.5	20.6	..	114.0
65	Thomson Corporation	Canada	Publishing and printing	7.4	7.9	5.5	6.0	41.3	46.4
66	Glaxo Holdings	United Kingdom	Pharmaceuticals	7.3	10.8	6.4	7.2	25.1	37.1
67	NEC Corporation c	Japan	Electronics	..	31.9	6.3	27.7	..	140.9
68	Veba c	Germany	Trading	..	32.4	10.5	39.4	21.7	129.8
69	Robert Bosch c	Germany	Motor vehicles and parts	..	15.2	10.1	22.1	64.2	177.2
70	Solvay c	Belgium	Chemicals	..	7.9	7.2	39	40.5	45.4
71	BMW c	Germany	Motor vehicles and parts	..	17.0	11.6	20.0	10.0	73.6
72	Pechiney	France	Metals	6.9	12.8	7.8	12.4	26.6	63.3
73	RTZ	United Kingdom	Mining and crude-oil production	6.8	6.9	7.2	44.0	45.0	68.3
74	Alcan Aluminum	Canada	Metal products	6.7	10.1	6.6	7.6	35.0	49.0
75	Mitsui c	Japan	Trading	..	69.8	32.3	147.8	..	11.5
76	Digital Equipment	United States	Computers	6.5	11.3	8.7	13.9	56.5	113.8
77	Usinor - Sacilor	France	Metals	6.3	18.1	11.1	16.5	28.7	89.0
78	Smithkline Beecham	United Kingdom	Pharmaceuticals	6.2	8.9	8.2	9.1	43.7	53.7
79	Atlantic Richfield c	United States	Petroleum refining	..	24.2	4.3	18.1	..	26.8
80	Hewlett - Packard	United States	Computers	5.9	13.7	9.2	16.4	..	93.0
81	Stora	Sweden	Forestry products	5.9	10.5	6.5	8.0	20.6	38.9
82	Canon	Japan	Computers	5.6	17.4	9.5	13.6	..	64.5
83	Ericsson c	Sweden	Telecommunication	..	7.9	7.1	8.1	36.2	66.2
84	GTE	United States	Telecommunications	5.4	42.1	2.4	20.0	24.9	131.2
85	Fletcher Challenge	New Zealand	Forestry products	5.4	11.7	3.2	5.5	18.4	30.6
86	McDonald's	United States	Restaurants	5.3	11.7	3.4	7.1	..	166.0
87	Sara Lee Corporation	United States	Food	5.3	10.0	4.5	13.2	55.4	128.0
88	BHP	Australia	Metals	5.3	18.0	3.6	11.4	14.3	47.0
89	Johnson & Johnson	United States	Pharmaceuticals	5.2	11.9	6.9	13.8	44.4	84.9
90	Mitsubishi c	Japan	Trading	..	30.7	21.2	26.5	..	107.9
91	Thomson	France	Electronics	5.1	18.1	9.1	13.4	53.2	10.1
92	Akzo	Netherlands	Chemicals	5.0	7.5	6.4	9.5	42.6	62.5
93	3M	United States	Scientific and photo. equipment	4.8	12.0	6.8	13.9	38.2	87.0
94	Neste Corporation c	Finland	Petroleum refining	..	9.8	10.0	12.8	5.3	13.0
95	International Paper	United States	Paper	4.6	16.5	3.4	13.6	23.0	73.0
96	Lonrho	United Kingdom	Mining	4.6	6.3	3.5	6.8	126.9	137.2
97	United Technologies	United States	Aerospace	4.6	15.9	8.7	22.0	86.6	178.0
98	Peugeot	France	Motor vehicles and parts	4.5	23.4	16.4	28.2	28.2	150.8
99	Norsk Hydro	Norway	Chemicals	4.5	12.5	6.0	9.8	17.8	34.0
100	Alcoa	United States	Metals	4.5	11.0	3.8	9.5	29.4	63.6

Source: UNCTAD, Division on Transnational Corporations and Investment.

a Industry classification for companies follows that in the Fortune Global 500 list in *Fortune*, 29 July 1991, and the Fortune Global Service 500 list in *Fortune*, 26 August 1991, except for Akzo, Daimler-Benz, GTE, ITT and McDonald's.
In the Fortune classification, companies are included in the industry or services
that represents the greatest volume of their sales ; industry groups are based on categories established by the United States Office of Management and Budget. Several companies, however, are highly diversified.
These companies include 3M, GE, Grand Metropolitan, Hanson, ITT, Sandoz and United Technologies.

b Foreign sales figures are outside Europe whereas foreign employment figures are outside the United Kingdom and the Netherlands.

c Data on foreign assets are not available; ranking according to foreign assets estimated on the basis of the ratio of foreign to total employment, foreign to total fixed assets and other similar ratios.

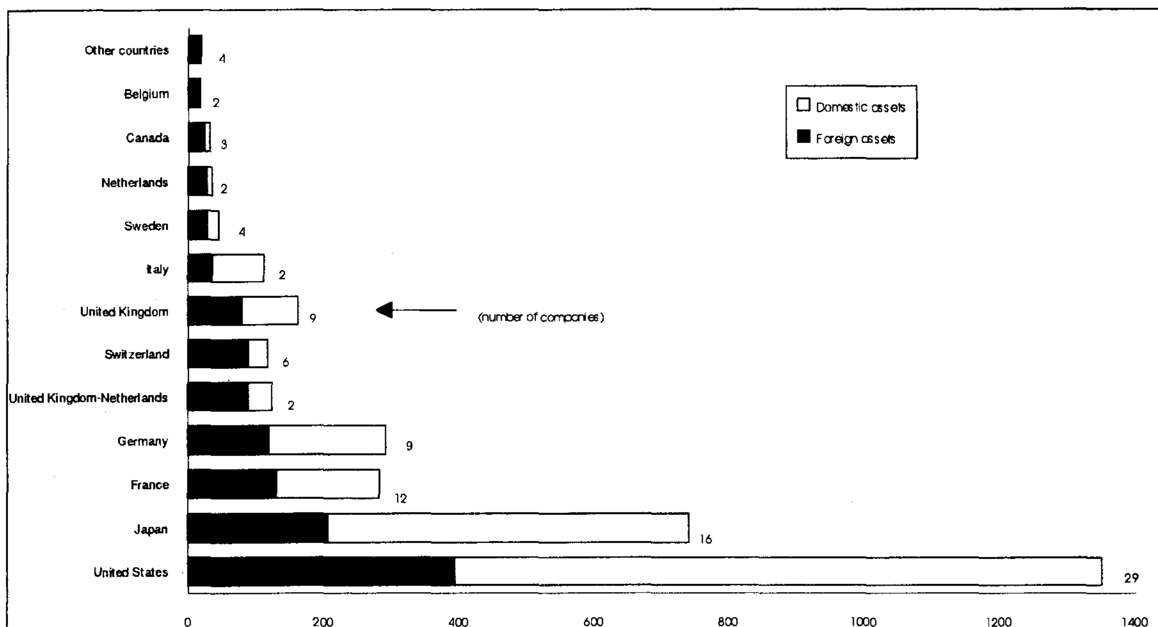
d Company's businesss include electric power generation, transmission and distribution, and rail transportation.

e Provisional data based on estimates.

and host countries' output, demand patterns, trade and technology flows, employment and labour practices. They also influence the structure and pattern of competition of their industries.

All of the world's 100 largest TNCs are based in developed countries: 38 in the European Union, 29 in the United States, 16 in Japan, and the remaining 17 in Australia, Canada, Finland, New Zealand, Norway, Sweden and Switzerland (figure I.1). While TNCs from the largest source countries — France, Germany, Japan, the United Kingdom and the United States — have the largest *absolute* value of assets abroad, firms from smaller countries, such as Belgium, the Netherlands, Sweden and Switzerland, have a larger *share* of their assets abroad. For example, Solvay (Belgium) has about 90 per cent of its total assets and 90 per cent of its 45,000 employees located abroad. The limited domestic markets of these countries constitute a constraint for their TNCs to expand at home.

Figure I.1. The top 100 transnational corporations: number of companies and assets by home country, 1992
(Number of companies and billions of dollars)

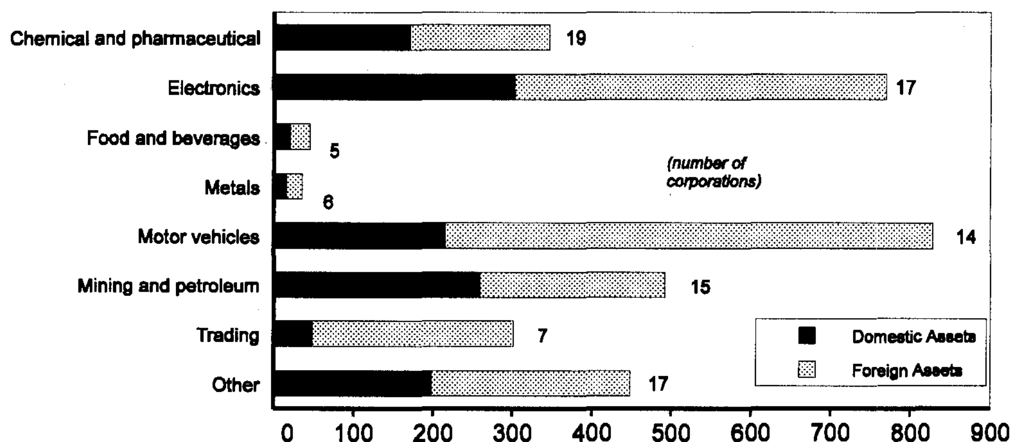


Source: UNCTAD, Division on Transnational Corporations and Investment.

In terms of distribution by industry, the largest number of the 100 TNCs originates in the chemicals and pharmaceuticals industries, followed by the electronics, computers, oil and motor vehicles industries (figure I.2). Ranking by size of foreign assets changes the sequence of these industries: the most important industry is electronics, followed by the oil, chemicals, pharmaceuticals and motor vehicles industries (box I.1).

Changes in foreign assets — the ranking variable of the 100 largest TNCs — were uneven during the recent recession. While they increased by 7 per cent in 1991, the expansion in 1992 was only 1 per cent.[1] Foreign assets of these companies in 1991 increased slightly more than domestic assets in 1991, which rose by 5 per cent. In 1992 foreign assets rose by 1 per cent, slightly less than the 3 per cent increase in domestic assets. Since assets are expressed in nominal dollar terms, their

Figure I.2. The top 100 transnational corporations: assets by industry, 1992



Source: UNCTAD, Division on Transnational Corporations and Investment.

growth is also affected by exchange-rate fluctuations. In 1990, the United States dollar fell sharply against the major European currencies and the Japanese yen, thus boosting the dollar value of assets denominated in those currencies. In 1991, by contrast, the dollar remained fairly stable against those currencies, but in 1992, after the currency turmoil in the European Monetary System, it appreciated against the major European currencies, thus reducing the dollar value of the assets of European TNCs. Therefore, to a certain extent, the growth of foreign assets of the 100 largest TNCs had been less affected by exchange-rate movements in 1991 than in 1992.

Half of the top 100 TNCs registered an increase in foreign assets in 1992. In the remaining companies, foreign assets either stagnated or declined (table I.3). For those companies, the decline of foreign assets has been accompanied by a parallel reduction of total assets, mainly reflecting divestment or a reduction of output in response to the economic recession in developed countries.

Total employment by the top 100 TNCs in 1992 is estimated at about 12 million. About 43 per cent of that figure was in affiliates abroad, a share unchanged since 1990. For those TNCs within the group of the top 100 for which data are available for the past decade, the growth of foreign employment has been modest compared to the growth of foreign assets.

B. Foreign direct investment

The principal measure of annual changes in the cross-border investment activities of TNCs is FDI flows. As long as such flows remain positive, even if they decline from year to year, they mark the expansion of TNC activities. The outstanding feature of FDI flows during 1992 and 1993 was their considerable increase into developing countries; flows into these countries reached record levels of over $50 billion in 1992 and an estimated $80 billion in 1993, an increase of 32 per cent in 1992 and an estimated 55 per cent in 1993. In fact, between 1986 (the beginning of the latest global FDI upswing) and 1993, investment flows into developing countries increased five-fold. As a result, developing countries accounted for 33 per cent in 1992 and an estimated 41 per cent in 1993

Box I.1. The top 100 transnational corporations and their industries

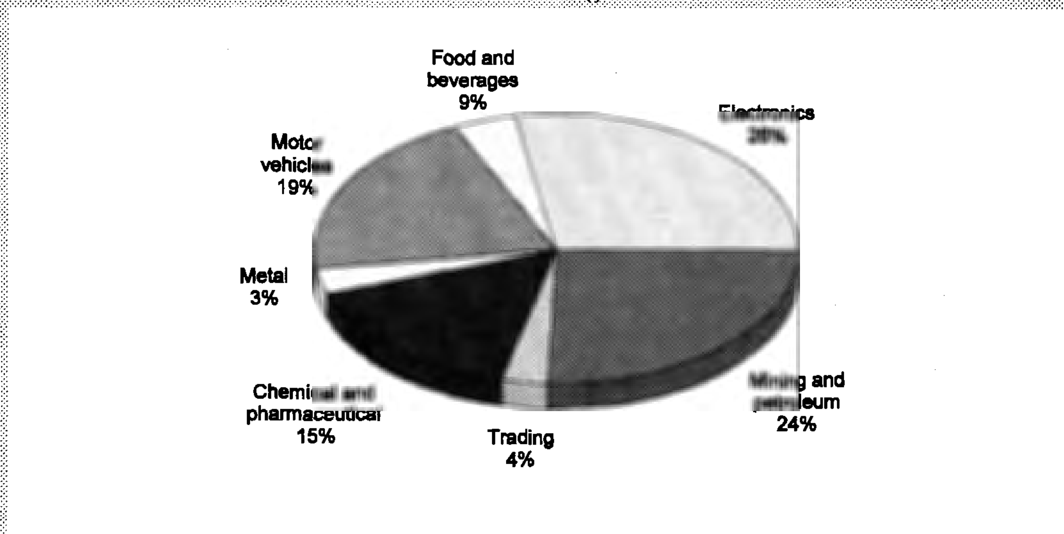
Among the top 100 TNCs, those in *computers and electronics* had the largest assets abroad in 1992. During the early 1990s, these companies, pushed by rapidly changing technologies, competition and increasing market segmentation, undertook either large greenfield investments or major acquisitions. As a result and despite the recession, the value of their foreign assets increased from $215 billion in 1990 to $300 billion in 1992 (figure 1). In that year, 7 of the top 17 TNCs in electronics and computers were Japanese (Matsushita Electric Industrial Co., Sony Corporation, Toshiba Corporation, Hitachi Co., Sharp, NEC and Canon). Total sales of these firms were $250 billion, of which about 30 per cent are abroad. Japanese electronics manufacturers have made some major acquisitions in the United States and expanded their production facilities in South and South-East Asia. Among the European firms, the fastest growth of assets abroad was registered by the French electronics group Alcatel-Alsthom, which moved up from the twenty-first position in 1990 to the sixth position in 1991 and then fell to the tenth position in 1992. The group has diversified into telecommunications, engineering and transport through a number of acquisitions. With three-quarters of its sales outside France, a management base in Paris and a financial base in the Netherlands,[a] Alcatel has also become one of the world's most transnational business groups.

Companies in the *oil* industry -- typically prominent among the top 100 TNCs -- grew slowly due to falling demand and declining oil prices, and their ranking generally declined. Traditionally, these companies have held most of their assets abroad, in response to geographical location of oil deposits and also reflecting the capital intensity of this industry.

Automobile manufacturers generally maintained their rankings among the top 100 TNCs, despite rationalizations and cost-cutting measures that resulted in a certain decrease of both total and foreign assets, sales and employment. International partnership arrangements and even mergers -- normally difficult in this industry -- have been used widely in view of large unused capacity of automobile manufacturers (especially in Europe) and stagnant demand.

Figure 1. The top 100 transnational corporations: distribution of foreign assets, by industry, 1992

(Percentage)



Among the 16 TNCs in *chemicals and pharmaceuticals*, 12 firms are European and four are based in the United States. It is interesting to note that Japanese companies in these industries do not rank among the top 100, despite some significant acquisitions made recently in the United States and in Europe.

a *Financial Times*, 5 January 1994.

Table I.3. Changes in foreign assets of the top 100 transnational corporations, 1990-1992

Growth rate	Number of TNCs	Name of TNC
Rapid growth (more than 10 per cent)	32	Daimler Benz, Hanson, ENI, Toyota, Veba, Chrysler, Matsushita Electric Industrial, Nissho Iwai, Alcatel Alsthom, Seagram, General Electric, Robert Bosch, Xerox, Marubeni, Toshiba, Procter & Gamble, Honda, Sandoz, Bridgestone, Lyonnaise des Eaux, Pepsico, Sharp, NEC Corporation, BMW, Total, Ericsson, Sara Lee, Nestlé Corporation, International Paper, Lonrho, Hitachi, Canon.
Strong growth (5 to 10 per cent)	13	Eastman Kodak, Glaxo, Digital Equipment, Smithkline Beecham, Atlantic Richfield, BHP, Johnson & Johnson, Nestlé, Elf Aquitaine, Grand Metropolitan, Chevron, Texaco, Electrolux.
Average growth (2 to 5 per cent)	10	Renault, Holderbank, Usinor Sacilor, Hewlett-Packard, GTE, McDonald's, Volkswagen, Siemens, Philip Morris, Saint Gobain.
No growth	14	Nissan Motor, ITT, Thomson Corporation, 3M, United Technologies, Norsk Hydro, Royal Dutch Shell, IBM, General Motors, Mobil, Sony, Du Pont, B.A.T. Industries, Petrofina.
Decline	31	Rhône-Poulenc, Itochu Corporation, Amoco, Roche Holdings, ICI, Volvo, Solvay, Pechiney, RTZ, Mitsui, Stora, Alcan Aluminium, Fletcher Challenge, Mitsubishi, Thomson, Akzo, Peugeot, Alcoa, Exxon, Ford, Philips Electronics, Asea Brown Boveri, British Petroleum, Unilever, Fiat, Bayer, Dow Chemical, Ciba-Geigy, BASF, Michelin, Hoechst.

Source: UNCTAD, Division on Transnational Corporations and Investment.

of global FDI inflows, shares unsurpassed throughout the period since 1970.[2] Estimated flows into developing countries in 1993 were the same as total world inflows in 1986. This increasing significance of developing countries as hosts to FDI occurred while investment flows into developed countries declined further in 1992(table I.4), although they began to recover in 1993.

South, East and South-East Asia as well as Latin America and the Caribbean — but not Africa — participated in this increase. The attractiveness of developing countries to FDI can largely be explained by their good economic performance overall, contrasted with lingering recession or slow growth in developed countries, efforts of TNCs to find cost-efficient locations for international production and new dynamic markets, combined with the ongoing relaxation of investment regulations, including the implementation of privatization programmes open to foreign participation. A detailed review of regional trends is featured in chapter II, but highlights by region are:

Table I.4. Inflows and outflows of foreign direct investment, 1981-1993

	1981-1985	1986-1990	1988	1989	1990	1991	1992	1993[a]	1981-1985	1986-1990	1991	1992	1993	1981-1985	1986-1990	1991	1992	1993
	Annual average								*Annual average*					*Annual growth rate*				
Country	*(Billions of dollars)*								*Share in total (percentage)*					*Growth rate (percentage)* [b]				
Developed countries																		
Inflows	37	130	131	168	176	121	102	109	74	84	74	65	56	1	24	-32	-5	7
Outflows	47	163	162	212	222	185	162	181	98	96	96	95	..	3	24	-17	-12	12
Developing countries																		
Inflows	13	25	28	27	31	39	51	80	26	16	24	32	41	-4	17	25	32	54
Outflows	1	6	6	10	10	7	9	14	2	4	4	5	..	33	49	-28	33	55
Central and Eastern Europe [c]																		
Inflows	0.02	0.1	0.015	0.3	0.3	2	4	5	0.04	0.1	1	3	3	1	90	716	85	25
Outflows	0.004	0.02	0.02	0.02	0.04	0.01	0.03	..	0.01	0.01	0.005	0.02	..	-11	20	-74	172	..
All countries																		
Inflows	50	155	159	196	208	162	158	194	100	100	100	100	100	-0.1	23	-22	- 2	23
Outflows	48	168	168	222	232	192	171	195	100	100	100	100	..	3	24	-17	-11	14

Source: UNCTAD, Division on Transnational Corporations and Investment, based on UNCTC, 1992a; UN-TCMD, 1993a; UNCTAD-DTCI, 1994a, 1994b, 1994c; International Monetary Fund, balance-of-payments tape, retrieved in April 1994, and estimates of the Organisation for Economic Co-operation and Development; and annex tables 1 and 2.

a/ Based on preliminary estimates.

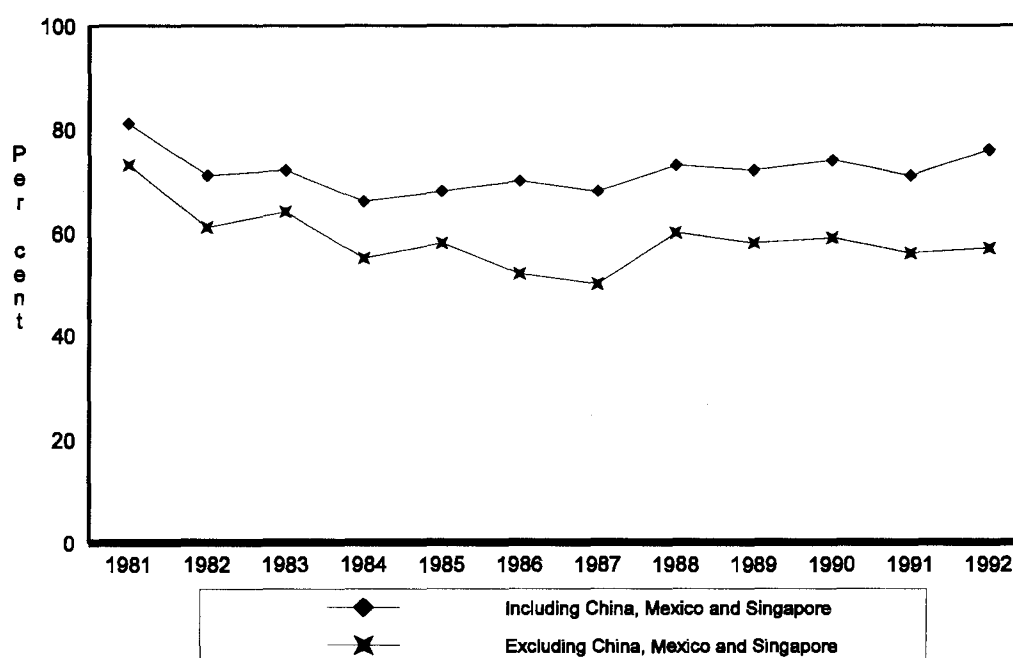
b/ Compounded growth rate estimates, based on a semi-logarithmic regression equation.

c/ Former Yugoslavia is included in developing countries.

Note: The levels of worldwide inward and outward FDI flows and stocks should balance; however, in practice, they do not. The causes of the discrepancy include differences between countries in the definition and valuation of FDI; the treatment of unremitted branch profits in inward and outward direct investment; treatment of unrealized capital gains and losses; the recording of transactions of "offshore" enterprises; the recording of reinvested earnings in inward and outward direct investment; the treatment of real estate and construction investment; and the share-in-equity threshold in inward and outward direct investment.

Figure I.3. Share of the ten largest host countries in foreign-direct-investment inflows to developing countries, 1981-1992

(Percentage)



Source: UNCTAD, Division on Transnational Corporations and Investment, based on table 1.5.

- *South, East and South-East Asia.* Vibrant economies, flourishing domestic markets and low production costs combined with high productivity encouraged more investment to flow to South, East and South-East Asia. With over $11.1 billion inflows and $4 billion outflows, China has emerged as the largest developing-country recipient and source of investment flows in 1992, accounting for over one-fifth of total inflows to all developing countries. In 1993, FDI flows into China were nearly $26 billion, or about one-third of investment flows into all developing countries. South, East and South-East Asia accounted for 57 per cent of total inflows to developing countries in 1992 (table II.10).
- *Latin America and the Caribbean.* Economic reforms leading to improved economic performance in several countries in Latin America together with regional integration schemes and continued efforts to attract TNCs through a further liberalization of investment regulations and through privatization programmes, contributed significantly to the re-emergence of the region as a major recipient of FDI. Latin America and the Caribbean accounted for 34 per cent of total inflows to developing countries in 1992 (table II.10).
- *Africa.* Foreign direct investment in Africa as a whole, after a relatively good performance during the second half of the 1980s, ceased to grow noticeably during the early 1990s. As a result, Africa's share in the total flows into developing countries declined from 12 per cent to 6 per cent between these two periods.

The flows of FDI into developing countries have been unevenly distributed, not only among regions but also, and even more so, among individual countries; in the years between 1981 and 1992, the ten largest host developing countries consistently absorbed between 66 and 81 per cent of total flows into developing countries (figure I.3). The composition of the ten countries has also

Table I.5. The ten largest host developing economies to foreign-direct-investment flows, 1981-1992
(Millions of dollars and percentage)

Host economy	*1981*	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*	*Total 1981-1992*
China		430	636	1 258	1 659	1 875	2 314	3 194	3 393	3 487	4 366	11 156	33 768
Singapore	1 660	1 602	1 134	1 302	1 047	1 710	2 836	3 655	2 773	5 263	4 395	5 635	33 012
Mexico	2 835	1 655	461	390	491	1 523	3 246	2 594	3 037	2 632	4 762	5 366	28 992
Malaysia	1 265	1 397	1 261	797	695	489	423		1 668	2 332	3 998	4 469	18 794
Brazil	2 520	2 910	1 560	1 598	1 348		1 225	2 969	1 267	901		1 454	17 752
Hong Kong	1 088	652	603	679		996	3 298	2 627	1 076	1 728		1 918	14 665
Argentina	837			268	919	574		1 147		1 836	2 439	4 179	12 199
Thailand			350	401				1 105	1775	2 444	2 014	2 116	10 205
Egypt	753		490	729	1 178	1 217	948	1 190	1 250				7 755
Taiwan Province of China					340	326	715	959	1 604	1 330	1 271		6 545
Nigeria	546	433	344		478		603		1 882			897	5 183
Indonesia										1 093	1 482	1 774	4 349
Colombia		366	618	584	1 023	674							3 265
Korea, Republic of						435	601				1 116		2 152
Venezuela											1 916		1 916
Philippines								936					936
Chile	383	401											784
Tunisia	293	340											633
Total, ten largest host countries	12 180	10 186	7 457	8 006	9 178	9 819	16 208	20 376	19 726	23 046	27 759	38 964	202 905
All developing countries	15 062	14 309	10 418	12 157	13 582	14 095	23 953	27 772	27 376	31 266	39 060	51 485	280 534
Percentage share of the ten largest host countries in total inflows to developing countries	81	71	72	66	68	70	68	73	72	74	71	76	72
Memorandum: **Percentage share of the host countries ranked from four to thirteen**	73	61	64	55	58	52	50	60	58	59	56	57	58

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of the Organisation for Economic Co-operation and Development and annex table 1.

been relatively stable over that period (table I.5). The high concentration of inflows is not dependent on the size of inflows to the top three recipients. The share of host developing countries ranked four to thirteen, that is excluding the top three recipients: China, Mexico and Singapore, is not significantly less (figure I.3 and table I.5). On the other hand, flows of investment into the 47 least developed countries were only $303 million in 1992 (less than the size of inflows to Pakistan), and their share of total inflows to developing countries was 0.6 per cent in 1992, declining from 0.9 per cent in 1991.

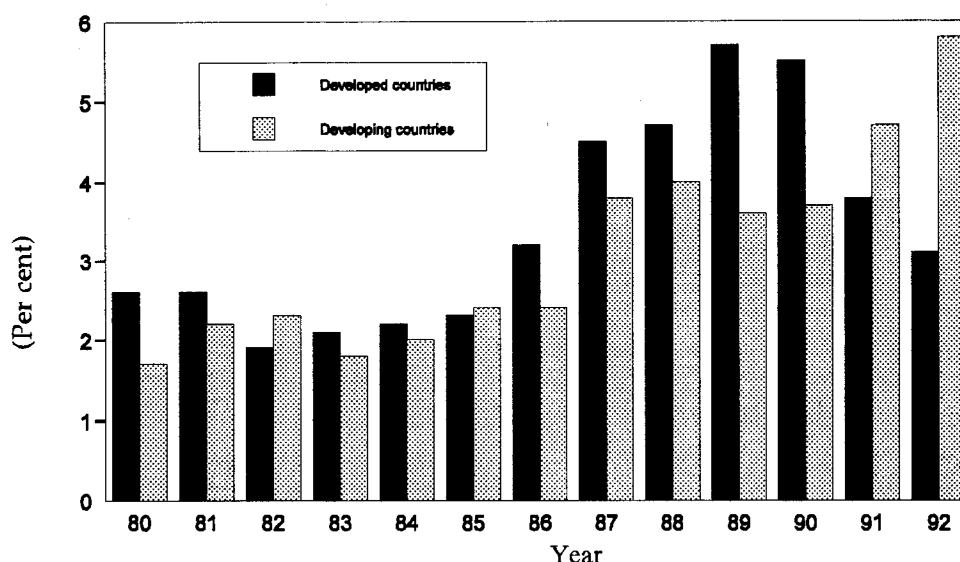
Inflows to the countries of Central and Eastern Europe continued to grow in the 1990s, accounting for almost 3 per cent of worldwide inflows of FDI in 1992. The pace of growth of inflows has, however, slowed down due to economic recession in the principal source countries and difficulties encountered in the process of transition towards a market-economy system. Investment flows continue to be unevenly distributed among the countries in Central and Eastern Europe reflecting, among other things, different levels of development and different rates of progress in the establishment of market economies and the institutions needed to sustain them. Potentially large domestic markets (if growth resumes and more progress is made in the transition to market economies), proximity to Western European markets, a high level of human resource development, low wages, low production costs, exploitable natural resources (in some countries) and the privatization of state-owned enterprises are factors that have induced investments in the region.

Inflows to developed countries continued to decline in 1992, although less steeply (15 per cent) than in 1991 (32 per cent). The decline in FDI flows into developed countries in the 1990s is mostly a consequence of poor economic performance resulting from a cyclical downswing in economic activity. Flows into developed countries are estimated to increase to $109 billion in 1993 as growth resumes in these countries. The highlights are the following:

- *United States.* Sluggish economic growth and low profitability of investments discouraged TNCs from investing in the United States, the world's largest host country since the late 1970s. Mergers and acquisitions in the United States have also declined drastically from 1990 to 1992. Cyclical as well as special problems in Japan — the largest investor in the United States — contributed to the dramatic fall (63 per cent) of Japanese investment flows into the United States in 1992. As a result of all this, flows into the United States in 1992 — at $3.4 billion — were about 13 per cent of their level in 1991 (table II.7). However, FDI flows into the United States recovered in 1993 to reach almost $32 billion.
- *Western Europe.* In contrast to the 28 per cent decline in inflows experienced by the European Community in 1991, inflows increased by 9 per cent to reach about $79 billion in 1992. Despite sizeable declines in flows into other countries in Western Europe (notably, Sweden), the region as a whole accounted for more than 80 per cent of total flows into developed countries in 1992: an unusually high share caused by the abnormally low level of flows into the United States in that year.
- *Japan.* The inflows of $2.7 billion in 1992 reflect a near-doubling from 1991. Still, Japan remains a small recipient, accounting for less than 3 per cent of total flows into developed countries in 1992.
- *Other developed countries.* The overall level of flows into these countries declined somewhat in 1992, reflecting a sharp fall of flows into New Zealand. These countries accounted for 9 per cent of total flows into developed countries in 1992.

The share of FDI inflows in gross fixed capital formation has more than doubled between 1986 and 1992 (figure I.4). In the early 1990s, that share has been noticeably higher for developing than developed countries. In 1992 it was more than twice as high. By region, the highest shares were found in Latin America and the Caribbean and in Western Asia. In contrast, owing to the

Figure I.4. The share of foreign-direct-investment inflows in gross fixed capital formation, developed and developing countries, 1980-1992
(Percentage)



Source: UNCTAD, Division on Transnational Corporations and Investment, based on annex table 5.

rapid growth of domestic investments, that share was smaller for South, East and South-East Asia and the Pacific.

The decline in worldwide FDI *outflows* in 1992 to $171 billion (from $232 billion in 1990 and $192 billion in 1991) was mostly in response to the continued recession or slow growth in major home and host countries (see chapter II). Outflows from the five major home countries declined by 10 per cent in 1992 to $113 billion. Notwithstanding that decline, these countries continued to account for two-thirds of worldwide outflows — a share not significantly different from that during the 1980s (table I.6). Large decreases in outflows from Japan — the largest home country in the late 1980s — took place for the second consecutive year and accounted for 65 per cent of the worldwide decline in 1992 (table II.1).

Having declined in 1991, outflows from developing countries increased by 33 per cent in 1992 to reach more than $9 billion (table I.4). As a result, the share of developing countries in world investment outflows in 1992 was over 5 per cent, compared to 2 per cent in the period 1981-1985 and 4 per cent in the period 1986-1991. Almost 90 per cent of these outflows are accounted for by the four Asian newly industrializing economies and China.

The importance of the services sector continued to increase in the early 1990s (table I.7). Services was the largest sector in the outward FDI stock of the five major home countries in the early 1990s, accounting for between 46 per cent and 66 per cent of the total stock compared to between 35 per cent and 53 per cent in the mid-1980s.

As FDI flows were positive, despite their decline, the worldwide FDI stock — a proxy for the productive capacity of TNCs outside their home countries — continued to increase, reaching an estimated $2.1 trillion at the end of 1993 (table I.8).[3] Foreign-direct-investment flows into developing countries have begun to grow significantly faster than their exports of goods and non-factor services, at 17 per cent versus 13 per cent in 1986-1990, and 25 per cent versus 4 per cent in 1991. Furthermore, foreign affiliates of TNCs generated worldwide sales of $4.8 trillion in 1991,

Table I.6. Outflows of foreign direct investment from the five major home countries, 1981-1993

(Billions of dollars and percentage)

	1981-1985 [a]	*1986-1990* [a]	*1988*	*1989*	*1990*	*1991*	*1992*	*1993* [b]	*1981-1985* [a]	*1986-1990* [a]	*1991*	*1992*	*1993* [b]	*1981-1985* [a]	*1986-1990* [a]	*1991*	*1992*	*1993* [b]
Country	*(Billions of dollars)*								*Share in world total (Percentage)*					*Annual growth rate (Percentage)*				
France [c]	3	17	14	19	35	24	31	21	6	10	12	18	11	-17	45	-31	29	-32
Germany	4	16	13	18	29	22	16	17	9	9	12	9	9	13	27	-22	-29	5
Japan [c]	5	32	34	44	48	31	17	12	11	19	16	10	6	8	32	-36	-46	-29
United Kingdom	9	28	37	35	19	16	16	26	19	17	8	9	13	-2	4	-18	1	61
United States [d]	11	22	14	34	24	33	33	50	23	13	17	19	25	-5	15	38	-0.03	52
Total [e]	32	115	113	151	155	126	113	126	67	68	66	66	64	-.03	23	-19	-10	11

Source: UNCTAD, Division on Transnational Corporations and Investment, based on UN-TCMD, 1993b; International Monetary Fund, balance-of-payments tape, retrieved in April 1994; and annex table 2.

a Compounded growth rate estimates, based on a semi-logarithmic regression equation.

b Based on preliminary estimates.

c Not including reinvested earnings. In the case of France, reinvested earnings are not reported after 1982.

d Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles. Also excludes currency-translation adjustments.

e Totals may not add up, due to rounding.

Table I.7. Sectoral composition of outward foreign-direct-investment stock of the major home countries, various years
(Percentage)

Home country	Year	Primary sector	Secondary sector	Tertiary sector	Total
France	1987	4	50	46	100
	1991	9	44	47	100
Germany	1985	4	43	53	100
	1992	2	39	59	100
Japan [a]	1985	17	29	52	100
	1993 [b]	5	27	66	100
United Kingdom	1984	33	32	35	100
	1991	18	36	46	100
United States [c]	1985	15	44	41	100
	1992	7	42	51	100

Source: UNCTAD, Division on Transnational Corporations and Investment, based on Banque de France, "Note d'information: encours des investissements directs étrangers en France", various years; Deutsche Bundesbank, *Die Kapitalverflechtung mit dem Ausland: Beilage zur Zahlungsbilanzstatistik*, various issues; Japan, Ministry of Finance, *Monthly Finance Review*, various issues; United Kingdom, Central Statistical Office, *Overseas Transactions, 1991* and *Census of Overseas Assets, 1984*; United States, Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, various issues.

[a] Based on notifications. Does not include branches and direct purchase of real estate. Therefore, total does not add up to 100 per cent.

[b] As of September.

[c] Excluding investment stock in the finance (except banking), insurance and real estate industries of the Netherlands Antilles.

compared to world exports of goods and non-factor services of $4.5 trillion ($3 trillion, excluding estimated intra-firm trade, table I.9).[4]

C. Major factors behind recent trends

1. Economic recession and growth

A major factor behind the recent decline in worldwide FDI flows has been the continuing economic recession in the developed countries (UNCTAD, 1993a) — the major home and host countries for FDI in the world economy (table I.10).[5] As studies on the link between FDI and GNP show, the growth of worldwide FDI flows is closely and positively correlated with the changes of global output (UNCTAD-DTCI, 1993a, chapter 4). Outflows from the five largest source countries

Table I.8. Stock of foreign direct investment, by country and region, 1988-1993

(Billions of dollars)

Region/country	*1988*	*1989*	*1990*	*1991*	*1992*	*1993* [a]
A. *Outward*						
France [a]	51	75	110	130	161	182
Germany	104	121	152	173	179	196
Japan [b]	110	154	202	233	250	264
United Kingdom	185	194	229	232	221	247
United States [c]	346	390	432	467	489	539
World	1 146	1 360	1 649	1 822	1 932	2 125
B. *Inward*						
Developed countries	961	1 148	1 374	1 485	1 520	..
Western Europe	447	561	745	825	838	..
North America	407	472	504	528	541	..
Other developed countries	106	116	125	132	141	..
Developing economies	265	293	330	369	420	..
Africa	33	38	40	42	46	..
Latin America and the Caribbean	98	105	116	131	149	..
East, South and South-East Asia	105	121	143	163	192	..
Western Asia	27	27	28	28	29	..
The Pacific	2	2	2	3	3	..
Central and Eastern Europe	0.2	0.5	0.8	3	8	..
World	1 226	1 442	1 705	1 856	1 948	..

Sources: UNCTAD, Division on Transnational Corporations and Investment, based on UNCTAD-DTCI, 1994c and annex tables 3 and 4.

[a] Estimated.

[b] Not including reinvested earnings.

[c] Excluding investment stock in the finance (except banking), insurance and real estate industries of the Netherlands Antilles.

(France, Germany, Japan, the United Kingdom and the United States), which together account for about two-thirds of worldwide outflows, are also correlated with the changes of their domestic output (UNCTAD-DTCI, 1993a, chapter 4; Julius, 1990). A period of slow growth, especially when it coincides with structural problems, tends to decrease profits and therefore limits possibilities of self financing and, in turn, the capability of TNCs to engage in FDI expansion. Instead of undertaking new investments, TNCs engage in internal restructuring with the objective of lowering costs and raising efficiency, the implementation of which becomes more imperative during recessions. Foreign affiliates are also likely to maintain a cautious investment stance because possibilities for approval of new investment or for obtaining funds from parent firms are limited. More importantly, recession means shrinking markets, falling demand and fewer

Table I.9. **Worldwide foreign direct investment and selected economic indicators, 1992, and growth rates for 1981-1985, 1986-1990, 1991 and 1992**

(Billions of dollars and percentage)

Indicator	*Value at current prices, 1992*	*Annual growth rate (per cent)*			
		1981-1985 [a]	*1986-1990* [a]	*1991*	*1992*
FDI outflows	171	3	24	-17	-11
FDI outward stock	2 125 [b]	5	11	10	6
Sales of foreign affiliates of TNCs [c]	4 800 [d]	2 [e]	15	-13	..
Current gross domestic product at factor cost	23 300	2	9	4	5
Gross domestic investment	5 120	0.4	10	4	5
Exports of goods and non-factor services	4 500 [d]	-0.2	13	3	..
Royalty and fees receipts	37	0.1	19	8	5

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; UNCTAD-DTCI, 1994c; and unpublished data provided by the World Bank, International Economics Department.

a Compounded growth rate estimates, based on a semi-logarithmic regression equation.

b 1993.

c Estimated by extrapolating the worldwide sales of foreign affiliates of TNCs from Germany, Japan and the United States on the basis of the relative importance of these countries in worldwide outward FDI stock.

d 1991.

e 1982-1985.

profitable investment opportunities (including those for FDI), coupled with heightened competition stemming from a desire to prevent or minimize a fall in profits. In other words, the growth of FDI inflows is also correlated with the growth in domestic output (UNCTAD, 1993a; UNCTC, 1992b).

The impact of cyclical fluctuations in output on FDI flows operates through the interaction of conditions at home and abroad. The latest recession, however, has been confined largely to developed countries. In particular, falling demand as a result of recession led to declining FDI flows into developed countries. In contrast, rapid growth resulting in expanding domestic markets has made developing countries attractive destinations of FDI, especially when their growth performance is compared with that of developed countries. However, cyclical fluctuations in developed countries may have also influenced the growth of export-oriented FDI into developing countries, since some of these exports are directed to the markets of developed countries. But given that investments in developing countries are mostly market-seeking and that intra-regional trade (especially in Asia) has been growing, the impact of cyclical fluctuations in developed countries on investment flows into developing countries has probably been small.

Table I.10. Growth rates of real gross domestic product, 1988-1993 [a]

(Percentage)

Region/country	*1988*	*1989*	*1990*	*1991*	*1992* [b]	*1993* [c]
Developed countries	**4.4**	**3.3**	**2.3**	**0.7**	**1.5**	**1.5**
France	4.5	4.1	2.3	1.2	1.6	-
Germany	3.7	3.3	4.7	1.2	2.0	-0.5
Japan	6.2	4.7	4.8	4.0	1.3	1.5
United Kingdom	4.4	2.1	0.6	-2.3	-0.5	1.5
United States	3.9	2.5	0.8	-1.2	2.1	3
Developing countries	**4.4**	**3.5**	**3.4**	**3.4**	**4.9**	**5**
Africa	2.3	3.0	2.9	2.0	1.4	3
South, East and South-East Asia	8.5	6.1	6.4	5.3	4.9	5.5
Western Asia	-	3.2	1.9	-0.1	6.6	6
Latin America and the Caribbean	0.7	1.1	0.1	2.9	2.2	3
Memorandum:						
China	10.9	3.6	5.2	7.7	12.8	11
Central and Eastern Europe	**4.5**	**2.1**	**-6.3**	**-9.0**	**-16.8**	**-10**

Sources: United Nations; 1993; annex tables A2, A3 and A4.

[a] Data on regions are weighted averages based on the value of GDP at 1988 prices and exchange rates.

[b] Partly estimated for developed countries and Central and Eastern Europe and preliminary estimates for developing countries.

[c] Forecast, based on Project LINK.

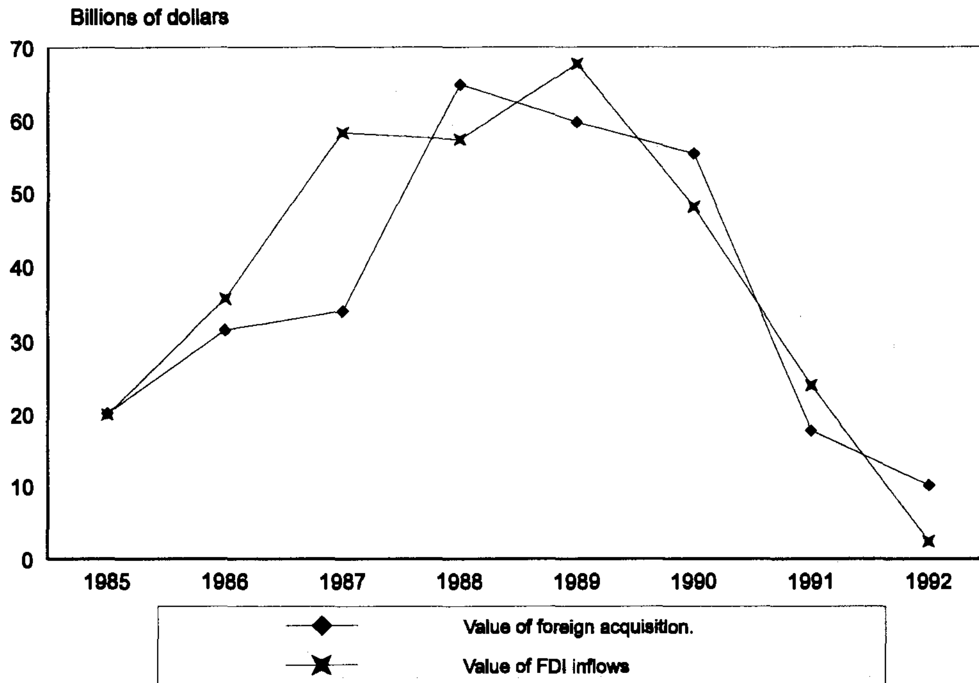
Table I.11. Value of worldwide cross-border acquisitions and foreign-direct-investment inflows to the developed countries, 1986-1992

(Billions of dollars)

Item	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
Worldwide cross-border acquisitions	39	71	113	122	113	50	75
FDI inflows to developed countries	67	109	131	168	176	121	102

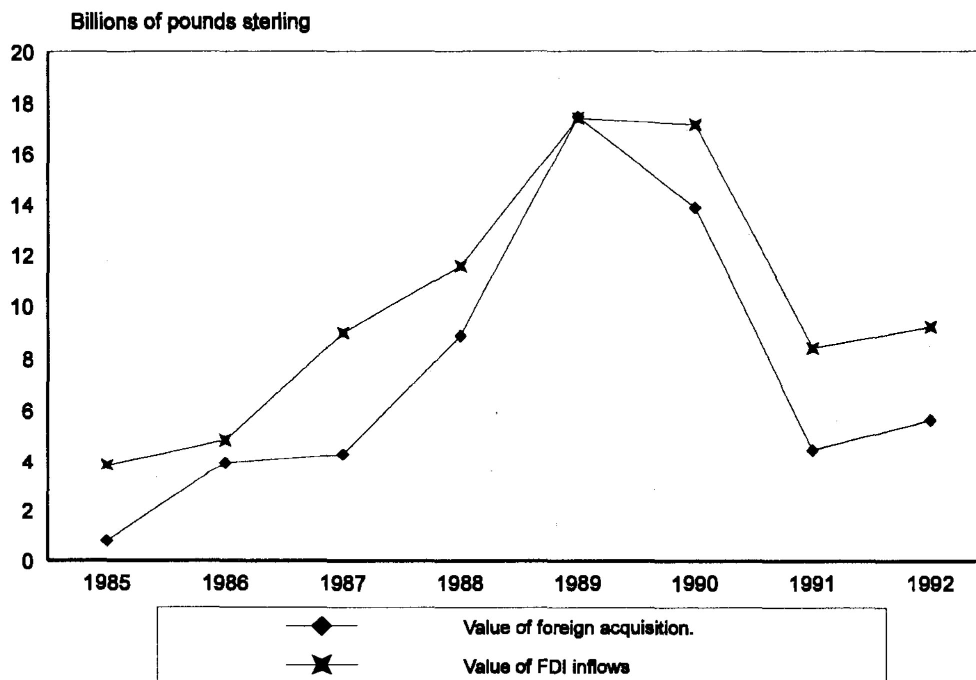
Source: UNCTAD, Division on Transnational Corporations and Investment, based on Jungnickel (1993); KPMG, *DealWatch*, various issues; and annex table 1.

Figure I.5. Foreign acquisitions and foreign-direct-investment inflows in the United States, 1985-1992



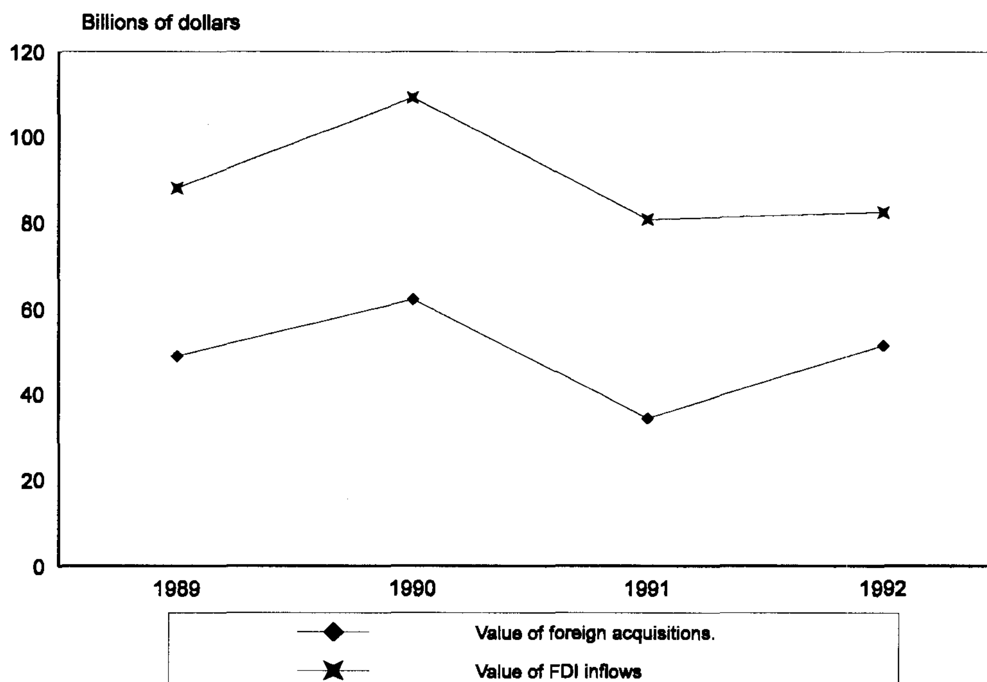
Source: UNCTAD, Division on Transnational Corporations and Investment, based on Fahim-Nader, 1992 and Fahim-Nader and Bargas, 1993.

Figure I.6. Foreign acquisitions and foreign-direct-investment inflows in the United Kingdom 1985-1992



Source: UNCTAD, Division on Transnational Corporations and Investment, based on *Acquisitions Monthly*, various issues; and United Kingdom, Central Statistical Office, *Overseas Transactions*, various issues.

Figure I.7. Foreign acquisitions and foreign-direct-investment inflows in Western Europe, 1985-1992



Source: UNCTAD, Division on Transnational Corporations and Investments, based on *Acquisitions Monthly*, various issues, and UNCTAD-DTCI, 1994c.

2. Mergers and acquisitions

The shift towards more complex corporate strategies (UNCTAD-DTCI, 1993a and chapter III) can lead under certain circumstances to concentration on internal restructuring, which has been partly reflected in a decline of cross-border mergers and acquisitions, a major generator of FDI prior to the recession. The surge in cross-border mergers and acquisitions as an important element of TNC strategies to expand international production was a significant factor in the explosive growth of FDI during the second half of the 1980s. Worldwide cross-border acquisitions accounted for approximately 70 per cent of the FDI inflows to the developed countries during the period 1986-1990; that share was significantly higher in the peak years 1988 and 1989, amounting to 86 and 73 per cent, respectively (table I.11).[6] In 1990, cross-border acquisitions declined by 7 per cent and, in 1991, by 56 per cent, leading to a comparable behaviour in worldwide investment flows. Indeed, growth and decline in worldwide investment flows have seemed to coincide broadly with the boom and decline of cross-border acquisitions.

The link between mergers and acquisitions and FDI inflows can be shown with greater precision for the United States and the United Kingdom as host countries, as well as for Western Europe as a host region. In the United States, the rapid growth in the value of foreign acquisitions between 1985 and 1989 (at an annual rate of 29 per cent)[7] contributed to the growth in FDI inflows (at an annual rate of 29 per cent, figure I.5).[8] Foreign companies acquired 3,643 United States firms between 1986 and 1990, valued in excess of $245 billion, and the bulk of these acquisitions took place in the period 1988 through 1990 (Fahim-Nader and Bargas, 1993). The period from 1990 to 1992 has seen a drastic decline in the values of foreign acquisitions owing to lower investment

outlays by both foreign parent groups — consisting of foreign parents and their foreign (non-United States) affiliates — and existing United States affiliates.[9] The decline in the value of foreign acquisitions in the United States (at an annual rate of 85 per cent) in the period 1990-1992 has been associated with an even more drastic decline in FDI inflows from $48.4 billion in 1990 to $3.4 billion in 1992 (table II.7).[10]

Similar trends are evident in the United Kingdom, when comparing changes in the value of foreign acquisitions and FDI inflows in the periods 1985-1989 and 1990-1992 (figure I.6). The rapid growth in the value of foreign acquisitions in the United Kingdom between 1985 and 1989 (at an annual rate of 70 per cent) has been associated with the rapid growth in FDI inflows (at an annual rate of 39 per cent). Conversely, the significant decline in the value of foreign acquisitions (at an annual rate of 45 per cent) in the period 1990-1992 has been associated with a decline in FDI inflows, but at a slower pace (at an annual rate of 31 per cent).

Analogous trends are noted when examining the value of foreign acquisitions and FDI inflows in Western Europe (figure I.7): both reached a peak level in 1990, declined in 1991 and slightly recovered in 1992, but below the peak level. The declines in cross-border acquisitions in Western Europe were smaller and lasted less than did those in the United States, as companies attempted to strengthen product and market positions prior to the advent of the Single Market programme in the European Union. The implementation of this programme has acted as a factor offsetting negative impact of recession on cross-border acquisition. Over 75 per cent of foreign acquisitions in Western Europe were accounted for by bidder companies coming from within the region.[11]

The boom in cross-border mergers and acquisitions in the late 1980s is best viewed as a strategic and economic response of TNCs to the changing international business environment. Key elements of the international business environment in the 1980s contributing to the boom include globalization and heightened competition; improvements in efficiency; access to expensive technological advances; the Single Market programme of the European Union; financial considerations; and rapid economic growth (table I.12). The first three can be considered as structural factors that are likely to influence positively the continuation of cross-border mergers and acquisitions over the longer term. The last three can be described as short-term factors that help to explain the bulge in FDI flows in the late 1980s.

The decline in cross-border mergers and acquisitions in parallel to that of FDI flows in 1990 and 1991 partly reflects cyclical fluctuations in economic activity: slower economic growth and lower profitability of investments, combined with tighter credit and increasing capital costs, dampened cross-border acquisitions. The aggressive pursuit of mergers and acquisitions by TNCs as an instrument to expand international production in the latter half of the 1980s has been superseded by a greater focus on integration and rationalization of their networks in the early 1990s. However, the continued impact of structural factors is likely to ensure the importance of cross-border mergers and acquisitions as a mode of FDI in the future. Indeed, data for 1992 show signs of recovery (table I.11). [12]

3. Privatization

Burdensome public-sector debts, continued poor performance of many State-owned firms, the adoption of market-friendly policies in the 1980s and the desire to attract FDI have led to the implementation of privatization programmes allowing TNC participation in many parts of the world. The number of privatized enterprises worldwide has grown rapidly in recent years, with the value of privatization sales amounting to at least $185 billion over the period 1988 to 1992.[13] Although developed countries began to privatize much earlier than other countries, since the late 1980s the privatization boom has concentrated in the developing world and in the transitional

Table I.12. The international business environment and mergers and acquisitions in the 1980s

Forces driving mergers and acquisitions	Application to cross-border mergers and acquisitions
Growing competition, globalization and favourable government policies	To achieve internationalization and geographical market diversification and to increase market share rapidly, firms prefer to engage in mergers and acquisitions as opposed to greenfield investments as a faster way to do so. Merger-friendly government policies encouraged the wave of mergers and acquisitions of the 1980s.
Higher efficiency in the face of growing competition and globalization	To achieve scale economies and synergies in value-adding activities, firms build integrated international production networks aimed at improving efficiency of the firm as a whole. Mergers and acquisitions allow the speedy establishment of such networks.
Access to technology and reduced costs of research and development	To gain access to new technology, share the risks and costs associated with technology development and reduce the time needed for product innovation, TNCs may acquire firms engaged in research and development or merge with such firms to access their technological capabilities and resources.
Response to the Single Market programme of the European Community	The Single Market programme created competitive pressures, as well as opportunities for European Community and third-country firms for mergers and acquisitions aimed at rationalizing production and distribution of goods and services within the European Community and increasing market share.
Availability of low-cost financing options available after the financial liberalization of the 1980s in many developed countries	To take advantage of the substantial growth in the availability of credit, innovations in corporate finance and the valuation of many companies below break-up values.
New investment opportunities in developed countries during the boom period in the second half of the 1980s	To take advantage of favourable investment opportunities created by economic growth to expand into new markets or activities. Periods of economic growth are also associated with a greater availability of investible funds from corporate profits or loans to finance mergers and acquisitions.

Source: UNCTAD, Division on Transnational Corporations and Investment, based on Hamill, 1993a.

economies of Central and Eastern Europe. In developing countries and transitional economies, the number of privatizations surpassed that in developed countries during the period 1988-1992 and the total sales volume from privatization exceeded that in developed countries for the first time in 1992.[14]

Only few privatizations in developed countries involved complete sales to foreign investors; in certain cases, a portion of the shares of the privatized companies (typically in the range of 15 to 20 per cent) was offered for sale in equity markets abroad.[15] As a result of the greater restrictions imposed by developed countries on foreign participation in privatization programmes, the importance of privatization-induced FDI in these countries has been smaller than in developing countries and Central and Eastern Europe, particularly when compared to the absolute size of FDI.

More privatizations in developed countries are scheduled in the future (proposed sales of State-owned enterprises in Western Europe alone could amount to $150 billion by 1998), in industries such as oil, air transport, telecommunications and utilities, typically considered strategic to the national interest of a number of countries. Although a number of these enterprises are expected to be open to foreign participation,[16] they will probably attract limited FDI because the extent of such participation may be limited or the preferred mode of association with foreign companies may take the form of alliances rather than take-overs.

Of all regions of the world, Central and Eastern Europe has experienced the largest share of FDI from privatization. Over the period 1988-1992, FDI from privatization amounted to over $5.2 billion, or 67 per cent of total FDI inflows to that region (table I.13 and OECD, 1993d).

The privatization of over 400 medium-sized and large State-owned enterprises in developing countries over the period 1988-1992 has generated over $49 billion in total sales. Of these, sales to foreign direct investors were $8.7 billion or about 17 per cent. Foreign direct investment through privatization accounted for about 5 per cent of total FDI flows into developing countries over that period, with marked regional variations (table I.13). Of all developing regions, Latin America and the Caribbean experienced the largest inflow of FDI from privatization (14 per cent of total FDI inflows overall, with much higher shares — nearly 25 per cent — in 1990 and 1991). Other regions had considerably less privatization activity and also considerably lower shares of privatization-associated FDI flows. Generally, for countries that have implemented privatization programmes, the flow of FDI induced through them is determined largely by the overall value and attractiveness of the assets being privatized, restrictions on foreign participation in privatization programmes, the overall investment climate of the country and the presence of fairly developed capital markets.

Beyond bringing in FDI capital directly, privatizations with TNC participation also often entail a commitment by foreign firms to invest additional capital, usually over time, in the acquired assets. Beyond that, by acting as a signalling device to foreign investors of the commitment of host-country governments to economic reform and, in particular, to the role of the private sector in domestic economic activity, privatization programmes can help to attract a continued flow of investments even after the completion of a particular programme (Sader, 1993). Furthermore, increased profitability — due to the expected efficiency gains from the transfer of State-owned enterprises to the private sector — as well as greater competition resulting from the break-up of State monopolies are likely to have a positive impact on the investment climate for FDI. Finally, to the extent that FDI from privatization takes place in infrastructure and finance in developing countries, it is likely to improve conditions for other firms contemplating investments in these countries.

D. The sustainability of flows into developing countries

The surge in FDI flows into developing countries in the early 1990s raises the question of the extent to which the level or growth rate of these flows can be maintained. Furthermore, the fact that a single country — China — accounted for 55 per cent of the increase in FDI flows into all developing countries in 1992 (and an estimated 51 per cent in 1993) raises the question of whether it should be expected that investment flows into developing countries decline (or that their rate of growth diminishes) if the ability of a few countries to attract FDI abates.

Moreover, in contrast to previous recessions, the recent rapid growth of FDI flows to developing countries has taken place against the backdrop of declining flows to developed countries. (In the early 1980s, FDI flows to both developed and developing countries declined.) The question arises, therefore, of how a recovery in the latter will influence the growth and level of FDI flows in the former. Finally, the fact that the record levels of FDI flows received by

Table I.13. Foreign direct investment from privatization in developing countries, 1988-1992

(Millions of dollars and percentage)

Region	1988	1989	1990	1991	1992	Cumulative 1988-1992
North Africa and Western Asia						
FDI from privatization	-	1	-	3	22	27
Share of total FDI inflows	-	0.05	-	0.21	1.01	0.29
Sub-Saharan Africa						
FDI from privatization	-	14	38	3	44	99
Share of total FDI inflows	-	0.4	3.7	0.2	2.7	1.1
East Asia and the Pacific						
FDI from privatization	-	-	-	75	302	377
Share of total FDI inflows	-	-	-	0.37	1.03	0.38
South Asia						
FDI from privatization	-	0.1	11	4	37	52
Share of total FDI inflows	-	0.02	2.0	0.9	5.8	2.1
Latin America and the Caribbean						
FDI from privatization	214	157	2 136	3 300	2 312	8 119
Share of totalFDI inflows	2.4	2.5	24.7	22.0	13.1	14.3
All developing regions						
FDI from privatization	214	172	2 185	3 385	2 717	8 673
Share of total FDIinflows	0.8	0.6	6.0	8.7	5.3	4.9
Memorandum:						
Central and Eastern Europe						
FDI from privatization	-	422 [a]	489 [a]	1 917	2 411	5 238
Share of total FDI inflows	-	..	..	74.7	52.5	66.8

Sources: Sader, 1993 and additional information provided by the author; annex table 1.

[a] Foreign direct investment from privatization is larger than the recording of FDI inflow (annex table 1). This is caused by the incomplete coverage of countries in Central and Eastern Europe in FDI inflow data in the balance-of-payments statistics reported by the International Monetary Fund.

developing countries also reflect one-time adjustments to policy changes (e.g., privatization), puts further doubt on their sustainability.

The sustainability of the present level or growth of FDI flows into developing countries depends on the interplay of a number of economic and policy factors, as well as the strategies of TNCs, that lie behind the present trend. Given that FDI has become the most important source of external finance to developing countries, whether or not its flow can be maintained is becoming an issue of greater importance.

1. Economic factors

- *Economic growth* of host countries is a principal determinant of FDI inflows (UNCTC, 1992b; UNCTAD-DTCI, 1993b). Rapid economic growth ahead of population growth leads to

increases in per capita income and consumer demand for goods and services that help attract FDI. The estimated growth rates for developing countries as a group in the early 1990s have been the highest of the past decade and well above those for developed countries (table I.10). The 1993 growth rates are especially favourable for South, East and South-East Asia (5.5 per cent) and, notably, China (11 per cent). Although the economic recovery in developed countries currently under way will help them attract considerable FDI flows again, long-term forecasts of economic growth suggest rates substantially higher in developing countries than those in developed countries.[17] Sustaining the current level or perhaps even the rate of increase of investment flows into developing countries will therefore be favourably influenced by the growth prospects of these countries.

- The *size of the domestic markets* of recipient countries is another principal determinant of FDI flows (UNCTC, 1992b; UNCTAD-DTCI, 1993b). Large domestic markets provide new investment opportunities for market-seeking FDI. Transnational corporations establish production facilities in countries with large domestic markets in order to ensure better access and service. Regional integration schemes among developing countries, or between developed and developing countries (e.g., NAFTA) help developing countries, especially small ones, overcome the problem of the small size of their domestic markets, and also encourage efficiency-seeking investments, as TNCs seek to reap the benefits from achieving economies of scale and scope. A number of planned or ongoing regional integration schemes in Asia and Latin America, if they are successful in creating enlarged markets, will work in favour of sustaining the level and growth of FDI flows. And, of course, rapidly expanding domestic markets of middle-income developing countries are, in themselves, a growing attraction to foreign investors.
- Partly as a result of improved economic performances of many developing countries, returns on investments in at least some of those countries have been above average (table I.14). Higher *profitability* sends positive signals to foreign investors regarding expected returns and helps boost future FDI flows. Profitability, however, is also related to factors other than economic performance. For example, risky investments are usually associated with higher expected returns, but riskiness itself might discourage the growth of FDI. This might explain the high profitability of United States FDI in Africa: in spite of it, the flows of FDI to this continent are low. In the longer run, the rate of return on investments in developing countries is expected to be above that in developed countries (Julius, 1993), a factor with a positive influence on the level and growth of FDI flows.
- The availability of *labour* in many developing countries — which, for a given level of productivity typically costs less than in developed countries — may exert a positive influence on labour-intensive, efficiency-seeking FDI. Today, improvements in human resources (undertaken, to a certain extent, by foreign affiliates) have led to the emergence of a highly skilled, low-cost workforce in some developing countries (e.g., the Asian newly industrializing economies and India). Thus, the potential developing-country locations available to TNCs that offer varied combinations of costs, productivity and skills have multiplied. In the past, developing countries attracted mostly low-skill, low-cost labour-intensive activities; now, more and more developing countries can offer a wide-ranging configuration of costs, productivity and skills to attract an expanded set of TNC activities, which can help sustain FDI inflows.
- Improved *infrastructure* allows TNCs to build regionally integrated networks of foreign affiliates and to engage in intra-firm trade and resource flows, and creates channels for the distribution of output. As such, an improved domestic infrastructure helps TNCs organize better their investments within a country or region and allows them to supply domestic, regional or international markets. Intensified efforts by some developing countries (e.g., Taiwan Province of China, Thailand and Chile) to improve their domestic infrastructure

Table I.14. Profitability of majority-owned nonbank foreign affiliates of nonbank United States parent firms, 1977-1991 [a]

(Percentage)

Region/country	*1977*	*1982*	*1987*	*1988*	*1989*	*1990*	*1991*
Developed countries	**12.5**	**10.0**	**16.8**	**19.9**	**18.1**	**15.6**	**12.8**
Canada	9.9	7.2	11.9	13.0	12.1	8.1	4.8
Europe	13.8	11.0	18.9	22.9	20.0	17.6	14.9
Other developed countries	13.7	11.6	14.6	17.0	18.1	15.4	12.2
Developing countries	**23.9**	**14.6**	**12.9**	**14.0**	**17.1**	**15.9**	**13.7**
Africa	33.2	10.8	14.7	22.9	20.1	22.2	22.7
South, East and South-East Asia and the Pacific	29.9	34.2	22.3	25.4	26.8	30.1	26.0
Western Asia	-54.2	28.7	8.7	11.1	9.4	19.0	16.4
Latin America and the Caribbean	11.7	10.1	10.7	10.9	14.6	11.4	9.4
All countries	**14.6**	**11.6**	**15.3**	**18.0**	**17.7**	**15.7**	**13.0**

Source: UNCTAD, Division on Transnational Corporations and Investment, based on United States, Department of Commerce, Bureau of Economic Analysis, 1992a, 1985, 1981a and *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates* (Washington, D.C., Government Printing Office), various issues.

[a] Measured by net income as a share of owners' equity.

(especially transportation and communications), including improvements secured through privatization involving FDI, will play a role in maintaining the level and growth of investment flows.

- Flows of FDI are also related to the movement of *exchange rates* (UNCTAD-DTCI, 1993b). Appreciating exchange rates are usually associated with investment outflows, as companies find it cheaper to acquire foreign assets and are driven to invest abroad in order to raise production efficiency by cutting costs. As a result, more efficiency-seeking outward investments might be expected if a country's currency appreciates *vis-à-vis* the dollar or other major currencies) and domestic costs (translated into foreign currencies) are pushed upwards as a result. To some extent, this is already reflected in the flow of Japanese FDI into Asia in the 1990s: even if the yen does not appreciate further, Japanese TNCs will probably continue to seek to lower production costs and rationalize investments by moving some activities abroad (chapter II). Combined with labour cost considerations mentioned above, this factor is likely to influence positively the growth of FDI flows into Asia.

2. Policy factors

- *Private sector development.* The renaissance and nearly universal recognition of the principles of a market-based economy and the changing attitudes of governments towards the private sector form the environment in which investments by private firms, including TNCs, flourish. Government support to the domestic private sector can serve as a magnet to FDI (as for example, in Chile and Mexico). The emergence of domestic suppliers' and distributors' networks comprising private domestic firms that can be linked with TNCs through sub-contracting or other non-equity arrangements can give an additional impetus

to FDI flows into developing countries. In other words, the ability to outsource components or to disseminate output through domestic distribution channels is becoming increasingly important to TNCs, and the private sector of many developing countries has been responsive to such needs. Thus, policies pursued by many developing countries aimed at developing an indigenous private sector will help sustain FDI flows to developing countries.

- *Macroeconomic reform.* Many developing countries have adopted policies to curb inflation (e.g., Bolivia, Chile), service external debt, raise domestic savings and improve their export performance. The continued implementation of sound domestic macroeconomic reforms remains an important factor for the sustainability of FDI flows into developing countries.
- *Liberalization.* The initial jump in FDI flows associated with the opening up of countries (or industries) to FDI, as TNCs seek to exploit first-mover advantages, is typically followed by additional investments, including those in the form of reinvested earnings. Efforts by developing countries to liberalize investment regimes have recently concentrated at the sectoral level, notably on services. The liberalization of services allows TNCs to encompass them into their existing production networks. At the same time, measures to lower foreign-ownership thresholds and allow TNCs into previously restricted resource-extraction and processing industries have been introduced in several developing countries (e.g., petroleum exploration in Mexico, gold mining in China). The liberalization of FDI regimes of developing countries is expected to continue and this will contribute to the sustainability of investment flows. Furthermore, in a world in which FDI, trade and technology are becoming increasingly interdependent, liberalization is also likely to extend beyond investment to include trade and technology frameworks. Such developments are important for the ability of TNCs to integrate their production activities globally or regionally, and this is likely to help sustain FDI flows. The further liberalization and deepening of equity markets in developing countries can help sustain FDI flows by providing an additional source of finance to foreign affiliates and allow TNCs to acquire domestic firms listed in those markets (box I.2).
- *Privatization.* As noted earlier, the one-time investment flows entering countries that have implemented privatization programmes involving FDI, are often complemented by additional inflows to which the initial FDI gives rise, for instance, in the form of reinvested earnings. Furthermore, privatization can trigger additional investment flows by sending positive signals to foreign investors regarding attitudes towards the private sector and TNCs. Embarking on the privatization of State-owned enterprises with FDI participation (e.g., in Africa), or continuing the implementation of existing privatization schemes (in Latin America) may therefore contribute to the sustainability of FDI flows into developing countries.
- *Regional integration.* As already discussed in the context of market size, to the extent that developing countries expand their economic boundaries through participation in regional integration schemes, either among themselves (e.g., Mercosur, ASEAN, the Andean Group) or with developed countries (e.g., NAFTA — and its possible extension to Chile — and APEC), they can create large markets and improve growth prospects. A number of regional integration schemes among developing countries involve a greater commitment by the members and will probably be more successful in attracting FDI than their predecessors. Regional integration schemes can trigger intraregional investments, as well as third-country investments, as the experience of NAFTA has indicated, and thus help sustain FDI into the participant developing countries.

Box I.2. Emerging markets and the sustainability of foreign direct investment

During the late 1980s and early 1990s, the rapid growth of FDI flows into developing countries has been accompanied by a rapid increase of foreign portfolio investment (table II.11), a development that was triggered by the establishment and growth of capital markets in developing countries open to foreign participation. Portfolio *equity* investment, in particular, which barely existed in the developing countries in the early 1980s, reached $14 billion in 1992 (table II.11) and is expected to increase further in 1993. In fact, this investment, together with FDI, accounted for a sizeable proportion of recent aggregate net long-term resource flows to developing countries (table II.11). The geographical pattern of portfolio equity flows to developing countries, moreover, has a profound similarity to that of FDI. The ten largest developing-country recipients of FDI over the period 1981-1991, with fairly well-developed capital markets that allow foreign participation, are also major recipients of portfolio investment flows. This raises the question of the influence of capital markets on the level and pattern of FDI flows.

The direct impact of stock markets in developing countries on FDI is still small. This can be attributed to a number of factors, including ceilings on foreign ownership and limitations on the types of shares available for sale and industries in which investments can be made. For example, prior approval is often required for the purchase of shares that carry voting rights (an instrument of lasting interest by TNCs over the management of a company that qualifies a foreign investment as direct). The amount of FDI that can be channelled through the local stock markets is also limited by the small number of domestic companies listed in some stock markets (e.g., Barbados, Nepal and some countries in sub-Saharan Africa). Potentially, however, as developing countries are interested in expanding their stock markets (e.g., by increasing the number of listed domestic companies) and continue to relax ownership and other restrictions on foreign investment,[a] the amount of FDI following this route will most likely rise.

Stock markets can help attract and sustain the inflow of FDI to developing countries also in various other ways. To begin with, a series of portfolio equity investments can eventually result in a FDI stake. The emergence of capital markets can encourage FDI by providing a vehicle through which the privatization of State-owned enterprises can take place (as in the case of Telmex in Mexico). In addition, stock markets facilitate mergers and acquisitions of listed domestic companies by TNCs, in particular through the provision of more widely accessible information on listed companies.[b] As a result, TNCs, including small and medium-sized firms with fewer resources, may be in a better position to make well-informed investment decisions than would be possible in the absence of stock markets, although this will also depend on the quality of regulatory and accounting systems. Freer capital markets also facilitate the financial management of TNCs through global diversification of the processes of both investment and the raising of funds. Open equity markets can also help to expand TNC activities in host countries by allowing TNCs that wish to invest in the host country (or expand existing investments) the choice of raising funds locally in addition to raising equity or loan capital from abroad.[c]

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a See Gooptu, 1993. Despite the ongoing liberalization and removal of restrictions on foreign ownership, several developing countries (e.g., Taiwan Province of China) still impose strict limits on foreign participation in domestic stock markets, as well as on the repatriation of dividends.

b The rules of capital markets require the reporting of details on financial performance of listed companies in accordance with transparent accounting regulations.

c Investment financed by foreign affiliates through the local capital market is, however, not recorded in data on FDI inflows or stock of the host country since the investment does not cross national borders and, as such, does not affect the balance of payments. The emergence of capital markets can, of course, increase the amount of FDI flows in the case in which funds raised in such markets are used to finance investments abroad.

3. Strategies of transnational corporations

- Pressures from growing international competition are forcing TNCs, including small and medium-sized firms and firms in developing countries, to search for new markets, as well as cost-competitive sites in which to locate production. Transnational corporations are increasingly compelled to locate many of their activities abroad in order to increase the efficiency of production and remain competitive internationally. As the location-specific advantages of host developing countries are increasingly compatible with the strategies pursued by TNCs, there is a greater likelihood that investment flows to these countries will be sustained.

- As a consequence of international competition and in addition to the growing transnationalization, more and more frequently TNCs adopt complex strategies and establish integrated production networks, within a region or globally, facilitated by technological developments (UNCTAD-DTCI, 1993a). Complex strategies of TNCs, offer a wide spectrum of opportunities for attracting FDI (including high value-added investments) that, again, influence the sustainability of FDI flows. Although many developing countries are not yet included in the complex strategies of TNCs, as regional integration schemes with developing-country participation are adopted, the likelihood of being incorporated in such TNC strategies increases.

* * *

The pressures exerted by the interplay of these factors influence the sustainability of the level and growth of FDI flows. Overall, prospects for maintaining FDI flows into developing countries are favourable. The degree of importance and the configuration of the above factors influencing the sustainability of investment flows is likely to vary across developing regions (table I.15). For the countries in South, East and South-East Asia and the Pacific, prospects for sustained FDI flows are very promising given that most factors work in their favour. For Latin America, prospects for sustaining the present growth of FDI flows are also favourable assuming that countries continue to implement sound macroeconomic policies and can maintain economic growth. For sub-Saharan Africa, prospects for FDI are not so favourable, given that most countries in that region have not yet reached a take-off stage of growth, progress in economic reform is slow and the size of domestic markets is small. It must be recognized that, given that economic growth and competitiveness of developing countries are, to a certain degree, themselves dependent on FDI, the sustainability of FDI flows also relies on the activities of existing TNCs.

In addition, factors specific to individual developing countries that are becoming important players in the world economy will influence the extent to which the present growth rate of FDI flows into developing countries will endure. The success of some of the largest recipients of FDI among developing countries that are often among the top ten, for instance, Brazil, China, Mexico and Singapore, to sustain or increase flows of FDI is important in that respect. New entrants will also help maintain the present level or growth of FDI even if flows to traditional recipients decline. For example, even if FDI flows into China slow down, the market of India has yet to be fully tapped.

It is, of course, difficult to predict how and to what extent these factors will materialize, individually or together, especially since some of them have a certain one-off character. In addition, the economic performance of the developed countries — which, after all, continue to be the principal sources of FDI — will exercise considerable influence on future FDI flows. At the same time, however, to the extent that the investments made in developing countries create a growing stock of FDI geared either to the domestic market or, in the context of integrated

Table I.15. Factors influencing the sustainability of foreign-direct-investment flows to developing regions

South, East and South-East Asia

Economic factors

- continued rapid economic growth;
- ability of some major recipients (e.g., Thailand, Taiwan Province of China, China) to overcome infrastructure bottlenecks;
- extent of transnationalization of Asian-based TNCs driven by cost factors or market access, including those from the newly industrializing economies (especially, Singapore), the "second-tier" industrializing economies (Thailand, Malaysia, Indonesia) and China;
- continuous availability of low-cost, productive and increasingly skilled labour;
- economic recovery, coupled with yen appreciation in Japan, the dominant investor in the region;
- ability of China to sustain and India to attract more FDI.

Policy factors

- economic reform in the Asian economies in transition;
- further liberalization of FDI and outward-oriented trade policies;
- private-sector support, including that exerted through privatization;
- strengthening regional economic integration (ASEAN, AFTA, growth triangles).

Strategies

- regional rationalization and integration strategies of TNCs;
- market penetration.

Latin America and the Caribbean

Economic factors

- continuous adoption of sound macroeconomic policies, including debt servicing;
- sustaining or improving the present growth performance;
- improving infrastructure;
- growth of intra-regional FDI;
- ability of Argentina, Brazil, Chile and Mexico to sustain or attract more FDI.

Policy factors

- ongoing implementation of privatization schemes;
- strengthening regional integration (NAFTA, Mercosur, Andean Pact).

Strategies

- regional rationalization of production in response to integration;
- market penetration.

Africa

Economic factors

- further diversification of the production structure towards manufacturing and services;
- ability to enlarge markets and foster high growth rates;
- improving infrastructural facilities, including improvements obtained through official financial assistance;
- ability of South Africa to become an investment pole for sub-Saharan Africa.

Policy factors

- adoption of macroeconomic reforms, including alleviating the debt burden;
- further liberalization of FDI and related regimes, including those in the primary and services sector;
- introduction and expansion of privatization programmes.

Strategies

- extent to which based TNCs in the European Union integrate North Africa into their regional production networks.

Source: UNCTAD, Division on Transnational Corporations and Investment.

international production, towards regional or global markets, stable ties with host developing countries are established which have, to a certain extent, a self-perpetuating nature (e.g., through reinvested earnings).

Notes

1 When comparing asset values between different years, the changing membership of the list of the top 100 should be taken into account. Between 1989 and 1992, 19 companies exited the list owing mostly to mergers, acquisitions and divestitures. They are: Allied-Lyons (United Kingdom), the BOC Group (United Kingdom), Canadian Pacific (Canada), Foster Brewing (Australia), Northern Telecom (Canada), Ferruzzi Montedison (Italy), SCA (Sweden), SKF (Sweden), L'Air Liquide (France), Ahod (Netherlands), Hoogovens (Netherlands), Pirelli (Italy), Schlumberger (United States), The Sun Company (United States), Trizec (Canada), Union Carbide (United States), Groupe Bull (France), Générale des Eaux (France), Mannesmann (Germany). The new entrants included: Hanson (United Kingdom), Ericsson (Sweden), Sara Lee (United States), Roche (Switzerland), ENI (Italy), Petrofina (Belgium), Usinor-Sacilor (France), Holderbank (United Kingdom), Sharp (Japan), Hitachi (Japan), Fletcher Challenge (New Zealand), Stora, (Sweden), BMW (Germany), International Paper (United States), NEC (Japan), Neste (Finland), Lyonnaise des Eaux (France), Nissho Iwai (Japan) and Pepsico (United States).

2 Over half of the growth of flows into developing countries in 1992 and 1993 was accounted for by China where inflows in 1992, at almost $11.2 billion, increased more than two-and-one-half times over their 1991 level. In 1993, inflows to China were $26 billion — more than double their 1992 level. But even the exclusion of China in FDI inflows to developing countries in 1992 and 1993 shows a growth rate of FDI inflows in developing countries of 16 per cent in 1992 and 35 per cent in 1993.

3 The growth rate of worldwide exports of goods and non-factor services refers to 1991. In SDR terms, the rate of annual growth of worldwide outflows, gross domestic product, gross domestic investment, exports of goods and non-factor services, sales of TNCs and royalty-and-fees receipts during the period 1986-1991 were 14 per cent, 6 per cent, 6 per cent, 7 per cent, 9 per cent and 15 per cent, respectively. Hence, in SDR terms, worldwide outflows increased more than one-and-a-half times as fast as worldwide exports of goods and non-factor services, more than twice as fast as worldwide gross domestic product and gross domestic investment and considerably faster than royalties-and-fees receipts. Worldwide sales of TNCs grew one-and-a-half as fast as worldwide gross domestic product and as fast as worldwide exports of goods and non-factor services.

4 In the *World Investment Report 1993*, it was noted that the worldwide sales of foreign affiliates of TNCs in 1990 were $5 trillion. The fact that these sales declined to $4.8 trillion in 1991, despite the increasing productive capacity of TNCs indicated by FDI stock, can be explained by economic recession or slow growth in the developed countries (the major host countries for FDI) that resulted in significantly lower sales by foreign affiliates.

5 The growth of cumulative outflows of the five major home countries over 1970-1991 has been found to be explained largely by growth of their domestic output over the same period, as seen in the estimated regression equation FDI = -55.5 + 4.2 (GNP) (R2 = 0.89). The impact of business cycles on FDI on both the demand and supply side is further explained in UNCTAD-DTCI, 1993a.

6 Data on cross-border acquisitions reported here include all investments that result in the investor, located in one country, to hold more than 50 per cent of the outstanding voting securities of a business located in another country. Only general comparisons between cross-border acquisitions and FDI flows can be made. Calculating the value of cross-border acquisitions as a share of FDI inflows can be misleading for at least two reasons. First, data on the value of cross-border acquisitions reported here do not include FDI through reinvested earnings in a host country, nor do they include cross-border acquisitions that lead to minority stakes and joint ventures. The underreporting of the value of cross-border mergers and acquisitions resulting from that could lead to an underestimation of their share of FDI inflows. Second, where cross-border acquisitions or takeovers proceed in incremental stages and do not lead immediately to the threshold equity share of 10 per cent that is required to qualify as FDI, they are recorded as portfolio investments. However, subsequent investments that may lead to the attainment of the threshold value may not be recorded as FDI. The resulting underestimation of actual FDI implies that taking the value of cross-border acquisitions as a share of FDI could lead to an overestimation of their share.

7 Compounded growth rate estimates, based on a semi-logarithmic regression equation, are used in this chapter for annual growth rates of more than one-year period.

8 Although the value of FDI inflows in the United States started to decline in 1990, the value of foreign acquisitions began to decline in 1989.

9 Between 1991 and 1992, investment outlays of foreign parent groups to acquire *or* establish United States business enterprises declined faster than investment outlays of existing United States affiliates of foreign-based parent firms. Thus, foreign parent groups spent $14.1 billion (55 per cent of total investment outlays) to acquire or establish business enterprises in the United States in 1991; by 1992, that amount had declined by almost half to $7.2 billion (53 per cent of total investment outlays). See Fahim-Nader and Bargas, 1993.

10 The fact that the rates of growth (or decline) of cross-border acquisitions and FDI inflows are not similar in orders of magnitude is indicative of the fact that there are other determinants that influence level of FDI inflows. This suggests that an analysis of the association between cross-border acquisitions and FDI flows is useful only to the extent that it illustrates similar directions of change.

11 Data obtained from *Acquisitions Monthly,* various issues.

12 See KPMG, 1992. There are also preliminary indications that cross-border acquisitions have risen up in 1993, especially for firms in the United Kingdom. These firms spent $7.4 billion acquiring European firms in a surge of outward investments in the first 10 months of 1993 — an amount that was two-thirds higher than that in the same period of 1992. The increase in cross-border acquisition activities by these firms is largely due to their strengthened financial positions, combined with a gradual economic recovery of the United Kingdom and a lingering recession in most other countries of the European Union. See Michael Cassell, "UK spending on takeovers in EC surges", *Financial Times,* 8 November 1993.

13 Not included are privatization in the former German Democratic Republic which generated a sales volume of $25 billion and an additional $106 billion in investment commitments between 1990 and end-1992. See Sader, 1993.

14 Africa is the only region where full-scale privatizations have hardly begun. See Sader, 1993 and "Selling the state", *The Economist,* 21 August 1993.

15 Such was the case with the privatization of British Telecommunications PLC, in which a minority of the shares was offered in the equity markets of Canada, Japan and the United States. See Odle, 1993.

16 "Selling the state", *The Economist,* op. cit..

17 The World Bank, 1994, forecasts growth rates of 4.8 per cent and 2.7 per cent for the rest of the decade for the developing and developed countries, respectively.

Chapter III

Globalization, integrated international production and the world economy

Introduction

The two preceding chapters, together with earlier *World Investment Reports*, have documented the growing importance of foreign direct investment (FDI) and the central role that transnational corporations (TNCs) have acquired in the world economy. This chapter raises the question whether these developments, as part of a wider globalization process, are beginning to change the character of the world economy.

The world economy can be described along two distinct, but interrelated, dimensions: *market* exchanges and *production* activities that link consumers, producers and suppliers within and across national economies. The extent to which these economic agents engage in cross-border relations varies with market size and location, technological and other domestic economic advantages, and the openness of the policy framework and the links established through markets or production activities can involve many elements, in particular, capital flows, goods, services, people, technology, information and ideas. International integration describes the spread and deepening of these linkages across national boundaries.

States is now the largest home country, but it is not as dominant as a source of FDI as it used to be during the 1970s, when it accounted for 45 per cent of the world FDI outflows, far above its share of world GDP (36 per cent in 1970) and exports (12 per cent during the 1970s). In 1992, its shares of world FDI outflows, GDP and exports were 19 per cent, 26 per cent and 12 per cent, respectively.

- The share of the United Kingdom, the largest investor during 1986-1988, in world outflows was more than halved between that period and 1992, from 22 per cent to less than 9 per cent. The share of Japan, the largest source of FDI during 1989-1990, fell by half, from 20 per cent in that period to 10 per cent in 1992. Another big gainer in terms of outflows was France, the second largest home country by 1992.
- On the inward-investment side, the United States which, during the 1980s, had become the largest host country, accounting for over 40 per cent of world inflows during 1986-1988, saw its share shrink to 23 per cent in 1990 and to 16 per cent in 1991. By 1992, FDI inflows to the United States were only 2 per cent of world inflows. In that year, disinvestments almost matched new gross inflows and, as a result, the level of FDI inflows was only $3.4 billion — historically, a very small amount. France emerged as the largest host country in 1992, with a share of over 14 per cent of world inflows, about three times above its share during 1986-1988.

Since most other developed countries registered only relatively modest declines in FDI flows during the latest recession, it is the drastic changes among a few of the largest home countries that largely explain the decline in world outflows since 1990 (table II.1). Japan alone was responsible for 44 per cent and 65 per cent of the declines in world FDI outflows in 1991 and 1992, respectively. In fact, Japan's contribution to the decline in worldwide FDI flows in the 1990s was greater than its contribution to the increase in those flows (23 per cent) during the second half of the 1980s (table II.1). Drastic declines of outflows from another major home country, the United Kingdom, had already taken place in 1990 (outflows fell to $19 billion from $35 billion in the peak year of 1988), when world outflows were still surging to reach a historic high of almost $232 billion. Outflows from the United Kingdom continued to fall in 1991, but increased modestly in 1992.

On the inward-investment side, although there was a contraction of inflows to the European Union in 1991 (caused mainly by the halving of flows into the United Kingdom), most of the decline in world inflows during 1991-1992 was caused by the fall in flows into the United States (table II.1).

When FDI outflows are contrasted with inflows, it becomes evident that the dramatic changes in FDI flows were a geographically limited phenomenon observed primarily between Japan and selected Western European countries as home countries, and the United States as a host country. More than 80 per cent of the decline of FDI outflows from Japan during 1991-1992 took place in developed countries; the United States alone was responsible for 70 per cent and 56 per cent of that decline in 1991 and 1992, respectively (table II.2). The largest decline of United Kingdom FDI outflows in 1990 occurred also in the United States, which alone accounted for more than all the decline of the United Kingdom's outflows.

In addition to the changes in relative positions of the principal home and host developed countries, a major development in world FDI flows has been, as noted in chapter I, the continued increase of inflows to developing countries, fuelled in 1992, *inter alia*, by the rise of China to the rank of the world's third largest host country. Developing countries received increasing FDI flows from the United States, as well as from other principal home countries; for example, in 1992, outflows from the United States to developing countries rose by 15 per cent, while those to developed countries declined by 8 per cent. Similarly, outflows from the United Kingdom to developing countries increased in 1992, in a marked contrast to its declining outflows to developed

Table II.1. Annual average changes in world foreign-direct-investment outflows and inflows, by major home and host country and region, 1971-1992

(Millions of dollars)

Home/host country and region	*1971-1980*	*1981-1985*	*1986-1990*	*1991*	*1992*
	(Annual average)				
			FDI outflows		
World	+ 4176	- 206	+ 35564	- 39620	- 20761
Developed countries	+ 4127	- 235	+ 33678	- 36862	- 23066
Japan	+ 204	+ 812	+ 8320	- 17310	- 13500
Western Europe	+ 2270	+ 1058	+ 22233	- 31593	- 6352
European Union	+ 2189	- 339	+ 18474	- 22382	+ 2322
France	+ 272	- 170	+ 6516	- 10890	+ 7062
Germany	+ 311	+ 352	+ 4532	- 6272	- 6550
United Kingdom	+ 955	- 125	+ 1763	- 3475	+ 145
Sweden	+ 41	+ 236	+ 2446	- 7047	- 5583
United States [a]	+ 1164	- 2137	+ 3078	+ 9168	- 11
Developing countries	+ 103	+ 28	+ 1679	- 2729	+ 2288
			FDI inflows		
World	+ 4169	+ 111	+ 30880	- 45789	- 3711
Developed countries	+ 3292	- 428	+ 27286	- 55730	- 18215
Japan	+ 19	+ 72	+ 224	- 390	+ 1350
Western Europe	+ 1714	- 685	+ 18061	- 28401	+ 1706
European Union	+ 1685	- 873	+ 16488	- 27687	+ 6788
Belgium and Luxembourg	+ 123	- 99	+ 1401	+ 1321	+ 1696
France	+ 266	- 138	+ 2118	+ 1966	+ 6694
Germany	+ 27	+ 336	+ 1246	- 1560	- 590
Netherlands	+ 180	- 193	+ 2113	- 6147	- 163
United Kingdom	+ 864	- 929	+ 5391	- 16278	+ 2024
United States	+ 1547	+ 616	+ 5682	- 22976	- 23058
Developing countries, of which:	+ 875	+ 539	+ 3537	+ 7794	+ 12426
China	+ 6	+ 320	+ 366	+ 879	+ 6790

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994, national official sources; and annex tables 1 and 2.

a Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles.

Note: + indicates increase in FDI flows.
- indicates decrease in FDI flows.

countries (table II.2). Although Japanese outflows to developing countries declined, the fall has been considerably smaller than that to developed countries.

Table II.2. Increases and decreases in foreign-direct-investment outflows from Japan and the United Kingdom, by destination, 1988-1992

(Millions of dollars)

Host country/region	*1988*	*1989*	*1990*	*1991*	*1992*
		Japan [a]			
World [b]	+ 14691	+ 9920	+ 3894	- 17298	- 13504
Developed countries	+ 12875	+ 7724	+ 5229	- 15020	- 11291
United States	+ 9328	+ 2269	+ 4346	- 10371	- 6299
European Union	+ 2199	+ 3953	+ 1281	- 3053	- 4604
France	..	+ 292	+ 338	- 564	- 211
Germany	..	+ 257	+ 361	-	- 260
United Kingdom	+ 1870	+ 1328	+ 1384	- 928	- 2827
Developing countries	+ 1816	+ 2196	- 1355	- 2278	- 2213
South, East and South-East Asia	+ 967	+ 2490	- 362	- 2333	- 461
		United Kingdom			
World [b]	+ 5858	- 2031	- 17177	- 1588	+ 1441
Developed countries	+ 5898	- 2635	- 17393	- 253	- 1233
United States	- 1981	+ 490	- 19061	+ 3871	- 1635
Western Europe	+ 5466	- 1080	+ 1151	- 3341	+ 1471
European Union	+ 5937	+ 17	- 563	- 2363	+ 971
France	+ 2836	- 811	- 367	- 1207	+ 281
Germany	+ 563	+ 407	- 973	- 59	+ 670
Netherlands	+ 2057	- 887	+ 1334	- 2287	+ 967
Other Western Europe	- 473	- 1099	+ 1716	- 978	+ 499
Developing countries	- 40	+ 604	+ 216	- 1335	+ 2674
Africa	- 15	+ 1290	- 1126	+ 495	- 381
Latin America	- 197	- 716	+ 931	- 2080	+ 2305
Western Asia	+ 88	+ 133	+ 449	+ 430	- 779
South, East and South-East Asia	- 1	- 50	- 215	- 79	+ 1337

Source: UNCTAD, Division on Transnational Corporations and Investment, based on official national sources.

a Data are based on the balance-of-payments statistics.

b Differences between this table and table II.1 are due to the use of different sources. Data in table II.1 are based balance-of-payments data reported to the International Monetary Fund, while those in this table are based on national official sources.

Note: + indicates increase in FDI flows.
- indicates decrease in FDI flows.

An important question that arises, therefore, is whether these changes signal a new pattern of FDI flows — that is, the re-configuration of both major home countries and favourite locations for FDI — or whether they are only a temporary phenomenon that will disappear when the recession is over. A partial response to the part of this question concerning the flows to developing countries was given in the preceding chapter: while, quite likely, the growth of these flows will continue, the share of the developing countries will depend on whether the flows to the developed countries will recover when the recession ends. To answer this question, as well as the related

question of whether the shifts of positions among major Triad countries, shown earlier in this section, mark the beginning of a new pattern, a closer look is needed at the biggest changes, that is, at the Japanese outflows and the United States inflows, as well as at the other components of flows between major home and host countries. Can Japan regain its leadership position in world outflows or at least recover the level of its outflows? Can the United States do the same on the inflow side? Why did outflows from Japan decline so drastically during the recession, while those from the United States were maintained at a high level and those from the European Union as a group suffered only to a small extent? Is it a new trend in FDI flows or just a break in the trend that has begun in the mid-1980s? These questions will be taken up in the following sections.

2. Outflows from Japan

Japanese FDI outflows, after reaching a peak of $48 billion in 1990, declined by 36 per cent in 1991 and by 44 per cent in 1992, to the level of $17 billion.[1] Having been the largest source country for two years, Japan lost that position not only to the United States, but also fell behind France. Although the decline of Japanese outflows was reflected in all major destinations and industries, the largest decreases were recorded in the areas in which FDI grew relatively fast during the investment boom of the second half of the 1980s: the United States (accounting for 63 per cent of the decline to developed countries during 1991-1992) and in services (accounting for between 60 per cent and 90 per cent of the declines in the United States and Europe during the same period) (table II.3).

The drastic decline in Japanese outflows was caused by a combination of adverse cyclical and special factors, many of which are interrelated. In a clear distinction from Japan, a similar combination of these factors did not exist in other home countries; on the contrary, in a number of home countries, special factors counteracted the adverse consequences of the recession.

As in other developed countries, the recession led to a decreasing profitability of Japanese investments at home and abroad. Reinforced by special factors, the declines in profitability were probably higher in Japan than in other countries. At home, operating profits of Japanese companies declined by 1 per cent in 1991 and 20 per cent in 1992 (Bank of Japan, 1994). The ratio of profits to sales declined to 2 per cent by mid-1993, compared to 4 per cent in 1990. Abroad, profits of Japanese affiliates declined, especially in the United States and Europe. Overall, the level of current profits of Japanese affiliates in March 1992 was only about 30 per cent of that in March 1989, and the ratio of profits to sales was only 0.4 per cent, down from 1.4 per cent.[2] In the United States, Japanese affiliates recorded, in 1991, the largest loss ever, and when compared to affiliates from other home countries (see next section). Profits of Japanese affiliates in Europe decreased to almost zero in the same year. Surveys undertaken by the Japan External Trade Organization (JETRO) show that, in the United States and Europe, more than one-half of Japanese manufacturing affiliates incurred a loss in 1992 and 1993.[3]

Decreasing or negative profitability reduces the propensity of firms to invest because it shrinks the pool of profitable investment opportunities and diminishes earnings for reinvestment, an important source of investment financing. In the case of Japan, the deterioration of the financial position of all companies, including transnational corporations (TNCs), has been further aggravated by a fall in bank lending, as commercial banks have tightened their lending policies in response to the accumulation of bad loans and the need to adhere to international standards on capital adequacy. Outstanding bank loans declined by more than 1 per cent in 1992. Companies, including TNCs, faced shrinking investment opportunities and a capital shortage reduced investments. Thus, in addition to the declining FDI outflows, domestic investment also declined; investment in new equipment, for example, fell by 5 per cent in 1992 and by more than 10 per cent in 1993 (Japan, Economic Planning Agency, 1994). The financial difficulties facing Japanese banks

and other financial companies, being prominent outward investors themselves, also contributed to decreasing FDI outflows.

Some of the cyclical factors affecting both domestic and foreign investment for Japan were aggravated by a number of additional special factors, some of which are linked to cyclical swings:

- *Plummeting asset prices*. By 1992, stock prices plummeted to less than a half of their peak in 1989 due to the bursting of the bubble of asset prices triggered by a slow-growing economy. As a result, Japanese TNCs, which could previously finance FDI through capital raised from the sale of corporate bonds and through bank loans against inflated assets, faced increasing difficulties to do the same in the early 1990s. This factor was specific to Japan; in the early 1990s share prices in other major home countries, such as France, the United Kingdom and the United States, increased.[4]
- *A large number of cases of poor investments, in particular in the United States and Europe, in the euphoria of the investment boom of the 1980s without giving due consideration to long-term prospects for profitability*. Recession in host countries exposed the structural weaknesses of these investments and resulted in heavy losses, leading to disinvestment and to an unwillingness to undertake new investments in certain industries, even though their prospects regarding profitability were likely to improve. A case in point are the large investments in real estate in the United States that lost value as a result of the recession, leading to plummeting flows of FDI in that industry in 1992, which accounted for three-quarters of the decline of total flows to the United States (table II.3).
- *The completion of an investment round of establishing production facilities in developed countries, initiated in the mid-1980s*. According to a study on the link between FDI and structural transformation of Japanese economy, Japanese TNCs undertook overseas investment in four major waves. Each wave was characterized by types of FDI corresponding to the stages of industrial upgrading (figure II.1 and Ozawa, 1993). The third wave that centred on the establishment of assembly-transplanting FDI operations has just been completed in North America and Western Europe, the major host areas for Japanese FDI. This is especially evident in some manufacturing industries, notably automobiles, in which there appears to be, at the moment, no need to expand investments further (Ozawa, 1993). A recent survey of Japanese TNCs showed that this was the most important reason for not undertaking FDI or reducing it.[5] This also appears to be the case in services: for example, 73 per cent of the decline of flows to the United States in fiscal year 1991 was accounted for by services, especially by Japanese TNCs. Investments by Matsushita Electric Industrial Co., Ltd. and Sony Corporation in the entertainment industry were completed by 1990; thereafter the industry ceased to be a significant investment destination (table II.3).

In summary, the recent dramatic decline of Japanese FDI outflows is deeply rooted in a number of special factors that have been exacerbated by cyclical factors. In lieu of new investment, many Japanese parent firms embarked upon a massive restructuring of their foreign affiliates aimed at regaining profitability, even at the cost of losing market shares, traditionally an important consideration in the strategies of Japanese TNCs (box II.1).

The process of restructuring often involves considerable divestment, leading to further reductions in FDI outflows. The intensity of these divestments can be seen from the data concerning the longevity of foreign affiliates. In general, only one-half of Japanese foreign affiliates stand a chance to survive longer than 15 years (table II.4). The United States appears to be a market where Japanese TNCs face the most competition because the survival rate of Japanese affiliates is the lowest there, compared to other regions. Recently, closures of affiliates have increased in relation to all affiliates or newly-established affiliates. During 1991-1992, Japanese TNCs ceased operating or liquidated some 460 foreign affiliates, corresponding to 28 per cent of the number of newly-established foreign affiliates, compared to, respectively, about 190 closed

Figure II.1. Japan's structural upgrading and foreign direct investment

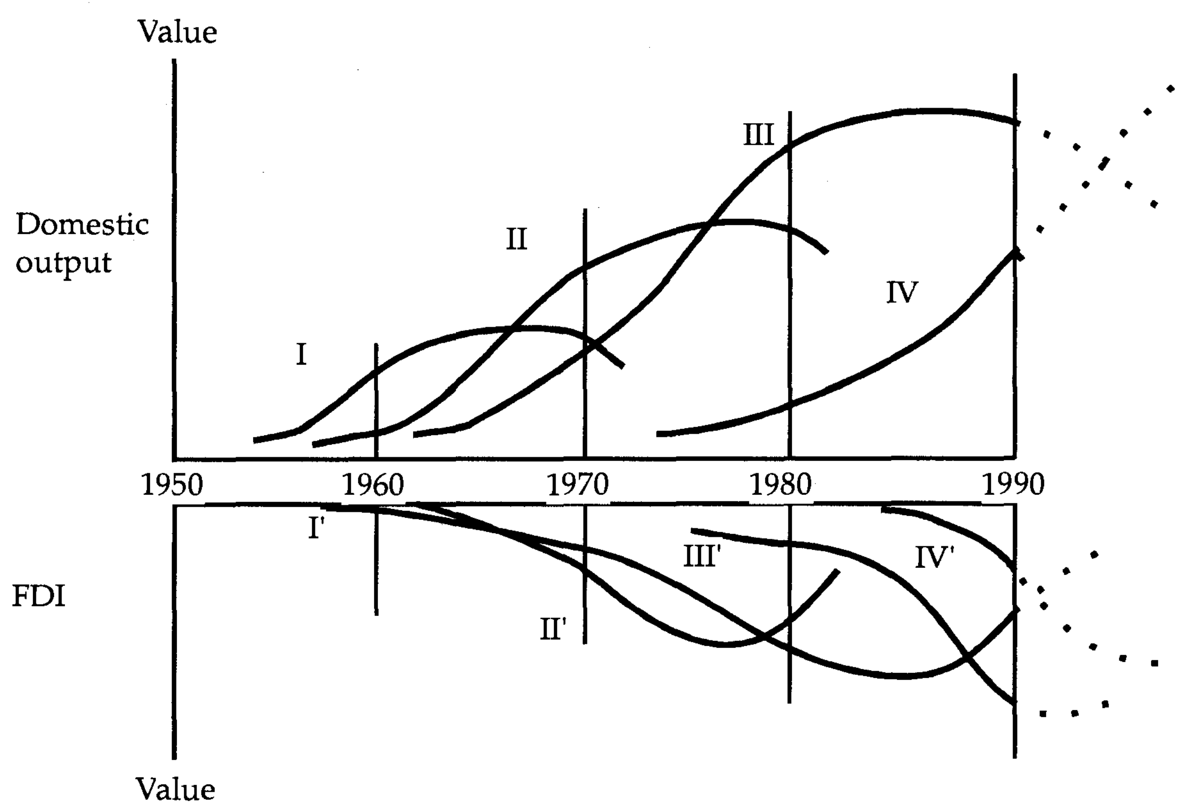
Stages of industrial upgrading

I. Labour-driven industrialization

II. Heavy and chemical industrialization

III. Assembly-based manufacturing

IV. Innovation-driven flexible manufacturing



Types of FDI

I'. Low-wage labour-seeking FDI

II'. Resource-seeking and house-cleaning FDI

III'. Assembly-transplanting FDI

IV'. Strategically networking (alliance-seeking) FDI

Source: Ozawa, 1993, p. 132.

Table II.3. Major industries responsible for decreases in Japanese foreign-direct-investment outflows to the United States and Europe, fiscal years 1991 and 1992[a]

(Millions of dollars and percentage)

Industry	*1991*	*1992*
United States		
Changes in FDI in all industries (Millions of dollars)	- 8 102	- 4 207
(Percentage)		
All industries [b]	- 100.0	- 100.0
Manufacturing	- 10.2	- 42.2
Electric machinery	- 18.9	- 3.2
Transport equipment	+ 1.6	- 1.9
Non-manufacturing [c]	- 89.7	- 57.3
Banking and insurance	- 8.2	- 0.1
Services [d]	- 72.8	+ 40.5
Real estate	- 4.3	- 76.4
Europe		
Changes in FDI in all industries (Millions of dollars)	- 4 923	- 2 310
(Percentage)		
All industries [b]	- 100.0	- 100.0
Manufacturing	- 38.7	- 25.5
Electric machinery	- 36.6	- 2.9
Transport equipment	+ 3.5	- 14.5
Non-manufacturing [c]	- 55.6	- 65.2
Banking and insurance	- 36.4	- 29.9
Services [d]	- 2.0	+ 0.1
Real estate	- 26.8	- 15.5

Source: Japan, Ministry of Finance, "Heisei 4 -nendo ni okeru taigai oyobi tainai chokusetsu toshi jokyo", press release, 3 June 1993.

a Data are based on notifications and are, therefore, different from those reported in the balance-of-payments statistics in table II.2.

b Includes branches that are separately reported. Thus, the total does not add to 100 per cent.

c Includes also the primary sector (agriculture, forestry, fishery and mining).

d Includes business services, hotels, films and other entertainment and broadcasting.

affiliates and a 20 per cent share during 1987-1988.[6] Nearly two-thirds of affiliates that were discontinued in Europe and the United States in 1991 and 1992 had been established during the investment boom of 1986-1990. Although it is normal that the life of many newly-established affiliates is not very long, this withdrawal rate is high, compared to the rate of less than one-third for the affiliates closed in 1987 and 1988 that were established during 1981-1985 (Toyo Keizai Shimposha, 1993, pp. 94-97). In terms of value, Japanese TNCs divested more than $10 billion in 1992, an amount equal to about one-third of FDI notified for outward investment in that year.[7]

Developing countries have also been affected by the declining Japanese outflows, but to a much lesser extent than developed countries. Within the developing countries, the least affected were those in South, East and South-East Asia. Outflows to that region registered the smallest

Box II.1 Restructuring of Japanese foreign affiliates

The restructuring of foreign affiliates can take various forms, ranging from simple closure through relocation to the strengthening of affiliates. For example, NEC Corp. not only stopped producing, but also selling television sets in the United States in 1993; Fujitsu Ltd. withdrew from the semiconductor business by shutting down its semiconductor affiliate in the United States in 1993; it also withdrew from the facsimile business in that same year. Hitachi, Ltd. closed a plant in California and shifted the production of video-tape recorders to Mexico and Malaysia; Seiko Epson Corp. stopped producing personal computers in Singapore in 1992; and Nissan Motor Co., Ltd. stopped producing cars in Australia in 1992.

As part of expanding operations in host countries and overall corporate strategy, many TNCs have strengthened their research-and-development capacities in existing affiliates or created new research-and-development centred affiliates. In January 1990, for example, only 14 per cent of Japanese manufacturing affiliates in Western Europe had research-and-development facilities; that share increased to 36 per cent by January 1994. Similarly, the number of independent research-and-development affiliates tripled during this period (from 22 to 65).[a]

Restructuring has not been limited to the manufacturing sector. Transnational corporations in the services sector, especially in construction, banking and securities industries, are also attempting to rationalize operations of foreign affiliates. For example, Shimizu Corp., a large general construction company, liquidated four real estate development affiliates in Australia in 1992 and most of its 17 affiliates in the United States. Kumagai Gumi Co., Ltd., another large general construction company, will shed about 40 per cent of foreign assets in five years by 1997, and liquidate more than 10 foreign affiliates. Japanese banks started to restructure affiliates in North America and Latin America: the Bank of Tokyo closed a representative office in Toronto, Canada; and the Japan Long-Term Credit Bank closed one in Rio de Janeiro, Brazil. Securities companies are also engaged in the restructuring of their foreign financial services operations. Kosei Securities Co., Ltd., a medium-sized company, had closed all foreign affiliates by 1992. Another medium-sized company, New Japan Securities Co., Ltd., liquidated five foreign affiliates in 1992. All big four securities companies, Daiwa Securities Co., Ltd., Nikko Securities Co., Ltd., Nomura Securities Co., Ltd., and Yamaichi Securities Co., Ltd. also restructured their foreign affiliates, especially in New York and Europe. For example, Yamaichi's London affiliate now employs only 40, down from the peak of 350. A Swiss affiliate of Nomura has now only about 20 employees, down from more than 200 not long ago.

One of the outcomes of the restructuring of foreign affiliates is, according to a JETRO survey, a decrease in the number of new affiliates established: for example, the number of manufacturing affiliates that started operating in 1992 in the United States was only 17, about one-eighth of the number in 1990 (145) (JETRO, 1993a). Similarly, in Western Europe, it was only about 19 in 1993, compared to 113 in 1990.[b]

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a JETRO, "Outline for the 10th survey of European operations of Japanese companies in the manufacturing sector", press release, 24 March 1994.

b Ibid.

decline among all regions (15 per cent in 1992), and have been among the first to recover: on a notification basis, outflows increased by 8 per cent during fiscal year 1992, ending in March 1993.[8] However, these increases were directed mostly to China and Indonesia, while the remaining countries in that region continued to experience decreasing flows.

Despite the economic upturn in many countries host to Japanese FDI, Japanese outflows did not recover in 1993, but declined further by another 29 per cent: their level in 1993 was $12 billion, about 28 per cent of the peak level of 1989. This lends support to the distinctive nature of the

Table II.4. Survival rate of Japanese foreign affiliates during the period of 1975-1990[a]

(Percentage)

Industry	*World*	*United States*	*Europe*	*South, East and South-East Asia*	*Latin America and the Caribbean*
Manufacturing	47	35	48	49	46
Chemicals	54	25	50	59	50
Electric machinery	57	40	55	59	53
Transport equipment	51	67	43	57	53
Commerce	62	54	65	61	69
Banking and insurance	58	56	65	64	68
Services [b]	45	39	42	53	41
All industries	50	48	59	50	51

Source: *Weekly Toyo Keizai*, 10 April 1993, p. 91.

a The ratio of the number of affiliates that operated between 1975 and 1990 to the total number of affiliates that existed in 1975. The figures are overestimated because affiliates that changed their names or merged with others included in the statistics are also considered to be withdrawn.

b Includes business services, hotels, films and other entertainment and broadcasting.

difficulties facing Japanese TNCs: while foreign investors from other home countries (e.g., the United States) reacted immediately to improved economic conditions by investing abroad, Japanese TNCs continued to restructure their operations.

It is very likely, however, that Japanese outflows will recover, though they may not soon reach again the record levels of the late 1980s. One reason is that Japanese TNCs are likely to approach re-emerging investment opportunities much more cautiously. Such opportunities are emerging quickly in the fast-growing neighbouring South and South-East Asian region, providing attractive locations for market-seeking FDI. Japanese investors can not afford to forgo these opportunities for too long without the risk of losing them to competitors, for example, United States TNCs that have intensified their investment efforts in that region.[9]

The continued appreciation of the yen and the resulting decline of profitability for export-oriented business was another factor that played a role in locational investment decisions of Japanese TNCs. The dollar fell from 240 yen per dollar in 1985 to 145 yen per dollar in 1990; and, during that period, Japanese outward FDI increased rapidly (figure II.2). According to the Economic Planning Agency, only 15 per cent of exporting firms can make profits under an exchange rate of 110 yen per dollar, while the exchange rate in early 1994 was moving in the direction of 100 yen per dollar.[10] Furthermore, although trade frictions are no longer such a strong motivation for Japanese FDI as they were a few years ago, they have not disappeared altogether: the avoidance of such trade barriers as voluntary export restrictions and anti-dumping measures constitute an investment motive for 15 per cent of Japanese manufacturing TNCs wishing to invest abroad during 1993-1995 in the United States and for 13 per cent of those that consider investing in Western Europe.[11] And, finally, the level of transnationalization of Japanese TNCs is still much lower than that of their principal competitors (United States and many Western European

TNCs),[12] indicating a potential, in the long term, for further transnationalization. And, indeed, the number of TNCs planning new overseas investment is growing: a survey by the Export-Import Bank of Japan undertaken in mid-1993 suggests that some 63 per cent of Japanese TNCs plan to invest abroad in the next three years; that result is 10 percentage points higher than that of the survey undertaken in mid-1992.[13]

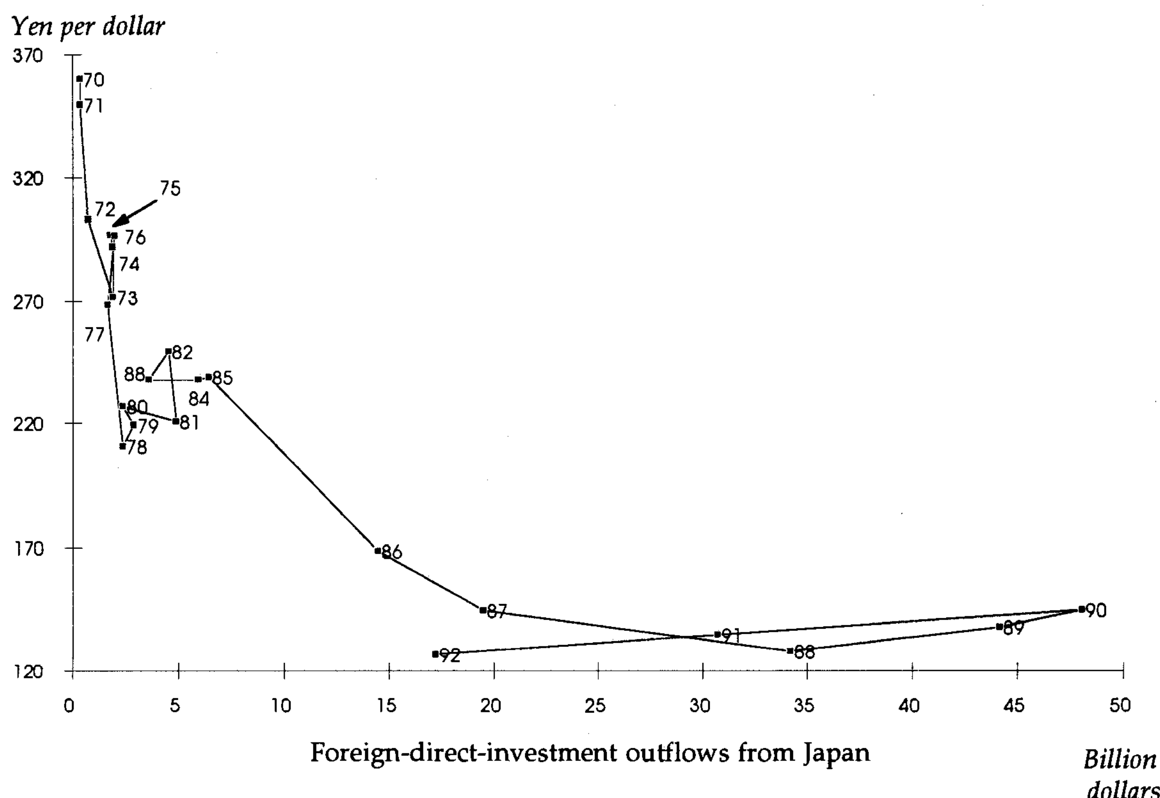
3. Inflows into the United States

United States inflows, after reaching a peak of $69 billion in 1989, then declined by more than $20 billion every year (table II.1), to reach a low point of less than $4 billion in 1992. That decline largely contributed to the fall in worldwide inflows. While losing its position of being the largest single host country in terms of inflows, the United States has kept its position as the largest host country in terms of stock ($420 billion in 1992), still well ahead of the United Kingdom and Canada.

The decline of Japanese FDI flows to the United States is a major reason for the drastic decline of FDI flows into the United States: in 1992, Japanese FDI was only one-fifth ($4 billion) of its level

Figure II.2. Japanese foreign-direct-investment outflows and exchange-rate fluctuations, 1970-1992

(Movement of yen against the United States dollar)



Source: UNCTAD, Division on Transnational Corporations and Investment.

Note: Plot figures represent years.

in the peak year of 1990. The significant reduction of FDI in the United States was also caused by European investors: European FDI inflows, at $8 million, were virtually non-existent in 1992. The United Kingdom accounted for the largest decline in United States inflows in 1992, followed by Japan, France and Canada. For most countries that decline was largely in services; for Japan, it was in wholesale trade and business and other services; for France and Canada, in financial services; and for the United Kingdom in business and other services. These industries alone accounted for between two-fifths and four-fifths of the overall decline of inflows from these home countries during 1991-1992 (table II.5).

The large size of the FDI stock in the United States may be one of the reasons why the declines in inflows during the recession were so substantial. Usually, the larger and more diversified the stock of FDI, the larger are the inflows needed to maintain or expand the existing stock. A good part of these inflows is typically financed from reinvested earnings generated by the existing stock. Conversely, during a recession, the larger the stock of FDI and the more it is oriented towards the domestic market and widely spread across the host economy, the higher is the likelihood that a large part of it will be affected by the recession. This seems to have been the case with the flows into the United States, where most FDI is oriented towards the domestic market.[14] When profit expectations and rates of return began to decline, reinvested earnings became negative and eventually turned into losses (tables II.6 and II.7), and the number of write-downs, closures or sales of assets of foreign affiliates multiplied. Reinvested earnings turned negative in 1989 and remained so until 1992, thus depriving foreign affiliates of an important source of investment finance.

The declines in FDI inflows between 1989 and 1992 were widely spread across all major industries. Moreover, industries responsible for the declines during that period were different from those during 1991-1992 (table II.5). In most cases, but not all, divestments in an industry or the decline of inflows to almost zero levels were preceded by losses, that is, by negative incomes. In the manufacturing sector, large divestments in 1992 were registered in machinery, with inflows of -$2 billion — a decline of $10 billion from their peak level in 1989 ($8 billion).[15] All important industries in the services sector — an important contributor to the FDI stock in the United States during the second half of the 1980s — experienced declines in income and FDI inflows between the period 1989-1990 and 1992 (or negative inflows). Retail trade, finance other than insurance and banking and real estate fared worse than the average for the services sector as a whole.

Recession or slow growth explains much of the declining flows into the United States, but not all. As discussed above, special additional factors influencing Japanese outflows to the United States added to that decline. This is clear not only from the drastic decline of flows from Japan into the United States, which were larger than from most of the other major home countries, but also from the data on investment income showing that Japanese losses were the highest of all countries (table II.6).

The recession does not explain another drastic decline of inflows: that from the United Kingdom, from $19 billion in 1989 to $4.5 billion in 1990, since it occurred before the recession took hold. The decline was mainly in manufacturing, and was not preceded by losses: on the contrary, the United Kingdom FDI stock has been one of those few stocks which, overall, have not suffered losses at all, even during the recession (another was that of the Netherlands). The explanation in this case is that the United Kingdom TNCs — linked to the United States market by traditional long-term ties — were very active participants in the wave of cross-border acquisitions of United States companies, which was triggered by the reduced prices of United States assets following the rapid dollar depreciation after the Plaza Accord in 1985 (United States, Department of Commerce, 1993d, pp. 9-10). Once the purchases of the targeted companies ended, FDI flows, buoyed by these purchases, subsided.

Table II.5. The largest home countries and industries responsible for decreases in the United States foreign-direct-investment inflows, 1989-1992 and 1991-1992

(Millions of dollars)

Home country/region	*Decreases in FDI inflows*		*Two largest industries responsible for the decline in FDI inflows* [a]	
	1989-1992	*1991-1992*	*1989-1992*	*1991-1992*
Europe	- 43038	- 13039	Chemicals and allied products (- 10135) Machinery (- 8383)	Insurance (- 5628) Machinery (- 4136)
United Kingdom	- 21547	- 6990	Food and kindred products (- 5936) Chemicals and allied products (- 4612)	Business and other services [b] (- 2992) Other manufacturing [c] (- 1631)
Netherlands	- 8814	- 2497	Chemicals and allied products (- 3235) Machinery (- 2619)	Insurance (- 1984) Finance, except banking (- 1778)
Switzerland	- 4656	- 962	Machinery (- 1612) Insurance (- 655)	Banking (- 862) Machinery (- 525)
France	- 3212	- 4930	Chemicals and allied products (- 656) Finance, except banking (- 624)	Finance, except banking (- 2811) Insurance (- 1158)
Germany	- 2349	- 778	Chemicals and allied products (- 1480) Petroleum (- 1094)	Insurance (- 1547) Chemicals (- 986)
Japan [d]	- 14693	- 6700	Finance, except banking (- 3774) Real estate (- 2871)	Wholesale trade (- 2350) Business and other services [b] (- 1846)
Canada	- 3937	- 4527	Finance, except banking (- 1981) Other manufacturing [c] (- 1484)	Finance, except banking (- 2983) Other manufacturing [c] (- 640)
Developed countries	- 60930	- 23868	Chemicals and allied products (- 11287) Machinery (- 9469)	Insurance (- 6001) Business and other services [b] (- 4708)
World	- 65622	- 22058	Finance, except banking (- 11312) Chemicals and allied products (- 11094)	Insurance (- 6165) Machinery (- 4018)

Source: United States, Department of Commerce, 1993b.

a In the order of magnitude.

b Hotels and other lodging places, business services, motion pictures, engineering, architectural and surveying services, accounting, research management and related services, and health services.

c Manufacturing, excluding food and kindred products, chemicals and allied products, primary and fabricated metals and machinery.

d It should be noted that data reported by the United States are different from those reported by Japan on which tables II.2 and II.3 are based. The differences arise mainly because Japanese data exclude reinvested earnings (both tables II.2 and II.3) or are on a notification basis and do not reflect actual transactions (table II.3).

Other reasons for the decline not linked to the recession could include concerns regarding regulatory developments in the area of taxation of foreign companies in the light of the pending unitary taxation court case between Barclays Bank and the state of California and proposals made during the election campaign in 1991 to raise substantial amounts in additional taxes from TNCs. These could have caused the postponement or even cancellation of investment projects until the case was decided and the Government stance cleared, thus adding to the declining inflows in 1991 and 1992.[16] Furthermore, Germany, a major home country for FDI in the United States, diverted some of its investment focus in the years following unification from the United States market towards Europe and the huge investment needs of the expanded domestic market.[17] Also, telecommunications, an industry undergoing a massive consolidation on a global scale in the early 1990s (in which large United States companies are major players), was bypassed by FDI, among other reasons perhaps because United States regulations limit foreign companies to 20 per cent of the equity in most of the largest companies in that industry.[18]

The drastic three years decline of FDI inflows to the United States raised concerns during 1992 and the beginning of 1993, similar to those in some Western European countries, about whether the United States was losing its attractiveness as a location for FDI. These concerns were, however, alleviated when inflows started recovering as the economy picked up in 1993 and reached that year an amount close to $32 billion, reinstating the position of the United States as one of the major host countries. Two major investment projects initiated by Mercedes-Benz and BMW in the United States in 1993 added to this optimism. These two projects were of important symbolic value in the discussions about attractiveness because they were undertaken by companies that until then had been able to operate successfully from their home country. Once they decided that, in order to maintain their competitiveness, they had to start building factories abroad, they could have done so in many locations in the world. They chose the United States for its large (and recovering) and competitive market, relatively low labour costs,[19] a large supply of skilled labour and a very good infrastructure, permitting easy distribution of cars in that large market and, if needed, their export — all very important locational advantages which, in addition

Table II.6. Income on foreign direct investment [a] in the United States, by major home country, 1982-1992

(Millions of dollars)

Country	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
Canada	- 596	10	304	348	390	778	589	- 855	57	- 1105	- 60
Japan	403	1013	1884	1561	1009	612	1355	670	-996	- 2085	- 1794
Europe	2934	4473	7054	5240	5701	7720	10604	8485	4400	2085	4639
France	- 385	- 416	- 178	- 157	54	137	345	209	- 915	- 462	- 264
Germany	- 491	151	803	605	- 23	- 5	414	305	- 147	- 714	- 457
Netherlands	1578	1890	3113	2131	2179	1906	2464	2027	179	381	1333
United Kingdom	1851	2128	2298	2127	2611	4208	5591	4726	5593	4078	3703
World	3155	5598	9229	6079	5379	8659	12774	7491	2936	- 1791	2470
Memorandum:											
Rate of return [b]	2.7	3.9	6.3	4.3	3.7	3.6	4.4	2.2	0.8	- 0.4	0.6

Source: United States, Department of Commerce, *Survey of Current Business*, various issues.

a Direct investment income is defined as earnings (distributed and reinvested earnings) after deduction of withholding taxes on distributed earnings plus net interest (payments of foreign affiliates in the United States less their receipts).

b Direct investment income divided by the average of the beginning and end-of-year direct investment positions.

Table II.7. United States foreign-direct-investment inflows and outflows, by type, 1981-1992

(Millions of dollars)

Year	*Total*	*Equity capital*	*Reinvested earnings*	*Intra-company debt*
		FDI inflows		
1981-1985 (average)	19 063	12 695	435	5 933
1986	34 091	25 086	- 2 293	11 298
1987	59 581	34 319	579	24 683
1988	58 571	45 046	1 963	11 562
1989	69 010	51 776	- 7 390	24 624
1990	48 422	56 239	- 14 156	6 339
1991	25 446	41 931	- 18 450	1 965
1992	3 388	22 467	- 11 573	- 7 506
		FDI outflows [a]		
1981-1985 (average)	10 928	1 544	11 784	- 2 400
1986	13 782	- 194	10 392	3 584
1987	28 033	6 057	19 079	2 897
1988	14 324	- 3 545	13 281	4 584
1989	33 826	7 529	12 413	13 884
1990	23 932	9 359	18 960	- 4 387
1991	33 100	17 292	15 915	- 107
1992	33 089	8 007	17 361	11 495

Source: UNCTAD, Division on Transnational Corporations and Investment, based on United States, Department of Commerce, 1993b and 1993c, and UN-TCMD, 1993b, p. 485.

a Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles except for equity capital and intra-company debt in 1992.

to political and economic stability, make the United States a location that foreign investors cannot afford to bypass. Important, although not a decisive factor in attracting FDI to the United States, is the growing readiness of individual states to offer various incentive programmes. For example, the state of Alabama offered Mercedes-Benz an incentive package amounting to $253 million, almost matching the size of the investment ($300 million). The package included $30 million for a training centre and $77 million for training its workers. Training programmes have become a very popular incentive that is now offered by 46 out of 50 states, and is apparently appreciated by TNCs.[20] Other incentives include direct loans (offered, for example, by Georgia, Illinois, Louisiana, Massachusetts, New Jersey, South Carolina, Texas, West Virginia), state tax exemptions and credits (e.g., Arizona, Georgia, Illinois, Louisiana, Massachusetts, New Jersey, South Carolina, Tennessee, Texas, West Virginia), or the establishment of foreign trade zones (e.g., New Jersey, Oregon, Texas).[21]

4. Outflows from the United States

The large decline of Japanese outflows helped the United States regain its position as the largest home country. In a marked contrast to most other home countries, the outflows of which declined during the recession, United States outflows remained, except for one year (1990), at the consistently high level of $33 billion annually during the period 1989-1992 (table II.7). In 1993 they

increased to some $50 billion. Apparently, United States TNCs have been successful in finding some profitable investment opportunities abroad in spite of the recession at home and the prolonged economic slowdown in their host developed country markets.

Several factors have contributed to this performance:

- The impact of recessionary conditions in Western Europe on United States FDI stocks and flows (and, for that matter, on any other FDI stock, including that of Western Europe and Japan) was not as large as the impact of the United States recession on Japanese and Western European FDI in the United States. The recession in Western Europe was milder and unevenly spread among countries and across time, thus permitting FDI declines in one country to be compensated by FDI increases in other countries.
- United States TNCs have not been burdened as much by special problems similar to those facing Japanese TNCs: their income on FDI was maintained at a high level despite the recession, while that of TNCs from Japan and some Western European countries suffered losses. Therefore, United States TNCs, not being distracted by problems with their foreign affiliates, could take advantage of the emerging investment opportunities that existed in spite of the recession.
- As the United States FDI stock abroad continued to generate significant income despite the recession, continued FDI outflows could be supported by reinvested earnings, traditionally a large source of financing FDI outflows from the United States (table II.7): more than one-half of outflows during 1990-1992 came from reinvested earnings. In 1989 and 1992, intra-company loans, one of the other two remaining components of FDI flows (which can move either way between parent companies and foreign affiliates), accounted, respectively, for 41 per cent and 35 per cent of total outflows. The direction and size of intra-company loans are determined by many factors among which the configuration of the differences in the interest rates in the United States and abroad, fluctuations of exchange rates and tax and profit-accounting considerations of TNCs are the most important.

All in all, United States TNCs were better positioned than their Japanese counterparts to exploit the investment opportunities during the recession, in various countries and industries. These opportunities were further enhanced by such developments as that of NAFTA, economic reforms in Latin America, growth in South, East and South-East Asia, the opening up of Central and Eastern Europe to FDI and the worldwide reorganization of some service industries, such as telecommunications, on a global basis.

The increases in United States FDI outflows between 1990 and 1991 and 1992 occurred almost evenly in developed and developing countries (table II.8). More specifically, Europe, Latin America and to a lesser extent South, East and South-East Asia accounted for almost all the increases in FDI outflows between 1990 and 1992. Both in developed and developing countries, such increases took place predominantly in the services sector (table II.8), which is not surprising because the Single Market programme of the European Union and recent liberalization efforts of developing countries were concentrated in this sector.

As regards Western Europe, the largest developed-country location for United States FDI, outflows reached a peak in 1989 (owing largely to the take-over wave), and after that fluctuated at a lower level, but without a clear downward trend. During the recessionary years, United States outflows to Western Europe actually increased when compared to 1990 (table II.8). The impact of the creation of the Single Market on restructuring and adjustment of all TNCs, including United States TNCs, through, *inter alia*, increased FDI, could have compensated partly for the decreases caused by the recession.

Among the developing-country regions, a noticeable change took place in the outflows to Latin America which has again become attractive to United States TNCs after the region began

market-oriented economic reforms and growth resumed (see next section on Latin America and the Caribbean). The anticipation of NAFTA triggered large United States outflows to Mexico, which in the 1990s became the largest host country in Latin America after Bermuda, attracting annual average flows of $1.8 billion during the period of 1990-1992 and surpassing Brazil, traditionally the largest recipient (after Bermuda) of the United States FDI in Latin America and the Caribbean, which received on average $1.4 billion of inflows annually during the same period.

United States outward stock grew fastest in South, East and South-East Asia: 18 per cent annually during 1990-1992, compared to 12 per cent increases in Latin America and 6 per cent in Europe. As a result, the share of South, East and South-East Asia in total United States FDI outward stock increased in 1992 to 7 per cent, from 5 per cent in 1990. The fast growing Asian market (see next section) generated the highest rate of return on the United States FDI: 23 per cent during 1990-1992, nearly twice the average rate of the 12 per cent in the world as a whole during the same period (table I.14). If the fast growth of United States outflows to South, East and South-East Asia continues, it may eventually lead to a reconfiguration of FDI clusters (chapter III), measured by FDI stock, which have been traditionally dominated in this region by Japanese TNCs. Until recently the volume of FDI outflows from the United States to many countries of this region was smaller than that from Japan but also that from Hong Kong, the Republic of Korea and Taiwan Province of China. Since 1990, however, the United States has been, in terms of flows, the largest investor in the Republic of Korea and Singapore and, since 1991, in Taiwan Province of China. In Thailand — where investment applications from major home economies, such as Japan, Taiwan Province of China, Hong Kong and some European countries, have decreased since 1990 — those from the United States have been increasing. In Indonesia and Malaysia, the United States moved to a higher position in the ranking of investors. In India, where inflows of FDI started growing rapidly after the 1991 liberalization, United States TNCs have taken the top position from the very beginning, with the share of total actual FDI inflows amounting to 17 per cent during the period 1991 to January 1994 (see section B, box II.6).

As already mentioned, the increasing United States FDI outflows to developing countries went largely into the services sector, reflecting not only the increasing importance of that sector in the economy, but also the change in attitudes of these countries towards many important service industries closed until not long ago to foreign investors (UNCTAD-DTCI and World Bank, 1994).

Typical in this regard is the change in the attitudes of governments towards the telecommunications industry, especially in Latin America. The first telephone systems in a number of countries in that region were established by United States TNCs in the 1920s. However, after the depression of the 1930s, they were nationalized. Recently, both developing countries and the formerly centrally planned economies have awakened to the fact that modern communications are vital to almost every aspect of their economies and that they have fallen far behind in communications technology. As a result, they are now looking towards TNCs as a source of the combination of technology and large amounts of capital needed to catch up in this area.[22] Hence, the United States FDI stock in telephone and telegraph communications industry in the world grew at an annual rate of 141 per cent during 1989-1992, the highest rate of growth among all industries.[23]

Another service industry in which the change has been remarkable is the banking and other financial services industry (but not yet insurance): this accounted for the bulk of the increases in FDI outflows in 1991 and 1992 to both developed and developing countries. The emergence and development of capital and financial markets in the growing number of developing countries have facilitated foreign investment, including direct investment, in these areas. Banking and other financial industries accounted for most of the increases in FDI outflows in 1992 compared to 1990 (table II.8).

5. Investment flows and Western Europe

Western European FDI flows experienced considerable changes during 1990-1992, but not as drastic as Japanese outflows and United States inflows (table II.9). Inflows declined from $110 billion in the peak year 1990 to $81 billion in 1991, and then recovered slowly to $82 billion in 1992. Investment outflows fell for two consecutive years from their peak level of $144 billion in 1990 to $112 billion in 1991 and to $106 billion in 1992 before they began to recover in 1993 ($109 billion). For the European Union, that decline lasted one year, and recovery has been more pronounced (table II.1).

Declines of inflows into Western Europe were mostly the outcome of recession or slow growth. However, the timing of the recession and, consequently, the timing of the decline in inflows, differed among countries; as a result, inflows continued to grow in some Western European countries (e.g., Belgium and Luxembourg) during the early 1990s (table II.1). Moreover, in a number of countries such as, for example, Germany and the Netherlands, the appreciation of their domestic currencies against the dollar by some 17 per cent between 1989 and 1992 modified the adverse impact of recession on FDI inflows by altering the dollar values of these inflows.

The major change in the pattern of FDI in Western Europe was the emergence of France as both the largest home and host country; the United Kingdom had held both these positions before the recession. While flows into France were consistently increasing, its outflows decreased in 1991 but maintained a high level of $31 billion in 1992. Flows to and from the United Kingdom suffered the largest absolute declines among Western European countries (table II.1 and table II.9). The decline of United Kingdom outflows (mainly to the United States) is partly attributable to the waning wave of cross-border mergers and acquisitions. The sudden drop in United Kingdom inflows was also caused partly by fewer mergers and acquisitions (chapter I); in fact, the United Kingdom had been, by far, the largest target country for mergers and acquisitions, accounting for almost 50 per cent of the value of cross-border mergers and acquisitions in Europe during 1989-1990, the peak years of that activity (also the peak years of United Kingdom FDI inflows).[24] Another factor behind the large declines of FDI in the United Kingdom was its recession, which was deeper and longer than in most other countries.[25]

In France, the Government's attitude towards FDI had changed towards a welcoming one, and included the relaxation of FDI regulations.[26] Cross-border mergers and acquisitions in France jumped by 61 per cent in 1992 to the level of 91 billion French francs from 57 billion French francs in 1991 — one half of that was accounted for by the TNCs from the European Union countries (JETRO, 1994, p. 273). These factors, combined with France's central geographical location, an excellent infrastructure and a skilled labour force have played a role in generating a better performance in terms of FDI inflows in spite of the recession.[27] On the outflow side, French TNCs have been the most active participants in cross-border mergers and acquisitions in Europe. Between 1988 and mid-1992, French TNCs accounted for 21 per cent of the value of cross-border mergers and acquisitions involving companies in the European Union, followed by the United States (17 per cent) and the United Kingdom (11 per cent).[28] In the United States, French TNCs were responsible for the largest volume of merger-and-acquisition deals in 1992 ($3.9 billion), a share of 22 per cent of the total value ($17.6 billion), followed by Japan ($3.3 billion) and Germany ($1.6 billion).[29]

Both Germany and France increased their FDI flows to the countries of Central and Eastern Europe, from $58 million and $16 million, respectively, in 1989 to $989 million and $339 million in 1992. Outflows to developing countries have remained stable or increased slightly: flows to developing countries from Germany, France and the United Kingdom in 1992 were $0.4 billion, $1 billion and $4.9 billion, respectively, compared to $0.6 billion, $1 billion and $3.8 billion in 1989.

Table II.8. Change in United States foreign-direct-investment outflows between 1990 and 1992, by region and industry

(Millions of dollars)

				Non-manufacturing					
Host region	*All industries*	*Petro-leum*	*Manu-fact-uring*	*Total*	*Whole-sale trade*	*Banking*	*Finance (except banking), insurance and real estate*	*Services*[a]	*Others*
Developed countries	+ 4027	- 3408	+ 440	+ 7151	+ 2770	+ 1540	+ 3576	- 91	- 644
Europe	+ 4865	- 3029	+ 200	+ 7695	+ 1851	+ 1455	+ 4175	- 201	+ 415
Japan	+ 23	+ 150	- 57	- 70	+ 492	+ 97	- 907	+ 21	+ 227
Canada	- 214	- 394	- 206	+ 590	+ 197	- 151	+ 219	- 53	+ 378
Others	- 647	- 135	+ 503	- 1064	+ 230	+ 139	+ 89	+ 142	- 1664
Developing countries[b]	+ 4845	- 899	+ 452	+ 5373	+ 696	+ 1170	+ 3423	+ 32	+ 52
Africa	- 589	- 740	+ 44	+ 145	- 30	- 20	+ 85	+ 28	+ 82
Latin America[b]	+ 3903	- 47	+ 666	+ 3284	+ 313	+ 882	+ 2698	- 18	- 591
South, East and South-East Asia	+ 1481	- 63	- 187	+ 1782	+ 420	+ 294	+ 557	- 69	+ 580
Western Asia	+ 50	- 49	- 71	+ 162	- 7	+ 14	+ 83	+ 91	- 19
World[b]	+ 9157	- 4111	+ 894	+ 12373	+ 3466	+ 2710	+ 6999	- 152	- 650

Source: United States, Department of Commerce, 1993c.

a Hotels and other lodging places, business services, motion pictures, engineering, architectural and surveying services, accounting, research management and related services, and health services.

b Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles.

Note: + indicates increase in FDI outflows.
- indicates decrease in FDI outflows.

Foreign-direct-investment inflows in Western Europe did not decline significantly despite recessionary conditions, partly because of a number of countervailing forces. These included the continued adaptation of corporate strategies and structures to the ongoing re-configuration of the Western European markets arising from the emerging Single Market, the expected extension of the European Union to three Nordic countries and Austria, a further liberalization of trade between the European Union and the European Free Trade Area, association agreements of some countries in Central and Eastern Europe with the European Union on the road to full membership, and the opening up of Central and Eastern Europe to FDI and trade.

Despite the economic recession, the rationalization of international production associated with the formation of the Single Market and the requirements of global competition have continued, limiting the decline of FDI flows especially within the European Union. The Single Market has, on the one hand, created opportunities for TNCs to produce for a much larger market and, on the other hand, has led to increased competitive pressures on firms (UN-TCMD, 1993d), magnified by the recession. Both opportunities and pressures triggered a change in the market orientation and organizational structures of companies, including TNCs, towards a more pan-European perspective. The Single Market is thus providing the framework in which TNCs can adopt complex forms of integrated international production strategies within the region, allowing substantial economies of scale. It has been estimated that 80 per cent of the economies of scale to be derived from the Single Market will be attained through industrial restructuring and only 20

Table II.9. Declines in foreign-direct-investment flows during the recent recession, major home and host countries in Western Europe
(Billions of dollars and percentage)

Country	Peak level		Bottom level		Difference	
	Billions of dollars	*Year*	*Billions of dollars*	*Year*	*Billions of dollars*	*Bottom as share of peak*
			Outflows			
Western Europe	144	1990	106	1992	- 38	74
European Union	117	1990	94	1991	- 22	81
Germany	29	1990	16	1992	- 13	55
Netherlands	15	1990	12	1992	- 3	80
United Kingdom	37	1988	16	1991	- 21	43
Finland	3.3	1990	0.4	1992	- 3	12
Sweden	14	1990	1.4	1992	- 12.6	10
Switzerland	9	1988	5	1992	- 4	56
Memorandum:						
Japan	48	1990	17	1992	- 31	35
Australia	5	1987	- 0.3	1992	- 5.3	..[a]
			Inflows			
Western Europe	110	1990	81	1991	- 29	74
European Union	100	1990	72	1991	- 28	72
Germany	11	1989	7	1992	- 4	64
Italy	7	1988	2.4	1991	- 4.5	34
Netherlands	12	1990	6	1992	- 6	50
Spain	14	1990	8	1992	- 6	57
United Kingdom	32	1990	16	1991	- 16	50
Switzerland	5	1990	1	1992	- 4	20
Memorandum:						
United States	69	1989	3	1992	- 66	4
Australia	8	1988	5	1992	- 3	63

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; and annext tables 1 and 2.

a Not reported owing to negative flows.

per cent through increases in output (Cecchini, et al., 1988). The need to realize these economies is a powerful incentive for cross-border rationalization of production, leading to a reallocation of resources within a region consistent with a greater degree of economic integration (Thomsen and Woolcock, 1993, p. 35).

While the rationalization of international production usually leads to new FDI flows, there are also instances when production is relocated back to home countries. This may be triggered by

differences in labour costs. As an example, Bowater, a United Kingdom-based packaging group, shifted production back to the United Kingdom from France and Italy, owing to considerations regarding employment costs.[30] Another example is IMI, an engineering company based in Birmingham, United Kingdom, that shifted production of drinks-dispensing machines from Germany to the United Kingdom, citing the view that there was a more co-operative and flexible work force, as well as lower social costs in the latter.[31] In another case, a number of German companies, after considering new locations for their production, opted to continue producing at home, citing the central location of Germany within Europe and the presence of abundant skilled labour suitable for high-technology production as the most important reasons for their decisions.[32]

Another reason for restructuring in Europe is related to the emergence and adoption by TNCs of more flexible, yet systemic, methods of production which in turn lead to cross-border investments through mergers and acquisitions and inter-firm collaboration in the form of strategic alliances, networks, cross-shareholdings and joint ventures. These forms are becoming increasingly popular among TNCs because they enable them to: share the escalating costs of research and development and cope with shortening product life cycles; exploit and further develop their core competence while permitting access to complementary competencies of other firms; combine their core strengths with those of other firms in order to penetrate new markets with existing products and technologies; and overcome weaknesses in static or declining markets.[33]

The adjustment of TNCs to a new configuration of markets and competition has been the most powerful factor countervailing the decline of FDI flows in Western Europe. As the recession recedes, that factor will again become important since the restructuring process in response to the Single Market is far from being completed.

Conclusions

The early 1990s have been unusual years for FDI flows. The steep decline of FDI outflows from Japan and of inflows to the United States and some Western European countries have changed considerably the pattern of major home and host countries that had emerged from the boom in investment flows in the second half of the 1980s. However, all indications are that these changes are temporary, and that these countries will return to the groups of major home and host countries, respectively, though not necessarily exactly to their previous positions within these groups. The full recovery of outflows from Japan may, however, take some time since, in addition to the recession, Japanese TNCs still have to cope with additional problems of a special nature. France has emerged, during the recession, as the largest home and host country of the European Union, replacing the United Kingdom. Overall, the recession has intensified competition among developed countries to attract FDI inflows.

B. Developing countries

Introduction

Decreasing FDI flows in the early 1990s have been accompanied by changes in their geographical pattern. The outstanding feature of that pattern has been the rapid growth of FDI in developing countries, culminating in inflows of $51 billion in 1992 and an estimated $80 billion in 1993 (table I.4). The *share* of developing countries in FDI inflows has continued to increase since 1989 and reached 32 per cent in 1992 and an estimated 41 per cent in 1993. Asia and the Pacific and Latin America and the Caribbean have received the bulk of these investments, while Africa and the least developed countries in all regions have lagged behind other developing countries as

recipients of FDI inflows (table II.10). Regional differences between and within developing regions are discussed here. This discussion is prefaced by a brief review that places FDI flows in the broader context of net resource flows to all developing countries and a special focus on the least developed countries — a group of countries largely bypassed by foreign investors.

1. Net resource flows into developing countries

The rapidly increasing flows of FDI into developing countries have taken place at the same time as the rapid growth of portfolio investment flows. The growth of these two types of financial flows, as well as the re-emergence of private loans, have brought about considerable changes in the composition of net resource flows to developing countries. Not only have net resource flows grown rapidly in the 1990s (they increased by almost a quarter in only one year, 1992), but their composition has changed entirely from official flows to private flows (table II.11). Among the latter, foreign direct and portfolio investments have become the largest and most dynamic components.[34]

Increases in long-term net resource flows to developing countries as a whole reflect good economic performances, improved or continuous access to international capital markets, as well as progress in the development of local equity markets. These characterize the economies of two sub-regions East and South-East Asia and Latin America.[35] As a result, South, East and South-East Asia and Latin America and the Caribbean (including these sub-regions) increased their share of the total net resource flows to developing countries from 42 per cent and 20 per cent in the second half of the 1980s to 51 per cent and 25 per cent in 1992, respectively (table II.11). A big change took place in Latin America and the Caribbean where the net transfer of resources (subtracting interest payments and other net resource-service expenditures from resource inflows) turned positive in 1991 for the first time since the outset of the debt crisis (CEPAL, 1992), both reflecting and encouraging further the reopening of that region's capital markets.

For South, East and South-East Asia as a whole, the share of FDI in all resource flows increased from 27 per cent during 1986-1990 to 34 per cent in 1992 (figure II.3); that of portfolio investment rose from 8 per cent to 13 per cent. A considerable change occurred again in Latin America and the Caribbean: during the late 1970s and early 1980s, prior to the debt crisis, all financial flows to that region consisted mainly of bank credits lent to, or guaranteed by, governments of borrowing countries, or both (Mortimore, 1989; UNCTC, 1990a). In the early 1990s, the dominant form of external finance was foreign investment, either direct or portfolio (especially equity), aimed at the private sector (table II.11).

Weak FDI flows and an almost total absence of portfolio equity investment during the early 1990s distinguish both Africa and Western Asia from other regions in terms of the structure of external financial flows: they both continue to rely on grants and official loans. In Africa, this is especially the case with sub-Saharan Africa, where FDI — the only private flows of meaningful size — accounts for only some 12 per cent of total net resource flows (table II.11). Also in South Asia, which accounted for only 16 per cent of all net resource inflows to South, East and South-East Asia in 1992, official lending and grants are the most important instruments of external financing; accounting, on average, for 48 per cent and 39 per cent, respectively, of these resource flows in 1992. South Asia has not yet attracted much private direct or portfolio investment. In contrast, private resource flows into East and South-East Asia accounted for 71 per cent of all net resource flows in 1992. In that subregion, China has become the single largest recipient of net resource flows among developing countries, estimated to have attracted more than one-third of these flows into South, East and South-East Asia and some 15 per cent of net resource flows into all developing countries in 1993 (The World Bank, 1993a, p. 5).

Table II.10. Foreign-direct-investment inflows to developing countries, by region, 1981-1992 [a]

(Billions of dollars and percentage)

Region	*1981-1985*	*1986-1990*	*1991*	*1992*
	(Annual average)			
Developing countries [b]				
Total	13.1	24.9	39.1	51.5
Share of the world total (Per cent)	26.3	16.0	24.1	32.5
Total without least developed countries	12.9	24.4	38.7	51.2
Africa				
Total	1.7	2.8	2.7	3.0
Share of developing-country total (Per cent)	12.9	11.4	7.0	5.9
Total without least developed countries	1.5	2.3	2.4	2.8
Latin America and the Caribbean				
Total [c]	5.9	7.7	15.0	17.7
Share of developing-country total (Per cent)	44.7	30.9	38.5	34.4
Total without least developed countries	5.8	7.7	15.0	17.7
Western Asia				
Total	0.4	0.4	0.5	0.7
Share of developing-country total (Per cent)	3.4	1.7	1.3	1.5
Total without least developed countries	0.4	0.4	0.5	0.7
South, East and South-East Asia				
Total	4.9	13.6	20.2	29.4
Share of developing-country total (Per cent)	37.6	54.8	51.8	57.1
Total without least developed countries	4.9	13.6	20.2	29.4
Memorandum:				
Least developed countries				
Total	0.2	0.5	0.3	0.3
Share of world total (Per cent)	0.4	0.3	0.2	0.2
Share of developing-country total (Per cent)	1.4	2.1	0.9	0.6

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of the Organisation for Economic Co-operation and Development; and annex table 1.

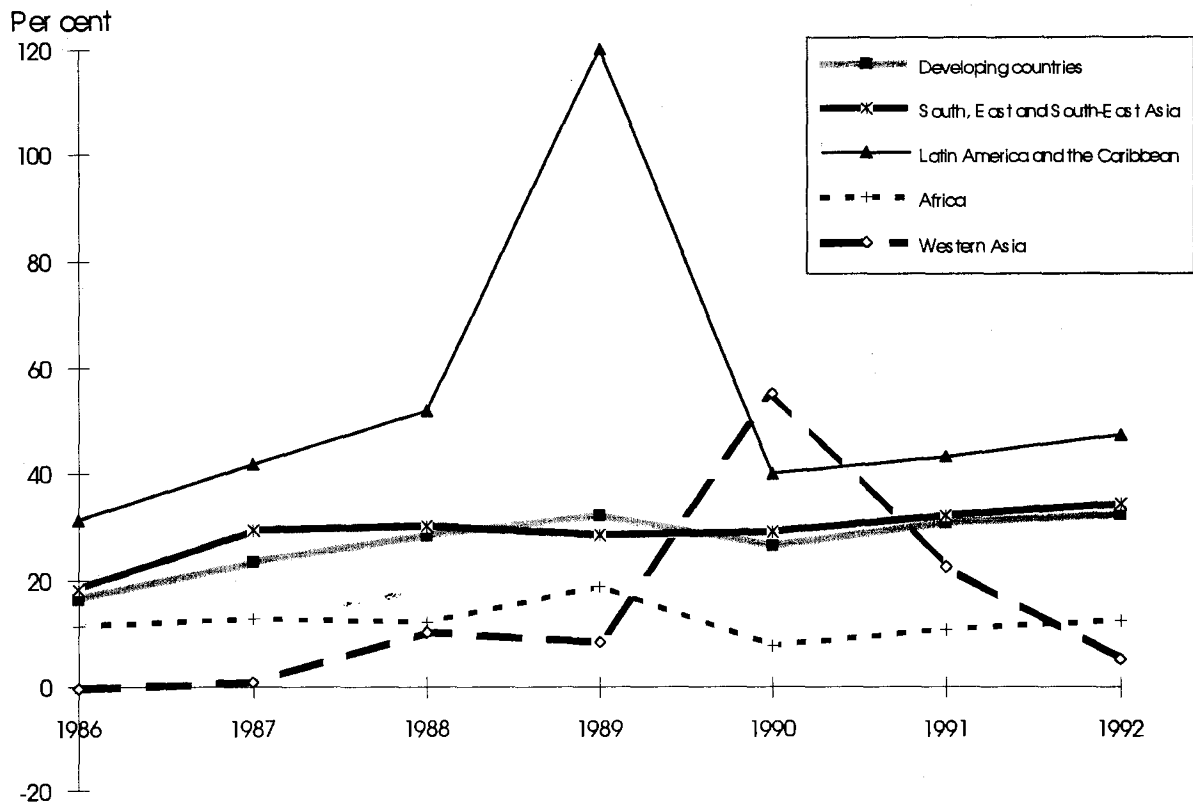
a Due to differences in regional composition, the data reported here are slightly different from those in table II.11.

b Includes developing countries in Europe (Gibraltar, Malta and the former Yugoslavia) and the Pacific Islands.

c Data in this table differ from those in table II.11 mainly due to the inclusion of Bermuda in the former.

Figure II.3. The share of foreign direct investment in total net resource flows, 1986-1992

(Percentage)



Source: The World Bank, 1993a.

In summary, FDI and portfolio investment flows have grown rapidly in East and South-East Asia and Latin America, reflecting the enormous needs of those regions for external financing. It has been estimated that South, East and South-East Asia alone will need more than $1 trillion to finance infrastructure and industrial projects over the next decade.[36] To satisfy those needs, these countries are increasingly borrowing from international and local capital markets. In the Eurobond market alone, Asian firms (excluding Japanese ones) issued bonds worth $14.7 billion in 1993, more than six times the 1992 volume.[37] Latin America and the Caribbean have re-established access to international capital markets, but their pattern of external financing is different from the one that preceded the debt crisis. Countries in that region receive more portfolio investments (especially equity investments) and FDI; thus they rely mostly on non-bank investors in private-sector enterprises, rather than on bank loans to public sector borrowers.

2. Least developed countries

One country group that has not benefited from the increase of FDI flows into developing countries continues to be the least developed countries.[38] Their share of FDI flows into all

Table II.11. Net resource flows into developing countries, by region and type, 1986-993[a]

(Billions of dollars)

Type of flow	*1986-1990 (Annual average)*	*1991*	*1992*	*1993*[b]
Africa				
Foreign direct investment [c]	2.6	2.5	2.9	..
Portfolio investment [d]	- 0.5	- 0.5	0.1	..
Private loans [e]	1.7	- 2.5	- 2.8	..
Official loans and grants [f]	16.8	23.3	23.0	..
Total	20.5	22.9	23.2	..
Latin America and the Caribbean				
Foreign direct investment [c]	6.4	12.4	14.5	17.5
Portfolio investment [d]	- 0.8	8.9	5.5	..
Private loans [e]	0.2	1.1	7.4	..
Official loans and grants [f]	7.4	6.4	3.4	6.3
Total	13.2	28.8	30.8	37.5
Western Asia				
Foreign direct investment [c]	0.3	0.5	0.3	..
Portfolio investment [d]	-	-	-	..
Private loans [e]	0.9	- 2.9	..	
Official loans and grants [f]	4.1	1.8	2.3	..
Total	5.4	2.2	5.5	..
South, East and South-East Asia				
Foreign direct investment [c]	7.5	14.5	21.1	26.1
Portfolio investment [d]	2.2	4.3	8.1	..
Private loans [e]	2.8	8.9	15.0	..
Official loans and grants [f]	15.0	17.8	17.7	21.1
Total	27.5	45.5	61.8	72.3
Total, developing countries [g]				
Foreign direct investment [c]	16.9	30.0	38.9	..
Portfolio investment [d]	0.8	12.7	13.7	..
Private loans [e]	5.0	6.7	22.4	..
Official loans and grants [f]	43.1	48.6	46.2	..
Total	65.8	98.0	121.1	..

Source: UNCTAD, Division on Transnational Corporations and Investment, based on The World Bank, 1993a.

a Excludes short-term flows.

b Projection by the World Bank.

c Due to the different coverage of countries, the figures are slightly different from those in table II.10.

d Portfolio equity investments and bonds. Gross figures for the former flows.

e Includes both publicly guaranteed and non-guaranteed loans.

f Excludes technical cooperation grants.

g Includes Malta and the former Yugoslavia.

developing countries has remained not only very small, but has declined from 2.1 per cent during 1986-1990 to 0.9 per cent in 1991 and 0.6 per cent in 1992. Their share of worldwide FDI inflows was even smaller: a minuscule 0.2 per cent in 1992 (table II.10). In absolute terms, the roughly 300 million of total inflows to all least developed countries in 1992 was smaller than inflows to Pakistan during that year.

Factors that have discouraged investment inflows to least developed countries have included the falling global demand for most of their primary exports, often coupled with high levels of external indebtedness; their persistently small domestic investment and slow economic growth (table II.12); their small domestic markets; their poorly developed physical infrastructure, often including difficult and expensive transport and communication links with the outside world (UNCTAD, 1993b, 1994a); and a poorly skilled labour force. In a number of least developed countries, political instability and, in some instances, violence and civil strife have become prohibitive deterrents to FDI. While a number of least developed countries have embarked upon significant structural reforms and liberalized their FDI regulations (chapter VII), such measures — though necessary and helpful — have not yet proven sufficient inducements for TNCs to increase their investment in the group of least developed countries as a whole.

The largest concentration of the least developed countries (31 out of 47) is found in *Africa*. These account for 80 to 90 per cent of the total FDI flows to the least developed countries. African least developed countries did not participate in the investment boom to developing countries that began in the late 1980s. Furthermore, the early 1990s brought a contraction of flows to $268 million in 1991 and $240 million in 1992, from $321 million in 1990.[39] Besides, flows during the period 1981-1992 never returned to their highest level of $444 million, reached in 1980. Within the group of African least developed countries, inflows are also highly concentrated: five countries absorb between 60 per cent and almost all of the annual inflows (table II.13). The table illustrates also the rapidly changing fortunes as regards investment inflows: only Botswana and Zambia appear consistently on the list of the largest host African least developed countries in all years.

Despite its small absolute size, the amount of FDI received by a number of least developed countries in Africa is large in relation to the size of their domestic economies (see section 3(c) in this chapter). On the other hand, several least developed countries in Africa (e.g., Burkina Faso, Cape Verde and Chad) receive minuscule amounts of FDI flows even in relation to their own small GDPs. A number of least developed countries in Africa typically attract very moderate amounts of investment, and inflows tend to fluctuate widely between disinvestments and positive flows from year to year (table II.14). But the ability of these countries to attract some FDI, despite wide fluctuations, suggests that they are, in principle, within the purview of foreign investors.

It appears that least developed countries in *Asia* are faring better than least developed countries in Africa: in general, inflows in these countries increased during the early 1990s, compared to the second half of the 1980s. As a number of Asian developing countries are graduating to higher value-added FDI, some least developed countries in Asia are inheriting labour-intensive FDI mostly at the low end of the value-added chain. Bangladesh and Cambodia fall into this category. Among those countries that have adopted market-oriented economic policies recently, Lao People's Democratic Republic and Myanmar have attracted some investments (table II.15). Approved inflows of FDI to Lao People's Democratic Republic between 1989 (when FDI was allowed for the first time) and 1992 totalled $27 million. In that country, 102 permits were granted to foreign investors (mostly from Thailand) in 1992 and 79 in the first half of 1993, mainly in services (including banking).[40] Foreign-direct-investment flows to Myanmar began only recently as distinct from the 1980s when there were virtually none. Major investors are Thailand, the United States, Singapore and Hong Kong. Myanmar has the potential to play an important role as a source of raw materials important to developed countries and nearby newly

Table II.12. Macroeconomic indicators and foreign-direct-investment inflows in developing countries, 1986-1993

(Percentage)

Item	Least developed countries	Developing countries: Total	Africa[a]	Latin America and the Caribbean	Western Asia[b]	South, East and South-East Asia	World
Growth rate of FDI inflows							
1986-1990 (average)	..[c]	21.0	7.4	15.7	21.4	35.9	32.6
1991	- 52.7	24.3	18.3	73.6	- 1.9	4.9	- 21.3
1992	- 15.3	18.7	12.5	-2.6	- 50.0	36.5	- 6.0
1993	..	57.0	..	..	..	..	23.0
Growth rate of gross domestic product[d]							
1986-1990 (average)	2.1	4.7	2.5	2.0	3.4	7.1	3.6
1991	0.6	4.5	1.6	3.3	2.4	6.1	0.6
1992	0.4	5.8	0.4	2.5	7.8	7.8	1.7
1993[e]	..	6.1	1.6	3.4	3.4	8.7	2.2
Export growth rate[f]							
1986-1990 (average)	2.7	11.4	3.7	5.0	7.6	13.1	6.1
1991	0.4	8.1	1.9	4.7	3.1	11.9	2.4
1992	0.1	9.5	2.1	8.5	8.4	11.2	4.6
1993[e]	3.6	9.4	0.1	4.1	6.9	12.7	3.0
Ratio of external debt to gross domestic product							
1986-1990 (average)	68.7	35.3	59.7	48.9	29.8	24.2	..
1991	55.2	32.3	58.9	43.6	24.0	24.9	..
1992	50.5	28.6	56.1	37.3	19.9	23.8	..
1993[e]	48.1	27.2	56.0	37.5	16.8	24.2	..
Gross fixed capital formation as percentage of gross domestic product							
1986-1990 (average)	16.1	24.2	20.9	19.7	21.8	29.3	..
1991	15.1	24.8	20.8	20.8	23.9	29.0	2.0
1992[e]	15.4	25.0	20.9	21.2	23.8	29.3	3.0
1993	..	..	..	..	..	..	..

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; International Monetary Fund, 1992, 1993b and 1993c; and UNCTAD, 1993b.

a Egypt and the Libyan Arab Jamahiriya are included in Western Asia except for the item on FDI.

b Includes Cyprus, Malta and Turkey except for the item on FDI.

c Due to negative inflows in 1986, growth rates cannot be calculated. Excluding the 1986 and 1987 data, the average growth rate was 24 per cent.

d Unlike table I.10, data in this table are not weighted averages. Therefore, there are some differences between these tables.

e Projection by the International Monetary Fund.

f Volume of merchandise exports. Data for least developed countries are estimates.

Table II.13. The largest five host countries among African least developed countries, based on foreign-direct-investment inflows, 1980, 1985 and 1990-1992

(Millions of dollars and percentage)

1980		*1985*		*1990*		*1991*		*1992*	
Botswana	112	Zaire	69	Zambia	203	Equatorial Guinea	42	Botswana	61
Zaire	110	Botswana	54	Botswana	38	Botswana	40	Zambia	50
Zambia	62	Zambia	52	Sierra Leona	32	Zambia	34	Sierra Leone	37
Niger	49	Togo	17	Malawi	23	Sierra Leone	30	Mozambique	25
Togo	42	Rwanda	15	Madagascar	22	Mozambique	23	Madagascar	21
Share in Africa's least developed-country total [a] (Per cent)	84		78		99		63		81

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994 and annex table 1.

a Excludes Liberia.

Table II.14. Highest and lowest amounts of foreign direct investment attracted by African least developed countries (excluding the largest recipients) during the period 1980-1992

(Millions of dollars)

Country	*Highest amount*	*Year*	*Lowest amount*	*Year*
Somalia	64	1987	-15	1984
Mauritania	27	1980	- 0.2	1992
Malawi	25	1987	- 3	1986
Lesotho	21	1988	2	1986
Rwanda	21	1988	2	1992
Tanzania	19	1981	- 8	1984
Gambia	15	1989	- 2	1984
Benin	13	1991	- 0.1	1983 and 1985
Burundi	11	1981	0.5	1985

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994 and annex table 1.

industrializing economies. For some least developed countries in the Pacific, FDI flows are large relative to the size of their economies (table II.15).

Manufacturing has become an increasingly important sector of FDI in a number of Asian least developed countries. Bangladesh, with about three-quarters of its exports being manufactured goods, has been receiving most FDI in manufacturing (textiles and apparel) (box II.2). Nepal

has also received FDI in textiles and apparel, which together with other manufacturing investments (e.g., carpets) account for nearly two-thirds of that country's exports (UNCTAD, 1992, p. 13). Foreign direct investment in Nepal, however, is concentrated in hotels and tourism, with significant multiplier effects for the economy in terms of the sale of locally manufactured products and the provision of services. Maldives is another country that has received considerable FDI in industry (which accounts for one-third of its exports), as well as in the development of hotels and tourist resorts (UNCTAD, 1992, p. 13).

For many least developed countries, FDI is often the only source of private external finance other than trade credits. Difficulties related mostly to their low level of development hinder their success in attracting these investments. A number of these countries offer locational advantages, which, if coupled with political and economic stability and friendly policies towards domestic and foreign companies, can make them attractive to foreign investors. These advantages include the availability of natural resources, touristic attractions and a low-cost labour force. In addition to overall FDI liberalization measures that are a necessary, although insufficient, ingredient of a good investment climate, targeting specific industries or even firms (including TNCs from developing countries) interested in matching their interests with the locational advantages of the least developed countries might be a possibility that can be explored, apart from general promotional efforts. However, even in the countries with some potential for attracting FDI, not to say, in the countries without such potential, official development assistance will remain essential for a good

Table II.15. Foreign direct investment and some economic indicators in selected least developed countries in Asia and Latin America and the Caribbean

(Millions of dollars and percentage)

Least developed countries	*Foreign direct investment*			*Per capita foreign direct investment 1991-1992a*	*Foreign direct investment as a share of gross domestic product, 1991-1992b*	*Per capita gross domestic product, 1991*	*Per capita gross domestic product, growth rate 1990-1991*
	1981-1985	*1986-1990*	*1991-1992*				
	(Annual average, million dollars)			*(Dollars)*	*(Per cent)*	*(Dollars)*	*(Per cent)*
Afghanistan	0.06	0.08	0.04	0.03	-	485	- 10.1
Bangladesh	- 0.04	2.16	2.55	0.02	0.01	201	0.9
Haiti	6.64	7.44	10.80	1.64	0.41	399	- 4.9
Lao People's Democractic Republic	- 0.32	2.40	8.50	1.98	0.83	237	0.8
Maldives	- 0.32	4.34	6.55	32.75	4.91	667	4.1
Myanmar c	0.07	0.69	8.85	0.21	0.03	655	- 0.8
Nepal	0.15	1.92	1.80	0.09	0.05	168	2.9
Samoa	0.06	1.41	2.59	12.95	1.43	908	- 0.5
Solomon Islands	0.90	5.86	15.35	51.17	9.62	668	0.1
Vanuatu	5.77	9.60	15.20	76.00	6.62	1 148	1.4
Yemen	17.52	9.08	11.81	0.98	0.15	668	- 7.2
All least developed countries	187	524	324	0.62	0.18	349	- 2.3
All developing countries	13 105	24 892	45 272	15.68	1.40	1 035	0.8

Sources: Same as for table II.10; UNCTAD, 1994a, tables 1 and 2, pp. A-3 - A-5; and annex table 1.

a Average FDI flows during 1991-1992 divided by population in 1991.

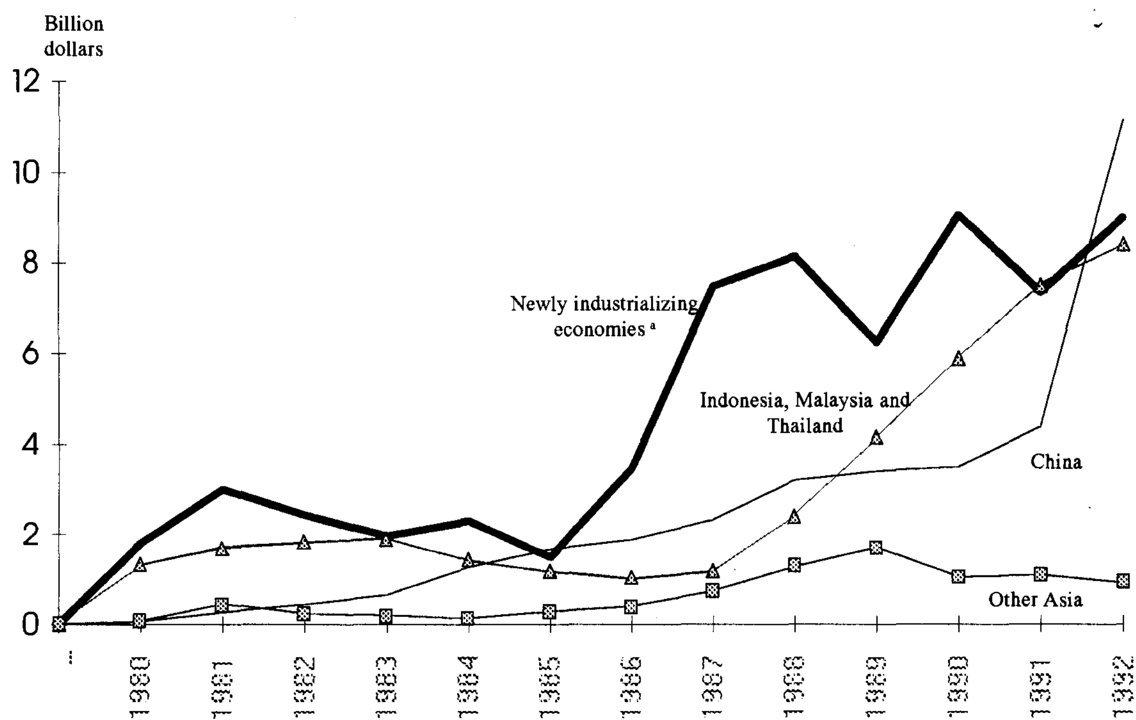
b Average FDI flows during 1991-1992 divided by gross domestic product in 1991.

c On an approval basis, cumulative inflows of FDI reported by the Government were $1,008 million between the end of 1988 (when the FDI law was promulgated) and 1993; see *Nihon Keizai Shimbun*, 1 February 1994.

As regards the newly industrializing economies of the region, investment inflows into the Republic of Korea and Taiwan Province of China fell by 51 per cent and 31 per cent, respectively, in 1992 (table II.16). Investments into Hong Kong and Singapore declined substantially in 1991, then increased by 257 per cent and 28 per cent, respectively, in 1992. As a result, these economies together attracted almost the same level of FDI in 1992 as during the late 1980s (figure II.4). Despite the slow-down of inflows, this level is high enough to permit these economies to continue to rank among the top 10 recipients of FDI among developing countries. The slow-down may be related to the restructuring of FDI owing to a loss of certain locational advantages and the acquisition of new ones. (The role of FDI in economic development and restructuring of these economies in Asia is discussed in box II.4.) Advantages that made these economies attractive to foreign investors in the 1980s — a stable macroeconomic climate, high growth rates of per capita income, expanding consumer markets, export-oriented trade policies, a well-developed (though, in some cases, deteriorating) infrastructure, a highly productive and educated workforce with entrepreneurial capabilities and an indigenous suppliers' network — remain unchanged. Furthermore, Hong Kong and Singapore have the most liberal investment regimes among developing countries, granting unrestricted national treatment to foreign investors in all areas.

Despite these attractions, rising costs in excess of productivity gains and an overburdened infrastructure (predominantly urban and road transportation) have discouraged efficiency seeking, labour-intensive FDI in these economies in recent years. Real wages increased by 30 per cent in Hong Kong, by 68 per cent in the Republic of Korea and by 36 per cent in Singapore between 1985 and 1990, while productivity gains during the same period were, for example, only 18 per cent in Singapore and 46 per cent in the Republic of Korea.[42] The loss of cost advantages of these economies has induced not only foreign, but also domestic companies to shift labour-intensive

Figure II.4. Foreign-direct-investment inflows to South, East and South-East Asia, 1980-1992



Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; and national official sources.

a Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

Box II.2. Foreign direct investment in Bangladesh

Bangladesh presents an interesting case of a least developed country that has been successful in obtaining a growing share of FDI flows. Rising labour costs and skills have led to the graduation of a number of other Asian countries to higher value-added activities. As a result, some labour-intensive activities are migrating from these countries to, *inter alia* Bangladesh. The stock of FDI was estimated to be 2.3 billion taka ($60 million) as of June 1992, not including export processing zones.[a] Investment flows to Bangladesh amounted to $3.7 million in 1992, up from $1.4 million in 1991.

Foreign investors have been attracted to the manufacturing sector of Bangladesh by its low wages and, in particular, its unused quota for exporting textiles and apparel to the markets of the European Union and the United States. (Ready-made garment exports rose from virtually nil in the 1970s to over one-half of its export earnings by the early 1990s.) Foreign direct investment in that industry accounted for nearly one-fifth of approved investment inflows in 1992, excluding export processing zones. The foundations of that industry were laid initially in 1979 through a collaborative agreement between Desh Garment Company, a local Bangladesh firm, and Daewoo Corporation, a TNC based in the Republic of Korea which provided labour training, start-up assistance and overall supervision of production and marketing.[b]

Aside from the textile and apparel industry, FDI in Bangladesh has been important in the food processing (20 per cent of cumulative approved investment by mid-1992), electric machinery (14 per cent) and chemical (13 per cent) industries. These investments, as with investments in textiles and apparel, tend to be concentrated at the low end of the value-added chain. Investors, mainly from other Asian developing countries, accounted for more than three-quarters of approved investments between mid-1990 and mid-1992. Firms from the Republic of Korea have dominated investment in the export processing zones, employing three times as many workers as Japanese firms (6,000 workers versus 2,000 workers) and exporting $4.3 million a month in 1992, compared to $2.3 million of exports by Japanese affiliates.[c]

a Stock data are not available for FDI including export processing zones.
b For details, see UN-TCMD, 1992a, pp. 214-215.
c JETRO, 1993b, pp. 234-237.

part of the necessary financing for their investments, especially investments in the improvement of infrastructure needed to provide adequate services to TNCs. The public support from developed country governments and, of course, international organizations, is also essential to the success of structural adjustment programmes carried out by least developed countries. Without such support, it is not likely that those countries could generate development and create conditions on a scale sufficient to attract meaningful amounts of FDI.

3. Regional trends

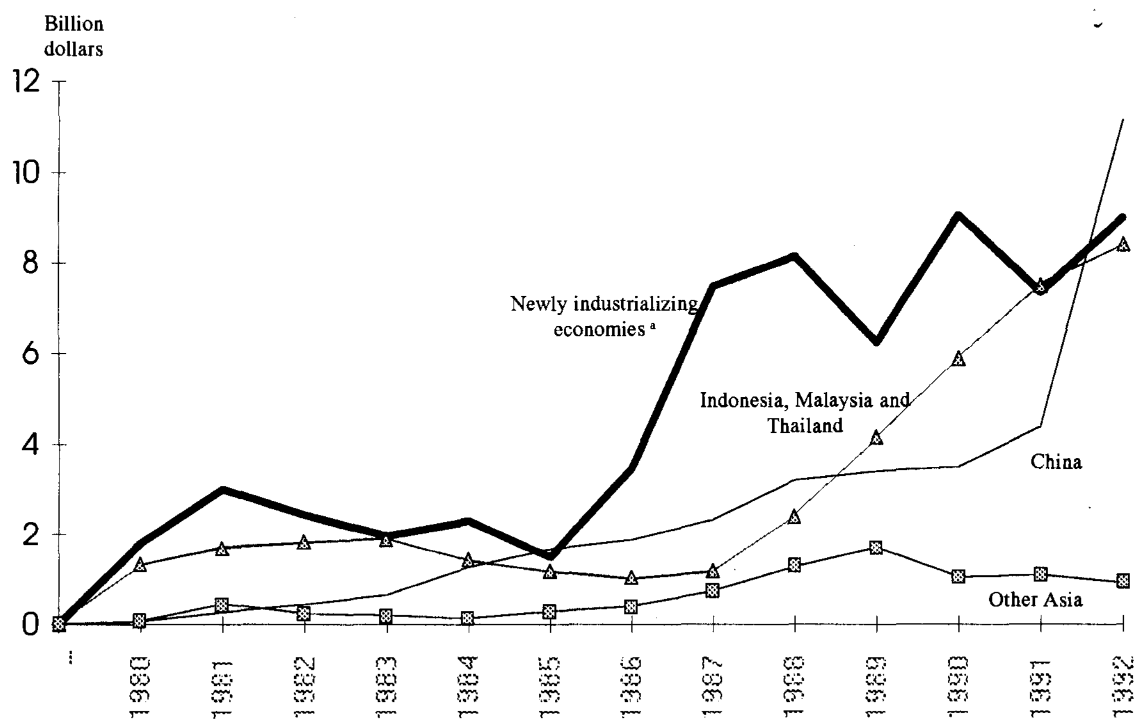
(a) Asia and the Pacific

Fuelled by high growth rates, large and increasingly affluent domestic markets, low production costs in a number of countries and a further liberalization of FDI policies, investment inflows to East, South and South-East Asia and the Pacific reached $30 billion in 1992, an increase of 45 per cent over the previous year. With inflows exceeding $11 billion, China emerged as the largest recipient of FDI among all developing countries in 1992, and dominated flows into Asia. Investments in China increased further to about $26 billion in 1993 (box II.3). Excluding China, the increase in investment inflows to East, South and South-East Asia and the Pacific was considerably less in 1992: 15 per cent, for a total of $19 billion.[41]

As regards the newly industrializing economies of the region, investment inflows into the Republic of Korea and Taiwan Province of China fell by 51 per cent and 31 per cent, respectively, in 1992 (table II.16). Investments into Hong Kong and Singapore declined substantially in 1991, then increased by 257 per cent and 28 per cent, respectively, in 1992. As a result, these economies together attracted almost the same level of FDI in 1992 as during the late 1980s (figure II.4). Despite the slow-down of inflows, this level is high enough to permit these economies to continue to rank among the top 10 recipients of FDI among developing countries. The slow-down may be related to the restructuring of FDI owing to a loss of certain locational advantages and the acquisition of new ones. (The role of FDI in economic development and restructuring of these economies in Asia is discussed in box II.4.) Advantages that made these economies attractive to foreign investors in the 1980s — a stable macroeconomic climate, high growth rates of per capita income, expanding consumer markets, export-oriented trade policies, a well-developed (though, in some cases, deteriorating) infrastructure, a highly productive and educated workforce with entrepreneurial capabilities and an indigenous suppliers' network — remain unchanged. Furthermore, Hong Kong and Singapore have the most liberal investment regimes among developing countries, granting unrestricted national treatment to foreign investors in all areas.

Despite these attractions, rising costs in excess of productivity gains and an overburdened infrastructure (predominantly urban and road transportation) have discouraged efficiency seeking, labour-intensive FDI in these economies in recent years. Real wages increased by 30 per cent in Hong Kong, by 68 per cent in the Republic of Korea and by 36 per cent in Singapore between 1985 and 1990, while productivity gains during the same period were, for example, only 18 per cent in Singapore and 46 per cent in the Republic of Korea.[42] The loss of cost advantages of these economies has induced not only foreign, but also domestic companies to shift labour-intensive

Figure II.4. Foreign-direct-investment inflows to South, East and South-East Asia, 1980-1992



Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; and national official sources.

a Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

Box. II.3. China's great leap forward

The recent FDI boom in China has been heralded as a miracle. In 1991, China ranked only thirteenth in the world and third among the developing countries in terms of FDI inflows. In 1993, it became the second largest FDI recipient in the world (following United States) and the single largest host country among the developing countries (figure 1).

During 1992 and 1993, 132,000 new projects were approved, with commitments more than triple the total of the previous 13 years. Actual inflows during these two years amounted to $37 billion ($11.1 billion in 1992 and $25.8 billion in 1993),[a] equivalent to one-and-a-half times the total inflow accumulated during 1979-1991. While FDI inflows grew, on average, by 30 per cent annually during 1985-1990, they leaped by 156 per cent in 1992 and 134 per cent in 1993. In the late 1980s, the average size of FDI projects was less than one million dollars; in contrast, projects above $50 million are now fairly common.

The past two years have also seen a significant expansion in terms of both sectoral and geographical patterns of FDI flows to China. While labour-intensive manufacturing continues to absorb a large share of FDI, inflows are increasingly directed towards capital- and technology-intensive industries, as well as towards infrastructure-building and services (particularly in the East and South-East provinces). At the same time, labour-intensive and resource-seeking investments are now gradually moving to the Northern and inland provinces. This sequential pattern of development — which had earlier been observed particularly in the Asia and Pacific region (described as "a flying-geese formation") — appears to be taking place within China.

The growing FDI inflows into China have been also evidenced by the large number of commitments by large TNCs in what might be termed the "third wave" of FDI inflows,[b] dwarfing earlier investments by overseas Chinese. A number of the world's largest TNCs have now a presence in China;[c] many of them have sizeable direct investments. Large TNCs, such as Mitsui, Marubeni, Siemens, Coca Cola Co., Motorola, IBM, Philips, Volkswagen, TPL and AT&T have recently revised upwards their investment plans in China. There is a wide perception in the business community that no one can afford to ignore the enormous investment opportunities in China.

With over 50,000 foreign affiliates in operation and a total stock of over $61 billion, the impact of FDI on China's economic development is becoming more and more tangible. Foreign affiliates have contributed significantly to the growth of China's exports (figure 2). The export share of foreign affiliates in total national exports increased from 13 per cent in 1990 to 28 per cent in 1993, amounting to $25.2 billion. China now ranks as the eleventh largest exporter in the world and second largest exporter among the developing countries; its exports accounted for 17 per cent of its GNP in 1992. There is no doubt that FDI has fuelled China's export boom and contributed to sharpening its international competitiveness.

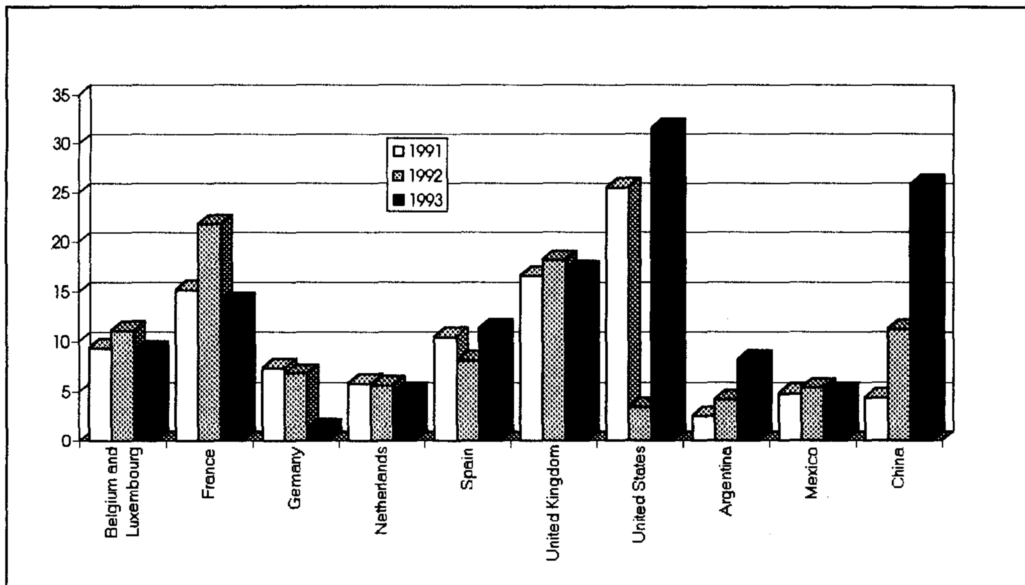
In 1993, the total annual outputs of foreign affiliates reached 300 billion yuan ($52 billion), with tax contributions of 10.7 billion yuan ($1.9 billion) in 1992 and 8.8 billion yuan ($1.5 billion) in the first half of 1993. In some large industrial cities, the tax contribution of foreign affiliates accounted for over 10 per cent of tax revenues in 1993. As of the end of 1992, there were nearly 6 million employees in foreign affiliates. Although they accounted for only about 4 per cent of the total employment in urban areas, foreign affiliates have played a positive role in the implementation of China's full employment policy (the unemployment rate in urban areas was 2.3 per cent). Foreign direct investment now accounts for around 10 per cent of gross national investment (which itself has also been growing rapidly). It should be noted that the importance of FDI is much greater in the coastal regions which have been an engine of growth for the Chinese economy.

A number of factors, acting in combination with one another, contributed to the current boom in FDI:

- The rapid expansion of the domestic market, driven by a strong economic performance;[d]
- The gradual opening of the domestic market to FDI, inducing a large number of market-seeking investments. In 1992, some service industries, such as transportation, banking, real estate and retail trade, and 52 cities and areas became open to foreign investors;
- Low-cost production and rich natural resources, attracting a large number of TNCs;

Figure 1. The world's ten largest recipients of foreign-direct-investment inflows in the 1990s

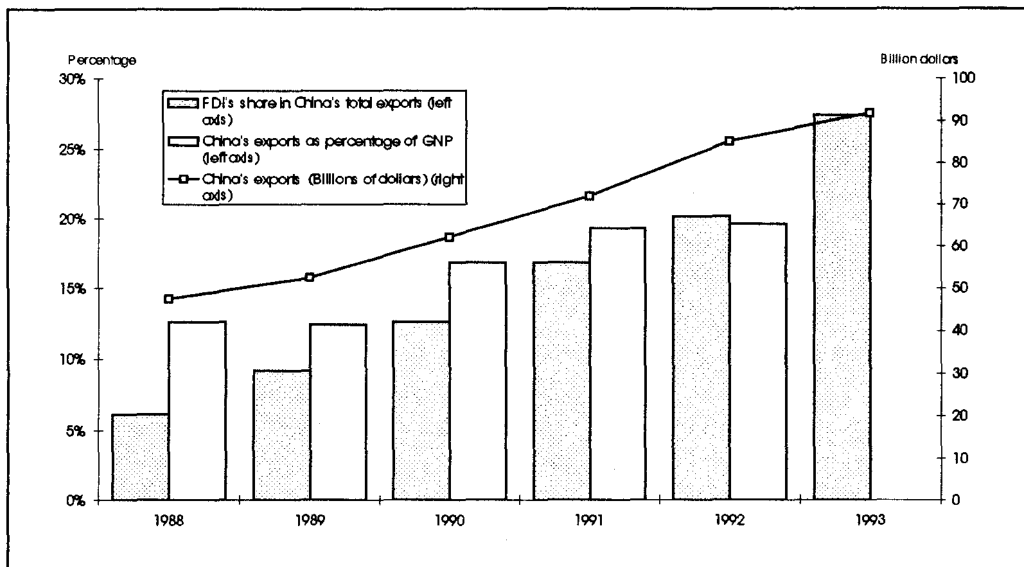
(Billions of dollars)



Source: annex table 1 and estimates of UNCTAD, Division on Transnational Corporations and Investment.

Figure 2. The contribution of foreign direct investment to China's exports

(Billions of dollars and percentage)



Source: Zhan, 1993.

- The restructuring of the economy towards market-based mechanisms and other economic reforms, significantly improving the overall enabling framework for foreign (and domestic) investors;
- High economic growth in neighbouring countries and the improvement of relations with the Republic of Korea and Taiwan Province of China. These economies used to have negligible investment outflows to China in the 1980s; they have now become major sources of investment in China, ranking third and sixth, respectively.

Looking ahead, some of these factors can be maintained: it is likely that China's economy would still be growing at a high rate until the end of the century (perhaps between 7 and 10 per cent per annum); the liberalization of the FDI regime is expected to proceed further, especially through the opening of more industries and geographical areas to foreign investors,[e] and allowing more flexible modes of investment, while providing incentives to preferred high-technology and infrastructure projects. The current round of market-oriented reforms, if carried out successfully, would contribute further to a more favourable environment for FDI. For example, the eventual full convertibility of the domestic currency is expected by the end of the century. The sheer size of the domestic market, still expanding rapidly, and the diversity of the Chinese economy in many respects — e.g., labour costs, endowment in natural resources — have a potential to sustain not only large quantities of FDI, but also different types of these investments, namely, market-seeking, resource-seeking and efficiency-seeking.

China will probably remain a major FDI recipient in the years to come, at least in the short-run. However, the rate of FDI growth will depend largely on China's future political stability, the consistency of its economic policies and its macro-economic management capabilities, as well as the extent to which China will succeed in its transformation into a market economy and its integration into the world economy, depending on developments in these and other respects, it is possible that inflows of FDI will experience short-term fluctuations, as had been the case in past years.[f]

Sources: Zhan (1993) and various national data.

a It should be noted that investment inflows are likely to be overestimated in two ways. About 70 per cent of FDI inflows are "in kind", that is, equipment and technology; translating the amount of these investments into cash tends to overvalue the amount of FDI (Zhan, 1993). The other overvaluation is caused by the disguise of some domestic investment that is re-routed through foreign affiliates in Hong Kong back into China as FDI in order to take advantage of fiscal entitlements awarded to foreign investors (Harrold and Lall, 1993).

b The first wave occurred in late 1970s and early 1980s, when there was great interest, but not much actual investment. The second wave took place in the mid- and late 1980s and was predominated by Asian companies.

c Shanghai alone has attracted about 120 of the world's 500 largest TNCs.

d During the period 1978-1991, real GNP grew at an average annual rate of 9.7 per cent; growth rates were 13 per cent in 1992 and 1993.

e Some of the newly opened sectors, such as banking, aviation, telecommunication, retail etc., are only partially liberalized.

f In November 1993, it was decided to introduce national treatment for foreign affiliates, in order to establish a level-playing field for both domestic and foreign firms. While this may improve the regulatory framework in the longer term, it reduces also existing preferential treatment of foreign investors; the latter may not only discourage the round-tripping of investment originating from domestic firms but probably also some "real" FDI.

Table II.16. Foreign-direct-investment inflows to selected South, East and South-East Asian countries, 1981-1992

(Millions of dollars)

Economy	*1981-1985* (*Annual average*)	*1986-1990* (*Annual average*)	*1991*	*1992*
China	850	2 853	4 366	11 156
Hong Kong	576	1 945	538	1 918
India [a]	59	182	145	140
Indonesia	236	599	1 482	1 774
Korea, Republic of	117	676	1 116	550
Malaysia	1 083	1 126	3 998	4 469
Pakistan	77	175	257	349
Philippines	63	493	544	228
Singapore	1 349	3 247	4 395	5 635
Sri Lanka	42	40	48	123
Taiwan Province of China	189	987	1 271	879
Thailand	279	1 188	2 014	2 116
Viet Nam	6	6	32	-

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; and annex table 1.

a Based on outward FDI flows to India from the members of the Development Assistance Committee of OECD. These data underestimate the magnitude of FDI inflows to India.

production abroad and thus expedite the process of industrial upgrading at home. In addition, these economies (as well as other Asian countries, such as Malaysia) are increasingly pursuing policies that encourage quality FDI through attracting high value-adding activities of TNCs.[43] This means, however, that establishing research-and-development facilities or regional headquarters fosters an upgrading in the activities of TNCs that is not necessarily accompanied by large investment flows.

The fact that the share of the newly industrializing economies in investment flows into Asia has diminished in recent years also reflects the emergence of a "second-tier" group of industrializing countries (Indonesia, Malaysia and Thailand) and China, where FDI grew rapidly in the late 1980s and 1990s from low initial levels. Those countries became preferred locations for labour-intensive FDI seeking to reduce costs and, more recently, market-seeking FDI (including such action by TNCs from the newly industrializing economies). In Thailand, for example, there was only a 3 per cent (total) increase in real wage rates between 1985 and 1991; and in 1991 the wage level was only 19 per cent of that of the Republic of Korea.

Japan in particular, still the principal source country for this region, has increased its investments in the new destinations of FDI at the expense of the newly industrializing economies: the share of the latter in the investment outflows from Japan to South, East and South-East Asia has declined steadily from 60 per cent in 1989 to 24 per cent in 1992.[44] As indicated earlier, recently, Japanese TNCs facing financial difficulties and low profits at home and abroad, as well as an appreciating exchange rate, have been seeking to reduce costs further by shifting production to

Box II.4. The role of foreign direct investment in East and South-East Asia

The experience with FDI of the Asian newly industrializing economies (the Republic of Korea, Taiwan Province of China, Hong Kong and Singapore) and the second-tier newly industrializing economies (Indonesia, Malaysia and Thailand) is of great interest to the developing world. In part, this is because of their outstanding economic performance — any factor that may be significant in explaining that performance has important lessons for other developing countries — in part, it is because they adopted very *different* strategies within the common context of export orientation. They all relied heavily on foreign technology to fuel their entry into world markets and were generally open to international technology flows. In contrast to a number of import-substituting countries, they made no attempt at self-reliance in technology.

However, the mode in which they imported technology, the efforts they made to complement and build upon imported knowledge and the interventions they undertook to encourage domestic enterprises to enter complex activities, all differed significantly. Some depended heavily on FDI by TNCs, others on licensing and the import of capital goods (also, often, from TNCs). Although all of these countries were successful in expanding industrial production and exports, they developed very different industrial structures, export specialization and technological capabilities. To a significant extent, this can be explained by their strategies regarding foreign technology and industrial promotion.

The recent, much publicized study by the World Bank of the East Asian "miracle" (World Bank, 1993d) attempts to explain the economic success of several countries in that region. It points to the role of factors like good macroeconomic management, human capital formation, general openness to foreign technology and export orientation. These are valid, but not original: no one disputes any longer the role of such factors in fostering long-term development. The study also notes the large *differences* between these countries in their policies on FDI, import protection and industrial targeting. However, the study does not attempt to analyze what impact these differences had on industrial structures, specialization and upgrading, and reaches generally negative conclusions on the role of industrial policy (selective interventions to promote industrial development and deepening). The subject of industrial policy remains controversial, and the World Bank's conclusions are strongly debated (Lall, 1994a).

Openness was essential to the Asian success, and technology imported from TNCs was an essential ingredient. However, an active strategy to maximize indigenous capabilities was essential for the industrial prowess of the larger "tigers". There remain many deficiencies in free markets as far as industrial and technological development are concerned, and a positive role exists for careful and selective government interventions in using FDI.

The high growth economies of East and South-East Asia may be divided into four broad categories as far as FDI strategies are concerned:

- Economies that followed passive open-door policies on TNCs and did not intervene to promote industrial development in other ways (e.g., Hong Kong).

- Countries that pursued active industrial policies for certain industries and promoted local enterprises in certain activities, but adopted effectively open-door, non-interventionist policies in some export-oriented industries (e.g., Thailand, Malaysia).

- Countries that actively sought heavy TNC participation in manufacturing, but intervened selectively to guide investors in directions and technological activity thought to be desirable for industrial upgrading (e.g., Singapore).

- Economies that selectively restricted FDI and sought to maximize reliance on externalized forms of technology transfer in the context of a comprehensive set of industrial policies to deepen the manufacturing sector, promote local linkages and increase local innovative capabilities (e.g., the

Republic of Korea and Taiwan Province of China and, earlier, Japan). These industrial policies encompassed interventions in trade, finance, skills, technology and institution building, with strongly selective aspects to practically all interventions.

Table 1 shows the share of FDI in gross domestic capital formation in these economies. It also provides data on research and development by productive enterprises as a share of GDP in a recent year. It shows, in very broad terms, that the economies that developed the most diverse, complex and technologically dynamic industrial sectors (the Republic of Korea, Taiwan Province of China and, earlier, Japan) had the least reliance on FDI. There was, apparently, a causal connection between industrial policy, selective restrictions on FDI, the pursuit of technological deepening and export-orientation that allowed these countries to achieve historically unprecedented rates of industrial growth. Certainly, their industrial strategies were aimed at the development of indigenous capabilities, and selectivity on FDI was one important aspect of their strategies. These are issues on which the World Bank's interpretation of the East-Asian "miracle" has little to say.

Table 1: Foreign direct investment as share of gross domestic investment, and research and development as share of gross domestic product in selected East and South-East Asian countries, 1981-1985 and 1986-1991

(Percentage)

Economy	*FDI/GDI, 1981-1985*	*FDI/GDI, 1986-1991*	*Research and development by productive enterprises as a share of GDP*
Hong Kong	10.7	11.4	0.3 [a]
Republic of Korea	0.5	1.1	1.3
Singapore	17.4	29.4	0.2
Taiwan Province of China	1.5	3.5	0.6
Malaysia	1.5	9.7	0.1
Thailand	0.1	6.3	0.03
Memorandum:			
Japan	0.1	0.1	1.9

Source: UNCTAD-DTCI, 1993a; Lall, 1992.

a Estimate.

To amplify on the experience of some economies of East and South-East Asia:

- First, *Hong Kong*, with the most liberal FDI regime, was able to attract substantial amounts of FDI and, at the same time, develop a dynamic indigenous industrial class that was very successful on export markets. Hong Kong is, however, a very special case, by virtue of its location, long entrepôt tradition, presence of large and highly developed trading and financial companies of the United Kingdom, and the influx of trained engineers/technicians from China. This allowed it to launch into export-oriented light manufacturing. In the case of garments, the relatively brief learning period, had been undergone already in China; other activities (toys, watches etc.) could be financed locally.

However, because of the essentially *laissez faire* policies pursued, Hong Kong's industrialization shows special features. The colony started *and stayed with* light labour-intensive manufacturing, though considerable upgrading has taken place. Hong Kong's success was based on an impressive development of operational and marketing capabilities, but there was little industrial deepening and diversification because of the lack of promotion of more demanding complex technological learning. There was some "natural" progression up the ladder of industrial complexity, but it was relatively limited in relation to other newly industrializing economies. As wages and land costs rose, Hong Kong had to relocate its manufacturing to other countries, mainly China, and suffered a significant loss of industrial activity at home (over the period 1986-1992, it lost about 35 per cent of its manufacturing employment, and that process is continuing).[a] The growth of its manufactured exports has slowed down considerably, and may even have declined during 1993-1994. Its impressive outward FDI performance, especially in China, is a reflection of its advanced entrepreneurial, but limited, technological capabilities rather than of broad industrial strengths (Lall, 1993a). At the same time, the lack of a strong technological base is of concern to the Government that is now launching initiatives, such as the Hong Kong Industrial Technology Centre, to promote selectively local high-tech companies.[b]

- Second, *Malaysia* has been able to develop an impressive array of high-technology exports driven almost entirely by FDI, because it was successful in targeting and attracting electronics assembly when the burst of labour-intensive activity started in developing countries. Its excellent infrastructure, stable and open economy, low wages and use of English has made it an ideal investment site, an advantage that seemed to grow over time, despite the fact that it imposed various equity sharing and other conditions on investors that were not wholly export-oriented. Malaysia benefited greatly from its location in a hub of dynamic growth, much of it driven by strategic industrial policy in the larger countries like the Republic of Korea and Taiwan Province of China. As technologies progressed and wages rose, TNCs responded by automating their facilities in Malaysia and diversifying; in turn other assembly operations were attracted, and today the country has annually some $34 billion of manufacturing exports. At the same time, Malaysia pursued active industrial policies in other activities, such as setting up public enterprises, promoting *bumiputra* ownership, helping small- and medium-sized firms and upgrading resource-based activities. To a large extent, however, these activities remained detached from the TNC sphere of manufacturing for export.

Has this dependence on FDI hampered growth in Malaysia? The evidence suggests not. However, Malaysia's technological base is small and underdeveloped, TNCs have low local content and their ability to upgrade constantly in the face of rising wages remains a source of concern. The pattern of industrial development has been skewed towards electronics and electrical industries — still assembly operations (though now fairly capital rather than labour-intensive) with low levels of linkages with local firms, little local design-and-development activity and no independent marketing capabilities. The scarcity of local technical skills is a constraint to further upgrading. The paucity of indigenous suppliers and technological support makes local research and development difficult for TNCs. Approvals of FDI in 1993 dropped by 60 per cent; over a longer period, FDI in high-technology activities has not been growing rapidly. The Government has ambitious technology-development plans, drawing on the model of the Republic of Korea. It is also launching selective policies towards TNCs to induce technological deepening and greater local content. Clearly, FDI in a late comer can do wonders for export performance and manufacturing output if certain conditions are met, but its impact on local technological capabilities remains weak. The conditions offered by Malaysia are unusual, and practically no other country (including its neighbours) has been able to reproduce them. The export drive by Thailand, for instance, is far more concentrated in low-technology assembly activity, and even is more so in Indonesia.

- Third, *Singapore* has the highest reliance of almost any country on TNCs, and has done extremely well from it. The Government has been very interventionist, but the form of interventionism has been very different from that in the Republic of Korea. The economy started with a base of capabilities in *entrepôt* trading, ship servicing and petroleum refining. After a brief period of import substitution, it moved into export-oriented industrialization, based overwhelmingly on FDI. Unlike Hong Kong, there was a weak tradition of local entrepreneurship, and there was no influx of technical know-how from China. For a decade or so, there was light industrial activity (garment and semiconductor assembly), after which the Government of Singapore acted firmly to upgrade its industrial sector, by intervening to guide TNCs to higher value-added activities and to create the specific high-level technical skills that would be needed.[c] The Government also set up a number of public enterprises to undertake those activities that were considered to enhance the country's future competitive advantage (including, most recently, an investment push into China); the public sector in Singapore accounts for a substantial proportion of GDP.

  Specific areas of both manufacturing and services (e.g., banking, freight and aircraft servicing) were selected for promotion by the Government of Singapore, but the policy instruments used did not include trade protection. Instead, they comprised a range of incentives and pressures that guided the allocation of foreign and local resources and lowered the cost of entry into difficult activities by providing the requisite skills and infrastructure. Manufacturing activity was guided into highly specialized processes and products, but there was no attempt to increase local content deliberately. Such specialization, along with the heavy reliance on FDI for technology and skill transfer, greatly reduced the need for indigenous technological investments (as compared, say, with the Republic of Korea). Thus, while selective interventions led Singapore's industry into sophisticated electronic products, precision instruments, optics and so on, the technological depth of the enterprises located there remained comparatively low. Some design-and-development activity did develop over time, but this was again with considerable urging and support from the Government.

  The lessons of Singapore are twofold. First, FDI can take a small economy a long way if it is carefully selected and guided, supplied with very good infrastructure and a disciplined and trained workforce, and given a competitive and stable investment environment. Second, it is not necessary to offer import protection to technologically complex activities if the main sources of operational and other technologies remain foreign and production is integrated with that in foreign countries (rather than with local suppliers) and is concentrated on selected stages of production. This strategy required both functional and selective interventions by the Government: the contrasting experiences of Singapore and Hong Kong with respect to the deepening of industrial activity illustrate this clearly.

- Finally, the cases of the *Republic of Korea* and *Taiwan Province of China* are by now well examined.[d] It only needs to be reiterated that the role of FDI was secondary to that of technology import in other forms and that the export drive was led by local firms to develop impressive technological capabilities. The Republic of Korea went much further in developing advanced innovative capabilities than did Taiwan Province of China, though perhaps at the cost of a more concentrated industrial structure and a worsening of income distribution. Unlike Taiwan Province of China, the Republic of Korea had to promote the growth of giant conglomerates (to internalize poorly functioning markets and bear the risk of going into demanding activities at world levels of efficiency), though the former also tried to enter heavy industry with public sector enterprises. Both economies invested heavily in higher education and technical training, and both created a range of technology-support institutions. Strong incentives (including subsidies and cheap credit) were given to promote local research and development and to use local research institutes. The Governments took a strong lead in targeting industries for technology development, and both countries have selected around ten to twelve activities for investment to promote their future competitiveness.

The most important point about the experiences of the Republic of Korea and Taiwan Province of China (and that of early Japan) is that while TNCs made important inputs into their industrialization, they were used by the Governments primarily in furthering the acquisition of technology and the development of local innovative capabilities. The externalities generated by these capabilities were captured by local firms and were used to dynamize the countries' competitive advantage. The internalized markets of TNCs were not, in other words, allowed to weaken the deficient factor markets of the host economies, but were tapped in such a way that local capabilities were strengthened. As their capabilities grew, FDI was allowed to play a larger role, but it never became the "custodian of development".

The best conditions for domestic "learning" are still to be determined, but the growing empirical evidence on developing countries' technological development suggests that simple "openness" and passive reliance on market forces may not be the best strategy for development. Transnational corporations remain the main source of innovation and technology, and in many instances investment by them is the best and most effective way to develop manufacturing and export capabilities. However, there are other cases in which a more independent approach can yield greater benefits to indigenous learning, for countries that have the capacity to undertake it. One of the lessons of East and South-East Asia is that the effort is feasible and worthwhile.

Source: Sanjaya Lall, "The role of foreign direct investment in East Asia: a note", prepared for UNCTAD, Division on Transnational Corporations and Investment, June 1994.

a "Survey of Hong Kong", *Financial Times*, 4 May 1993. A recent article in the *Far Eastern Economic Review* (29 May 1994, p. 68) shows that manufacturing employment declined from 45 per cent to 23 per cent of the total in 1980-1992.

b *Far Eastern Economic Review*, 26 May 1994, p. 69.

c When the local skill base was unable to cope, the Government allowed a controlled import of skilled manpower.

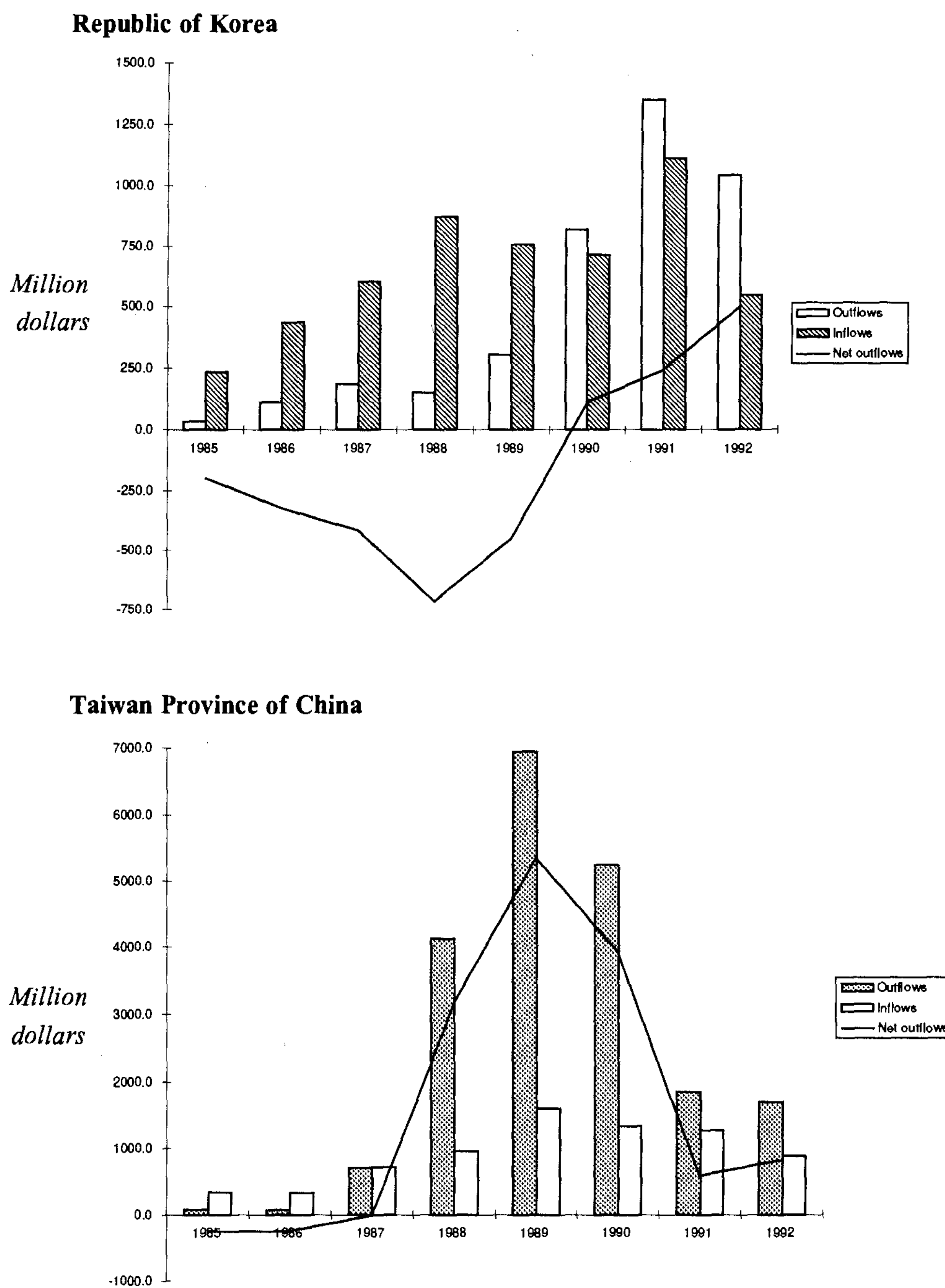
d For a summary description, see Lall, 1994b.

the second-tier industrializing countries and China. In their cost-cutting efforts, wage increases that outstrip productivity gains appear to be an important consideration in the decision of Japanese firms as to where to locate production in Asia, which places the newly industrializing economies at a disadvantage.

As regards outward investment, as already mentioned, firms from the newly industrializing economies continue to invest abroad: annual FDI outflows from the Republic of Korea, Singapore and Taiwan Province of China were $5.7 billion during 1988-1992, compared to $0.4 billion during 1983-1987. The Republic of Korea and Taiwan Province of China have become net outward investors since 1990 and 1988, respectively (figure II.5). Firms from Singapore, which have been lagging as outward investors compared with those from the other two economies, have recently undertaken a number of investments in China, as well as in Malaysia and Indonesia, in an effort to boost their regional presence.[45] Although most FDI from the newly industrializing economies is located in developing countries of Asia, recently such investment in North America and Western Europe has increased.[46] The 1990s have also witnessed the ascendancy of China as a new sizeable outward investor. In addition to being the largest host developing country, China is now the largest source of FDI from developing countries,[47] with investments in both developing and developed countries. All in all, FDI by developing countries from Asia into other developing countries of the region has become a considerable factor behind the increasing flows of these investments to developing countries, an outstanding feature of the recent trends in worldwide FDI .

Figure II.5. Foreign-direct-investment inflows and outflows for the Republic of Korea and Taiwan Province of China, 1986-1992

(Millions of dollars)



Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994 and national official sources.

Investments in Asia from the newly industrializing economies are often motivated by rising production costs at home. Traditionally, preferred locations for these investments have been members of the Association of South East Asian Nations (ASEAN), such as Thailand and Indonesia. In 1993, however, the level of outflows from the newly industrializing economies into ASEAN (excluding Singapore) was considerably less than in 1992: $2.2 billion in 1993 (January-September), compared with $4.5 billion in 1992.[48] Increasingly, China and Viet Nam are becoming attractive to cost-reducing, efficiency-promoting FDI from Hong Kong, Taiwan Province of China and, more recently, Singapore and the Republic of Korea. In turn, former recipients of these investments (e.g., Thailand) are themselves investing in neighbouring countries (Lao People's Democratic Republic). Investments by the newly industrializing economies in developed countries have different objectives, namely, to secure market shares and access to technology (UN-TCMD, 1993d).

Additional extra- and intraregional FDI flows in the region may be induced in the near future by the ASEAN Free Trade Area established formally in 1993 with a view to eliminating intraregional tariffs and non-tariff barriers provided, however, that the Area succeeds in creating a large regional market (box II.5). The present low level of trade interdependence among ASEAN members — intraregional trade accounted for only 17 per cent of the members' total trade in 1992 — indicates great potential for the expansion of intraregional market and trade.[49] If this potential is tapped by the ASEAN member countries, this is also likely to encourage the regional rationalization of the existing investments (Braga and Bannister, 1994).

South Asia is another part of the region, next to China, and in contrast to the newly industrializing economies, where investment inflows increased significantly in 1992 (by 39 per cent). Inflows into that subregion increased further in 1993 owing, primarily, to the renewed interest of foreign investors in India's sizeable domestic market as a consequence of the ongoing liberalization of its investment regime (box II.6). Between August 1991 (when the new industrial policy liberalizing India's investment regime was introduced) and February 1993, more than 2,300 foreign collaborations had been approved, with FDI amounting to 67 billion rupees ($2.6 billion), more than five times the total FDI approved between 1981 and 1990 (UNCTAD, Ad Hoc Working Group on Investment and Financial Flows, 1993, p. 28). Inflows into other countries in South Asia remain relatively small, hindered in part by the small size of their domestic markets, an underdeveloped infrastructure and administrative bottlenecks in implementing the typically liberal investment regimes.

Viet Nam, which opened to FDI only in 1988, has experienced rapid increases in FDI. Since then, investment in Viet Nam increased to about $2 billion by 1993, out of the $7.5 billion of investments that were approved.[50] The rapid growth of FDI in Viet Nam is attributed primarily to the availability of natural resources (petroleum) and low production costs. Firms from Taiwan Province of China are the largest investors in Viet Nam, accounting for about one-fifth of total approved FDI. These firms invest primarily in labour-intensive activities facing high production costs at home; by taking advantage of low wages in Viet Nam, they seek to retain their international competitiveness. Firms from Australia, France, Hong Kong, Japan and Singapore are also sizeable investors in oil exploration, manufacturing and services. A few automobile companies from Japan have set up joint ventures with other foreign manufacturers and domestic companies to produce cars for the domestic market. While FDI is viewed as a positive force in the modernization of the domestic economy, its poor infrastructure acts as a disincentive and a bottleneck as regards the amount of investment that Viet Nam can attract and absorb.

The lifting of economic sanctions against Viet Nam by the United States in February 1994 allows United States companies to invest in Viet Nam. Before, United States TNCs were only permitted to sign, but not execute contractual agreements. Coca Cola, for example, was allowed to sign an agreement to produce soft drinks in Viet Nam that was to become operative after the trade embargo was lifted. Immediately following the lifting of the trade embargo, Du Pont and

Box II.5. The ASEAN Free Trade Area and foreign direct investment

The ASEAN Free Trade Area (AFTA), launched in January 1993, was formed with a view to strengthening regional cooperation by way of further enhancing liberalization of regional markets and, at the same time, establishing a level playing field for FDI to avoid mutual competition among member countries. Market liberalization policies, as well as policies emphasizing macroeconomic stabilization and the development of human resources, have enabled ASEAN countries — which constitute the core of AFTA — to grow at rates of 6 to 12 per cent in recent years (with the exception of the Philippines). Flows of FDI, by enhancing the industrialization process, have contributed to the rapid economic growth. Accordingly, intra-ASEAN trade has expanded, giving rise to mutually complementary and dependent relationships in manufacturing.

The principal provisions of AFTA are:

- An agreement on a Common Effective Preferential Tariffs (CEPT) scheme (normal track), which aims at reducing intra-regional industrial tariffs to below 5 per cent within 15 years, between 1 January 1993 and 1 January 2008. The ASEAN Free Trade Area does not adopt common tariffs for extraregional countries. This agreement covers all industrial goods, including capital goods and processed agricultural products. Over 40 per cent of the value-added must be produced in the region. Exemptions are admitted for sensitive commodities, and restrictions on volume and non-tariff barriers for CEPT commodities are to be abolished.
- An agreement on CEPT (fast track): a "fast track" tariff reduction programme, which enables accelerated reductions, if agreed upon by more than two members. It applies to fifteen categories of goods; tariffs must be reduced to below 5 per cent within 10 years. The implementation schedules are shown in the accompanying table.

The *raison d'être* for the formation of AFTA springs from the recent closer economic tie-ups among the member countries and, in particular, the trade-FDI link within the region. The trade-FDI link in East Asia — induced in the 1980s through the initiative of Japanese TNCs through expanded FDI — is reaching a stage in which it is being further strengthened by FDI from the newly industrializing economies, thereby stimulating further economic integration in the region. Moreover, the recent burst in intraregional FDI can be expected to deepen further existing intraregional networks in the 1990s (Braga and Bannister, 1994).

Thus, the impact of AFTA on the strategies of TNCs can be significant. Transnational corporations can become more competitive by purchasing and producing within the region, taking advantage of low tariffs, rather than importing finished products from outside the region. As a result, they are likely to rationalize production in various countries in the region, establishing intraregional networks of specialization to procure parts and raw materials. Some corporate groups have already such networks, others are planning to establish them. For example, Japanese automotive manufacturers, such as Toyota, Nissan, Mitsubishi and Mazda (which were compelled to establish production bases in ASEAN countries), have begun to seek ways to foster a complimentary network of parts based on the Brand-to-

other major United States TNCs opened offices in Viet Nam. This removal of restrictions to trade and investment will, almost certainly, induce a further spurt of investment in Viet Nam from the United States.

Except for China and Viet Nam and, to a much lesser extent, Lao People's Democratic Republic, other economies in Asia that have liberalized their FDI policies have not yet attracted significant amounts of FDI. Despite the adoption of a joint venture law in 1984 and the development of the Rajin-Sonbong free economic zone targeting foreign investors, the Democratic People's Republic of Korea has attracted meagre amounts of FDI ($43 million in 1992).[51] Mongolia introduced its foreign investment law only in 1990, extending permission of investments to firms from developed countries (JETRO, 1993b, p. 250). In 1992, full foreign ownership was permitted in mineral resources. Despite that, mineral-rich Mongolia has been able to attract few investments in natural resources (oil, gas and gold mining), with the Russian Federation and China being the

Brand Complementation scheme launched in ASEAN countries in 1988, whereby firms can increase regional purchasing of parts and materials. Toyota introduced this scheme already in 1989, giving its Singapore subsidiary the role to coordinate procurement among the four supplying bases in, respectively, Thailand, Malaysia, the Philippines and Indonesia (UNCTAD-DTCI, 1993a, p. 138). The formation of similar intraregional networks by other firms can be expected to further reinforce the trade-FDI link.

Table 1. Implementation dates for common effective preferential tariffs
(Year and percentage)

Country	*"Fast-track" products*		*"Normal-track" products*	
	Current tariffs			
	Above 20 per cent	20 per cent and below	Above 20 per cent	20 per cent and below
Indonesia	1995	1993	1998	1993
Malaysia [a]	1993	1993	1993	1993
Philippines	1996	1993	1996	1996
Singapore [a]	1993	1993	..	1993
Thailand	1993	1993	1993	1996

Source: based on Japan, Ministry of International Trade and Industry.

a Singapore and Malaysia were the only countries that implemented CEPT on schedule; later in 1993 it was agreed that the first tariff reduction would be implemented simultaneously among all member countries from January 1994.

The total GNP of East Asia, including Japan, was about $4 trillion at the beginning of the 1990s, and it is projected to reach $6 trillion by 2015, surpassing the current GNP of the United States and the European Union. The integration scheme is likely to stimulate further growth in East Asia; as a result, FDI targeting such a market will increase. In particular, it is very likely that additional Japanese FDI will be attracted, especially if the yen appreciates further. Moreover, a probable increase in outward FDI by countries such as the Republic of Korea and Taiwan Province of China, losing their comparative advantages in labour-intensive goods due to an appreciation of their currencies and rising labour costs, may contribute to increasing FDI in East Asia.

Source: based on an input by the Japan Institute for Overseas Investment.

largest source countries. By 1992, FDI in Mongolia amounted to a total of $17 million. While all of these countries are eager to receive greater inflows of FDI, low per capita incomes, inadequate physical infrastructure, an underdeveloped financial system (including inconvertible domestic currencies) and inexperience in doing business with TNCs have contributed to the slow growth of investment.

Foreign-direct-investment flows into Western Asia started recovering from the adverse impact of the Gulf war. They increased by 48 per cent in 1992, reaching a record level of nearly $750 million. The flows are unevenly distributed between the countries of the region. Three quarters of the inflows were in oil-exporting countries. Saudi Arabia accounted for 70 per cent of flows into the oil-exporting countries and Cyprus accounted for 54 per cent of flows into the non-oil exporters. Many of the countries of this region receive insignificant amounts of FDI flows given their absorption potential determined by the size of their domestic market and their relatively high

Box II.6. Liberalization and foreign direct investment in India

The liberalization of the macroeconomic environment in India aiming at restructuring its domestic economy, reducing the fiscal deficit and increasing industrial competitiveness was accompanied by the liberalization of regulations on FDI. The first liberalization introduced in July 1991 provided automatic approval of FDI project proposals with up to 51 per cent foreign equity ownership in 34 priority industries. At the same time, local-content regulations were withdrawn. In 1992, and again in 1993, a series of proposals were made to dismantle more barriers to FDI, such as restrictions on the use of foreign brand names and trade marks and on participation in mining of thirteen minerals. In January 1993, the Foreign Exchange Regulation Act was amended to remove restrictions on foreign-owned enterprises and accord them national treatment. Full ownership was allowed for foreign firms on a case-by-case basis. Foreign participation was allowed in building, maintaining and operating certain highways and bridges on a toll-collection basis, as well as in operating telephone service networks in the country.[a] Foreign investors have freedom of repatriation of earnings, as well as repatriation of divested capital.

The policy on foreign technology agreements was also liberalized. Agreements involving less than 5 per cent royalty on domestic sales, 8 per cent royalty on exports and lump-sum payments up to 10 million rupees are now automatically approved by the Reserve Bank of India. To complement the relaxation of investment rules, import duties were lowered to 85 per cent for general goods and to 35 per cent for capital goods, and the rupee on the trade account became convertible in 1994. An array of tax holidays and capital-gains concessions was also implemented to attract FDI, especially in the energy sector that was opened to foreign firms in 1992. Taking advantage of the liberalized policies, several TNCs (e.g., Pepsi Cola, Nestlé, Suzuki and Colgate Palmolive) are increasing their stakes in their existing affiliates in India to 51 per cent from 40 per cent or less. Exxon, IBM and Coca Cola are examples of TNCs that disinvested from India following the Foreign Exchange Regulation Act of 1977, but have returned to take advantage of the sizeable domestic market.[b]

Table 1. Approved and actual foreign-direct-investment flows into India

(Millions of dollars)

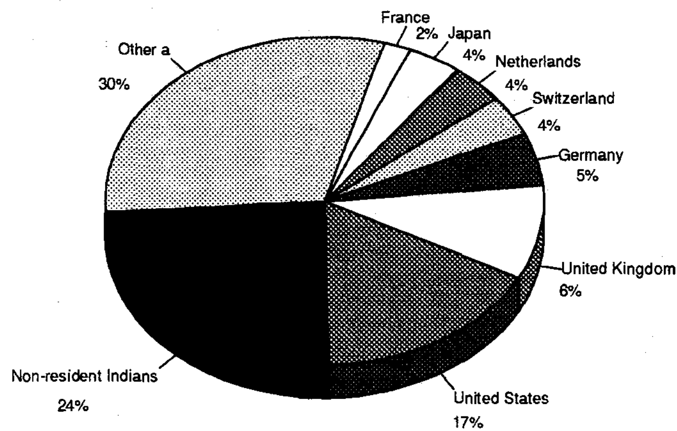
Year	*Approved*	*Actual*
1990	73	..
1991	171	113
1992	1255	220
1993	2858	577
1994 a	265	..

Sources: Consulate General of India, Frankfurt, Germany and The Secretariat of Industrial Approvals, The Government of India; India, Ministry of industry, *SIA Newsletter*, March 1994.

a First two months.

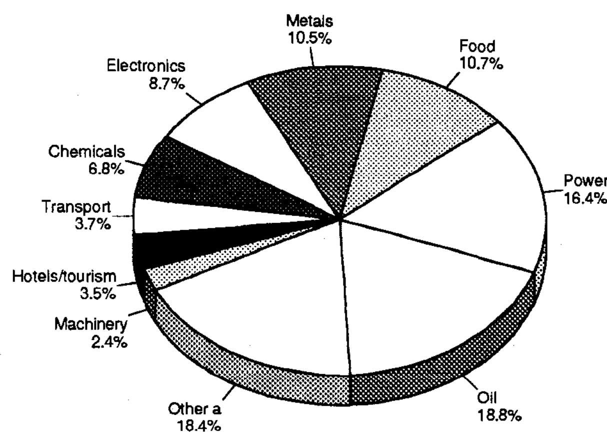
Approved and actual flows of investment reported by the Government of India indicate substantial increases during the period 1992-1993 (table 1). Actual flows are expected to rise to $2 billion by 1995, if the current rate of growth of these investments is to continue. The extent of realization of approved FDI in India in recent years reflects in part the sectoral composition of these investments; it is heavily skewed towards the power (electricity generation) and hydrocarbon (essentially petroleum refining) industries that accounted for 40-45 per cent of the approved investments: FDI in these industries is yet to materialize because of the length of the gestation period involved. The United States was the largest investor, accounting for 17 per cent of all actual investments during the period from 1991 until January 1994, followed by the United Kingdom and Germany with substantially smaller shares (figure 1). Non-resident Indians from different countries accounted for 11 per cent of these investments.[c]

Figure 1. Geographical composition of cumulative foreign-direct-investment inflows, 1991-January 1994
(Percentage)



Source: Consulate General of India, Frankfurt, Germany.
a Including Hong Kong (1 per cent), Singapore (1 per cent) and Sweden (1 per cent).

Figure 2. Industrial composition of foreign-direct-investment approvals, August 1991-November 1993
(Percentage)



Source: Consulate General of India, Frankfurt, Germany.
a Includes glass and ceramics, paper and pulp, telecommunications, and services and trade.

Infrastructure industries — power and telecommunications — and hydrocarbon are likely to continue to receive major investments for some years, not just because of their sheer size and because they represent newly opened areas to foreign firms, but also because the Government strongly welcomes such investments.[d] In the manufacturing sector, food processing, electronic parts, chemicals, industrial machinery, transport and machinery are the major industries that attract FDI (figure 2). In the services sector, FDI is concentrated in the development of computer software and financial industries. In early 1993, there were 25 software centres located just outside Bangalore.[e] These centres principally act as offshore maintenance facilities to service computer software for companies throughout the world. The main factors drawing FDI into Bangalore are relatively low salaries, the availability of qualified software engineers and the increasing ease of communications. Between 1985 and 1990, FDI in that industry has come from both large computer firms (e.g., Texas Instruments), as well as small joint ventures (e.g., Verifone).

The introduction of financial deregulation renewed foreign interest in Indian financial services. Since the beginning of 1993, banks have been allowed to set their own interest rates on loans of more than about $6,400. In addition, the private sector has also been permitted to provide more banking services and to operate mutual funds. These changes have resulted in a great deal of activity to establish joint financial ventures. For example, GE Capital, a unit of United States-based General Electric Company, signed a joint venture agreement with the Housing Development Finance Corporation to establish a consumer finance unit; and Asian Capital Partners (Hong Kong) has arrangements with the Industrial Development Bank of India for investment banking. Other joint financial ventures have been concluded for diversified financial services, fund management and for currency management.[f]

The process of economic liberalization in India has made great strides since 1991. Yet, there are still further adjustments required to provide support to the macroeconomic restructuring efforts and to make conditions for investment, both domestic and foreign, more attractive. A survey of the investment perceptions of 16 leading TNCs cited an array of difficulties in operating in India.[g] The complex web of regulatory controls and bureaucratic interventions is of particular concern. The lack of adequate infrastructure, particularly power, telecommunications and transportation, is also regarded as a major constraint. There is, however, strong support in the international investor community for the current direction of India's macroeconomic policy.

In terms of future policies affecting FDI, the Government has indicated that it would consider lowering corporate taxes and import duties, introduce a value-added tax, further deregulate banks and capital markets and open the nationalized insurance industry to foreign investors. The establishment and implementation of policies aimed at greater market efficiency is critical for encouraging both domestic and foreign investment in India. Complementary policies for the development of agriculture, the provision of social welfare nets for displaced labour and other similar measures are also important.[h]

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a Kumar (forthcoming); "India opens phone business to private firms", *International Herald Tribune*, 14-15 April 1994.

b IBM has a joint venture with the Tata group and Coca Cola has taken over Parle, a domestic beverages producer.

c India, Ministry of Industry, *SIA Newsletter*, March 1994.

d As was stated in the budget speech by the Finance Minister on 29 February 1992: "A policy to encourage private investment, including foreign investment, in the power sector has already been announced.... The Government will welcome proposals for private investment, including foreign investment, in production, refining and marketing of oil and gas...." (paragraph 21).

e In February 1994, the establishment of the Information Technology Park in Bangalore was announced aimed at providing facilities to companies, including TNCs wishing to set up operations there.

f *The Asian Wall Street Journal*, 7 September 1993.

g The Economist Intelligence Unit, *India Supplement* (London, 1993).

h "The money juggernaut", *Far Eastern Economic Review*, 11 March 1993.

per capita income. Developing countries with markets of similar size or at a similar level of development typically attract larger FDI flows.

(b) Latin America and the Caribbean

Latin America and the Caribbean continued to attract increasing flows of FDI in the 1990s, after a period during the mid-1980s when investment inflows had virtually dried up and, what little arrived, was generally obtained only at the cost of substantial incentives.[52] The revival of external financial inflows, including FDI, to the region reflects not only economic recovery and the perception that the debt crisis is resolved, but also the abandonment of the import-substitution development model (Ramos, 1993) that had been central to Latin America's pattern of industrialization and had helped attract considerable FDI flows during the previous decades. The structural adjustment programmes carried out by most countries of the region promoting market-oriented reforms and an outward trade orientation contributed to the recovery of economic activity in general and FDI inflows in particular. Investment inflows to the region grew rapidly in the early 1990s, doubling their annual average level of 1986-1990 (tables II.10 and II.17).

The recovery of FDI flows to the region as a whole, until 1990, was to a significant extent due to FDI related to debt-equity swaps and after that year to privatization (table II.17) — both forms of FDI sometimes referred to as "subsidized" FDI.[53] Despite the fact that the role of FDI related to privatization in the total FDI inflows was much smaller in 1990-1992 than the rate of FDI related to debt-equity conversion in 1988-1990, the total inflows to the region continued to grow, thus making the shift from subsidized forms of FDI to its conventional forms. This process is most notably advanced in Chile (box II.7) and Mexico .

Some countries of the region are still in a process of transition from receiving FDI through debt-equity swaps and privatization to receiving more conventional investments. In Argentina subsidized FDI accounted for a large share of all investments in 1992 (49 per cent) and in 1993 (78 per cent). The increasing flows into Venezuela were initially largely fuelled by debt-equity conversions and, in 1991, when they augmented sharply, by privatizations. In that year, subsidized FDI accounted for 78 per cent of total inflows. In 1992, they plummeted, pulling down the total inflows to less than one-third of the 1991 level (table II.17). Other countries — Brazil, Colombia and Peru — have not yet benefited substantially from FDI flows related to privatization and debt-equity conversions. As regards the latter, Brazil has been an exception, especially during 1988-1989, when these conversions fuelled the inflows, accounting for almost three-quarters of the total. Recent flows to Brazil, based almost entirely on conventional FDI, have been small in comparison to the size of the economy and the past historical levels of FDI flows into that country.

The countries that succeeded in attracting considerable FDI flows did so especially in the services and natural-resources sectors in which privatization programmes were concentrated (UNCTAD-DTCI, 1994a). About $7 billion (or two-thirds) of the investments in Mexico during 1991-1992 went into services industries (telecommunications, tourism, financial and professional services).[54] Similarly, $1.1 billion of FDI flows into Argentina and $1.5 billion into Venezuela in the same period were in services, primarily in power-generation, telecommunication and transportation. In the primary sector, petroleum has been the largest recipient of FDI through privatization. The privatization of the State-owned petroleum company, YPF, and gas companies in Argentina and the auctioning of petroleum concessions to foreign investors produced the single largest FDI inflow (about $2-3 billion) during 1991-1992 in that country. In Colombia in 1992 alone, $440 million (or 56 per cent) of FDI flows went into petroleum, according to the National Planning Department. Investments in the Cusiana fields not only contributed to the recent increase in FDI flows, but will continue to do so in the future, as they are expected to reach $1.6 billion.[55] Copper and gold mining projects, often in joint ventures with the State-owned copper company,

Table II.17. Latin America and the Caribbean: foreign-direct-investment inflows by mode of investment, 1988-1993

(Millions of dollars)

Country/mode	*1988*	*1989*	*1990*	*1991*	*1992*	*1993* [a]	*Total 1988-1992*
Argentina (total)	1 147	1 028	1 836	2 439	4 179	3 300	10 629
Conventional FDI	807	869	- 80	1 586	2 112	732	5 294
Debt-equity conversion	340	159	815	-	-	-	1 314
Privatization	-	-	1 101	853 [b]	2 067 [b]	2 568	4 021
Brazil (total)	2 969	1 267	901	972	1 454	2000	7 563
Conventional FDI	882	321	618	850	1 359	..	4 030
Debt-equity conversion	2 087	946	283	68	95	..	3 479
Privatization	-	-	-	54	-	.	54
Chile (total)	937	1 291	604	523	705	841	4 060
Conventional FDI [c]	2	69	249	563	737	891	1 620
Debt-equity conversion	796	1 107	355	-40	- 32	- 50	2 186
Privatization [d]	139	115	-	-	-	-	254
Colombia (total)	203	576	500	457	790	850	2 526
Conventional FDI	203	576	500	405	790	..	2 474
Debt-equity conversion	-	-	-	-	-	-	-
Privatization	-	-	-	52	-	..	52
Mexico (total)	2 594	3 037	2 632	4 762	5 366	6 900	18 391
Conventional FDI	1 671	2 648	2 432	3 956	5 275	..	15 982
Debt-equity conversion	868	389	85	19	-	-	1 361
Privatization	55	-	115	787	91	..	1 048
Peru (total)	26	59	41	-7	127	200	246
Conventional FDI	26	59	41	-7	-13	..	106
Debt-equity conversion	-	-	-	-	-	-	-
Privatization	-	-	-	-	140	..	140
Venezuela (total)	89	213	451	1 916	629	256	3 298
Conventional FDI	39	30	148	161	545 [a]	256	923
Debt-equity conversion	50	183	303	256	70 [a]	-	862
Privatization	-	-	-	1 499	14 [a]	-	1 513
Total above (total)	8 055	7 685	7 052	11 102	13 282	14 356	47 176
Conventional FDI	3 630	4 572	3 908	7 514	10 805	..	30 429
Debt-equity conversion	4 231	2 998	1 928	343	165	..	9 665
Privatization	194	115	1 216	3 245	2 312	..	7 082
Latin America and the Caribbean [e]	9 040	6 248	8 647	15 032	17 711	..	53 335

Source: UNCTAD, Division on Transnational Corporations and Investment, based on Calderon, 1993b and data provided by ECLAC/UNCTAD Joint Unit on Transnational Corporations.

a Estimates by ECLAC/UNCTAD Joint Unit on Transnational Corporations.

b All debt-equity conversion activities in 1991-1992 were directly related to privatization.

c Corresponds to net inflows of FDI based on Decree Law No. 600 and Chapter XIV of the Central Bank foreign-exchange regulations.

d Mainly Chapter XIX operations. The IMF does not include those flows as FDI in its statistics as it considers them portfolio operations due to the nature of the exchange mechanism.

e The differences in total inflows between this table and table II.11 are mainly due to the inclusion of Bermuda here.

CODELCO accounted for the single largest portion of new FDI to Chile (about $1 billion); there has also been significant FDI involvement in cellulose projects (box II.7).

Investments in the manufacturing sector, which used to be the core of FDI activity in Latin America during the import-substitution period, were less dynamic with two major exceptions. The first concerns the adaptation of foreign affiliates already present in that region to the newly liberalized and more competitive domestic markets. Although the overall dimension of this phenomenon is still not clear, restructuring foreign affiliates that used to supply solely local markets, with the aim of making them internationally competitive, is becoming increasingly apparent, as TNCs alter their strategies to take into account the trade and investment liberalization in Latin America and the Caribbean. The clearest and most important example of that phenomenon is the automobile industry in Mexico (Mortimore, forthcoming; de María y Campos, 1992; UNCTC, 1992c) in which new investments in the order of $4 billion have been announced for the 1993-1995 period. Announcements of major investments by automobile manufacturers in Brazil and Argentina in the context of Protocol 21 of Mercosur suggest that the restructuring of that industry is taking a region-wide dimension.[56] The second major exception to the generally sluggish picture for FDI in the manufacturing sector concerns the *maquiladora* industry. The surge in FDI taking advantage of United States legislation that offers tax incentives for the use of export processing zones for materials originating in the United States has continued. These investments go not only to border industries in Mexico, but also to a number of small economies (Costa Rica, Dominican Republic (box II.8) and Jamaica). The principal investments in the *maquiladora* are in export-oriented activities in electric and electronic equipment, automobiles and clothing industries.

In sum, FDI flows to Latin America and the Caribbean have strongly increased, with investments — especially through debt-equity swaps — declining in importance. Except for Mexico and, to a lesser extent, perhaps Chile, privatization programmes remain an important tool for attracting investments. Flows, however, remain concentrated in a few countries and exhibit an industrial pattern stemming from the economic developments in the principal recipients; yet they all have in common an increased export orientation. Overall, with the exception of Mexico and, to a certain degree, Argentina, manufacturing has attracted less FDI. Inflows in the primary and tertiary sectors benefited greatly from privatization programmes. Within the framework of liberal FDI and trade policies, there may be greater scope to attract investments into the manufacturing sector. However, the specific experiences of Mexico, and perhaps Argentina, with privatization have left a significant imprint on the FDI profile of the region during the 1990s.

* * *

The new economic policies in Latin America and the Caribbean clearly rest on the conviction that the region's future depends on an improvement of its international competitiveness and its further integration into the world economy. The means of that integration include not only trade, but also external finance and, in particular, FDI. The liberalization of legislation relating to foreign capital flows has been a prominent aspect of the region's landscape for several years now. While this perspective is generally shared by virtually all governments of the region, strategies to integrate into the world economy vary appreciably, especially in respect to the geographical scope of such integration (global, inter-regional or intraregional), its sequence and speed.

Free trade agreements within the region exemplify intraregional efforts. Agreements with regional partners so far focus primarily on Mexico's participation in the North American Free Trade Agreement (NAFTA). With regard to the multilateral trade negotiations, virtually all countries of the region have arrived at the conclusion that an open and unencumbered internation-

Box II.7. The revival of conventional foreign capital flows into Chile

As of 1993, Chile had enjoyed a decade of solid economic growth, averaging 6 per cent per year. The successful economic performance stemmed not only from market-based economic reforms but also, in large part, from a sharp change in Chile's growth strategy towards export-oriented industrialization based on the country's abundant supply of natural resources. Exports as a percentage of gross domestic product rose from 29 per cent in 1985 to 37 per cent in 1993. Growth was concentrated in three new groups of export products: fish products, fruits and forestry products (notably, paper and cellulose). As regards fresh fruits, for example, their share in total exports rose to ten per cent by the late 1980s (from 1 per cent in the mid-1970s), with annual export revenues exceeding $500 million. Foreign direct investment, attracted in considerable amounts to traditional and new export industries by the effective debt-equity conversion scheme known as Chapter XIX (table 1), became one of the pillars of this export-based strategy. In case of fruits exports, of the five largest fruit companies accounting for about half of Chile's fruit exports, four are TNCs. Their knowledge of export markets and ability to penetrate them have been important ingredients in Chile's successful export drive.[a]

Table 1. Chile: long-term capital inflows, by type, 1980-1993

(Millions of dollars)

Type of flow	1980-1982[a]	1983-1985[a]	1986	1987	1988	1989	1990	1991	1992	1993
Foreign direct investment	332	136	372	1 127	937	1 291	604	523	705	841
Conventional FDI[b]	332	109	116	230	2	69	249	563	737	891
FDI from debt-equity conversion	-	27	256	786	796	1 107	355	- 40	- 32	- 50
FDI from privatization[c]	-	-	-	-	139	115	-	-	-	-
Portfolio investment	41	-	-	-	-	87	359	225	452	1 157
Bonds	41	-	-	-	-	-	-	200	120	324
Equity	-	-	-	-	-	87	359	25	332	833
Loans (net)	2 200	984	19	- 790	- 938	- 1 316	645	- 258	133	223
Credits linked to DL 600 projects	115	- 1	67	185	388	311	749	336	51	615
Total[d]	2 527	1 572	398	345	339	73	1 676	466	1 329	2 193

Source: UNCTAD/ECLAC Joint Unit on Transnational Corporations, based on data provided by the Banco Central de Chile.

a Annual average.

b Corresponds to net inflows of FDI based on Decree Law No. 600 and Chapter XIV of the Central Bank foreign exchange regulations.

c Mainly Chapter XIX operations. The IMF does not include these flows as FDI in its statistics as it considers them portfolio operations due to the nature of the exchange mechanism.

d Includes other mid- and long-term capital.

The prime examples of FDI in traditional export activities are the La Escondida and La Disputada de Las Condes copper-mining projects which accounted for a major proportion of FDI through the Decree Law No. 600, that is, the law for normal FDI, during the 1987-1990 period. Most FDI projects in the forestry, fruit and fishing sectors took place by way of the debt-equity conversions (Chapter XIX) which provided a varying degree of subsidy in respect of the secondary market price of Chilean external debt instruments. Debt-equity conversions financed important industrial projects, including cellulose, paper and derivative products. Forestry as a whole (including both investments in the acquisition of existing companies and the implementation of new projects in that sector) received more than 30 per cent of the total investment channelled by that mechanism. These conversions were decisive in increasing FDI inflows: over the period 1985-1990, they were responsible for more than 75 per cent of FDI in Chile, or around 55 per cent, if loans associated with the Decree Law No. 600 are included in the FDI total.[b]

Chapter XIX gained widespread acceptance because it provided an implicit subsidy, through discounts, estimated at 46 per cent of the investment (Ffrench-Davis, 1990; Mortimore, 1991; UNCTC, 1993, pp. 43-81), which was not available to the users of Decree Law No. 600. The broad international publicity that this mechanism achieved and a favourable climate for investors created in Chile stimulated renewed interest in this country. In 1991, after the sharp increase in the price of Chilean foreign debt in the secondary market the mechanism lost its attractiveness to foreign investors; since then, no debt-equity conversions have occurred.

Despite this, inflows of foreign capital did not decrease, because in the meantime Chile's access to foreign capital became more stable due to a diversification of instruments (to include especially portfolio equity investment) and the growth of normal FDI flows. This was, in turn, possible owing to a revival of economic growth and of the confidence of investors in the Chilean economy: it increased so much that the country has recently attained investment-grade status in international capital markets.[c] As to the near future, several large new mining projects, as well as the expansion of existing ones, are planned with TNCs.[d] They include: La Candelaria ($1.5 billion), El Abra ($1.2 billion), Zaldivar ($600 million) and Cerro Colorado ($500 million). Important cellulose projects — such as Celulosa Arauco y Constitución ($600 million) and Celulosa del Pacifico ($587 million) — will also play a role in stabilizing or even increasing FDI inflows.

Source: based on an input by UNCTAD/ECLAC Joint Unit on Transnational Corporations.

a See Rozas, 1992; Behrens, 1992.

b DL 600 loans were mainly used in large mining projects. The Chilean Foreign Investment Committee includes these associated loans in their FDI statistics.

c The Standard and Poor's risk classification, for example, places Chile in the BBB+ category — below some OECD member countries and the Asian newly industrializing economies, but above the rest of the countries in Latin America.

d See *AméricaEconomia*, Special Numbers, December 1992 and December 1993.

al trade, investment and financial system is of fundamental importance to their development objectives. The region has therefore supported strongly not only the Uruguay Round, but also greater trade liberalization in all its forms, especially that leading to increased access to the markets of developed countries. The best evidence of this new liberal policy is that the region has embarked on the liberalization of FDI and trade policies, often in a unilateral fashion, coupled with a strong export orientation. In particular, the trade-liberalization programmes of nine principal countries of the region between the mid- and late 1980s led to a reduction of average tariffs by half, from 20-40 per cent to 10-20 per cent; similarly, maximum tariffs and the number of tariff ranges declined steeply (Agosin and Ffrench-Davis, 1993, p. 44; Alam and Rajapatirana, 1993, p. 45).

Box II.8. Foreign direct investment in small economies: the export processing zones in the Dominican Republic

Export processing zones have emerged as an important tool for small countries to attract foreign investors and integrate themselves into the world economy. The Dominican Republic established its first export processing zone in 1969, but only since 1983 have those zones achieved significant growth, stimulated by a number of domestic and external factors. On the domestic scene, these factors included political and social stability, incentives to reactivate export processing zones and the depreciation of the national currency. External factors included mechanisms facilitating access to the United States market, such as the Caribbean Basin Initiative, the Generalized System of Preferences (GSP) and certain United States tariff and tax provisions:

- The Caribbean Basin Economic Recovery Act, in effect since 1 January 1984, provides for nonreciprocal duty-free (or reduced duty) entry into the United States for a wide range of Caribbean Basin products (excluding clothing) (USITC, 1992). The Act draws the attention of foreign investors to the Caribbean Basin countries as a location for export-oriented FDI. Textiles and apparel are covered by a "Special Access Program" within which the United States has negotiated bilateral agreements, since 1986, with several Caribbean Basin countries including the Dominican Republic. These articles qualify for preferential treatment provided, however, that the fabric originates from the United States.
- The Generalized System of Preferences provides non-reciprocal duty-free entry for eligible articles shipped directly from beneficiary countries, as long as at least 35 per cent of the value of the product is added in the beneficiary country. All Caribbean Basin Economic Recovery Act countries are also GSP beneficiaries. Despite several key differences between the Caribbean Basin Economic Recovery Act and the GSP, many products of the Caribbean Basin countries are eligible for duty-free entry under either of the two mechanisms.
- The Harmonized Tariff Schedule subheadings 9802.00.60 and 9802.00.80 are tariff provisions that provide reduced duties for certain United States products processed or assembled outside the United States (mostly textiles and apparel) and subsequently re-exported to that country (so-called "production sharing").
- The United States Internal Revenue Code grants certain incentives to increase United States investment in the Caribbean Basin. Section 936 of that code applies to the profits of affiliates of United States TNCs operating in Puerto Rico. Under that section, profits are exempt from Federal taxes as long as they are invested directly in eligible projects or retained in local financial institutions. Investors are allowed to borrow funds from financial institutions of Puerto Rico to finance projects in certain Caribbean countries.

Financing under Section 936 is done by one arm of Puerto Rico's Caribbean Development Program. The other major part of that Program is the promotion of production-sharing operations (twin plants). The administration of Puerto Rico encourages firms with operations in Puerto Rico to seek opportunities for sharing production between Puerto Rico and a twin-plant operation in a Caribbean Basin site. Because Puerto Rican wage rates are considerably higher than those in most Caribbean Basin countries, it is usually the labour-intensive portion of the operation that is relocated.

By June 1989, 18 export processing zones had been established in the Dominican Republic, 9 in Barbados, 9 in Costa Rica, 7 in Jamaica, 5 in the Honduras and 2 in Haiti. By the end of 1992, the number of export processing zones (public and private) that had been established in the Dominican Republic had increased to 27, involving a total of 404 enterprises (Consejo Nacional de Zonas Francas de Exportacion, 1993). Firms can also operate with a Special Free Zone Status that makes it possible for them to operate outside the zones (for example, agricultural enterprises).

Most FDI in the export processing zones in the Dominican Republic is in manufacturing. The growth of gross exports (rising from $0.2 billion in 1983 to $0.5 billion in 1988 and $1.2 billion in 1992) demonstrates that those zones can be very dynamic,[a] especially when considering that exports from non-export processing zones declined in the Dominican Republic during the period 1988-1992 from $0.9 billion to $0.6 billion (Banco Central de la Republica Dominicana, 1993).

Export processing zones have also contributed to the creation of a more diversified export base. In 1988, clothing represented 36 per cent of gross exports of these zones; switches and commutators, 16 per cent; tobacco, 10 per cent: footwear, 9 per cent; and pharmaceuticals, 7 per cent (Willmore, 1993). According to the Central Bank of the Dominican Republic, export processing zones generated $0.3 billion net foreign exchange earnings, representing 11 per cent of total foreign-exchange earnings ($2.6 billion). Traditional exports represented 9 per cent; mining, 8 per cent; and tourism, 42 per cent of total foreign-exchange earnings.

Firms operating in export processing zones are obliged to meet local expenses in foreign currency. Salaries account for more than 60 per cent of these expenditures, while the remainder covers local inputs, such as rent, electricity, water and raw materials (2-3 per cent) (Dauhajre-Hijo, Riley, Mena and Guerrero, 1989). Operating in export processing zones involves a number of advantages: low wage rates, duty-free imports of raw materials, 8-20 years tax holidays, a streamlined bureaucracy and an adequate transportation network. From the point of view of the Dominican Republic, apart from foreign-exchange earnings, the advantages include employment for 142,000 people, that is, about 6 per cent of all the jobs in a country with a workforce of 3 million where unemployment is in the order of 25 per cent (EIU, 1993).

The clothing industry alone accounts for more than two-thirds of the jobs and enterprises in the zones. Most of those enterprises were created with capital from the United States (54 per cent), followed by the Dominican Republic itself (22 per cent), the Republic of Korea (11 per cent) and Taiwan Province of China (3 per cent). The strong presence of United States firms is explained not only by the proximity of that country's market, but also by the abundance of cheap labour, which makes it possible to compete with East Asian countries. Transnational corporations from the Republic of Korea and Taiwan Province of China invest in these zones in order to take advantage of the quotas under the GSP. More than 90 per cent of export processing zone exports are destined for the United States (including Puerto Rico and the Virgin Islands), a process made possible by the various aforementioned trade and tax arrangements that the United States has established for the countries in the Caribbean Basin.

Export processing zones in the Dominican Republic have not enjoyed the same success as zones in countries, such as the Republic of Korea, Mauritius and Santa Lucia, when measured in terms of their contributions to the process of industrialization. There is little vertical integration between the activities in the zones and the local economy (Rhee, Katterbach and White, 1990), a phenomenon that has been observed in other export processing zones around the world. In the more successful cases, in this regard, the authorities allow indirect exporters to import material inputs duty-free and encourage domestic producers to supply the export processing factories (Willmore, 1993), as well as to sell a proportion of their output locally. In the Dominican Republic, drawback mechanisms do not exist and local sales are discouraged (subject to taxation and other restrictions), thereby limiting the impact of the export processing zones on the local economy.

The low value-added nature of production in export processing zones is also directly related to the use of the advantages provided by United States tariff-schedule provision HTS 9802.00.80. Under that provision, duties are applied on the full value of the imported product (assembled in foreign locations and containing United States-made components) minus the value of the United States made-components. As a result, enterprises operating in export processing zones have an incentive to minimize locally purchased inputs in labour-intensive industries. This constitutes a major impediment to increasing local value added and may limit the usefulness of export processing zones as stepping stones to higher stages of industrialization via the transfer of technology.

Source: based on an input by UNCTAD/ECLAC Joint Unit on Transnational Corporations.

a Gross export figures also include imported raw material and intermediate inputs that are required for assembly.

The strengthening of intraregional links (without restricting integration into the international market) has been based so far mainly on a grid of bilateral agreements (CEPAL, 1994a, p. 10). Thirty three agreements were concluded during 1985-1993; of these, twenty seven were approved and six are to be implemented in the period 1994-1998. While Colombia and Venezuela have concentrated more on agreements with their partners in the Andean Pact integration scheme, Mexico and Chile have agreements with a wide array of partners, including regional ones (in the case of NAFTA). As a result of multilateral tariff cuts and bilateral agreements, intraregional exports grew from 10 to 17 per cent of total exports between 1988 and 1992. Furthermore, intraregional FDI grew appreciably, admittedly from a narrow base (box II.9). Chilean investments in privatized power companies in Argentina were prominent elements of this new regional FDI.

The North American Free Trade Agreement is so far the only free trade agreement involving regional developed (United States and Canada) partners.[57] It has also the strongest provisions for the liberalization of FDI. Its negotiation provided a strong boost to FDI flows to Mexico during 1986-1992. As a result, that country emerged as the most important recipient of such inflows (after Bermuda) in Latin America and the Caribbean. Many TNCs have now incorporated Mexico into their international production systems. In fact, Mexican companies themselves have invested in the United States, most notably in the cement and glass industries.

Other Latin American countries, fearing that NAFTA could develop into a closed regional grouping, have manifested their interest in becoming party to that agreement. The prominent exception has been Brazil.[58] High in the priorities of those wishing to join is the desire to gain better access to the North American market and to obtain considerable FDI and especially export-oriented FDI. As an example of Mexico shows (UN-TCMD, 1992a, pp. 40-42) FDI can become the principal means to translate formal access into increased exports, if TNCs choose, within their new strategies in the large market, to locate their specialized affiliates supplying the whole market in the low-cost member of the integration scheme. By comparison, other Latin American integration schemes have not generated much in the way of new FDI. That has been evident in the case of the Andean Pact and also seems to be the case for Mercosur (Argentina, Brazil, Paraguay and Uruguay) scheduled to begin as a customs union in 1995. With the exception of automotive firms interested in taking advantage of the trade provisions of Protocol 21, little in the way of increased and sustained FDI has resulted from the Mercosur scheme itself.

In summary, the desire to attract FDI is the key factor behind the interest of Latin American and Caribbean countries in integrating with the North American market. While international liberalization measures, as well as intraregional trade agreements, are creating a more competitive environment, they have led so far only to small increases of investment inflows meant to serve international or intraregional markets. As regards the latter, however, trade liberalization has laid the foundation for a restructuring of previously domestic-market-oriented FDI in the direction of regionally-oriented corporate networks (e.g., the automobile industry in Brazil). Progress towards greater economic regional integration could, therefore, generate and attract greater amounts of FDI for the regional market and, in this manner, contribute to the economic growth and restructuring in Latin America and the Caribbean.

(c) *Africa*[59]

During the 1980s, most African countries have adopted, typically as part of structural adjustment programmes, national regulatory frameworks conducive to FDI. These permit profit repatriation and provide tax and other incentives to attract such investment. In addition, efforts to increase FDI inflows have included efforts to simplify the investment-approval process (e.g., by setting up "one-stop" investment centres), the establishment of investment-promotion institutions and the increased use of representative offices abroad to publicize investment opportuni-

Box II.9. Intra-regional foreign direct investment in Latin America

One of the new developments in worldwide FDI and TNC activities has been the growth of TNCs from developing countries (UN-TCMD, 1993c) that undertake investment in developed countries and, increasingly, in developing countries of the same region. So far, this development — to the extent that it was significant — was almost entirely centred on the newly industrializing economies of Asia and quite recently on China as both host and home country. These FDI in other developing countries of the region reached such dimensions that it started to break the FDI monopoly of TNCs from developed countries. It also fuelled the increase of the investment flows to developing countries in general.

Latin America hardly participated in this development until not long ago. Cases of FDI by Latin American firms were rare. Whatever existed was concentrated in few countries and industries. The flows originated mostly from Brazil, Mexico and Venezuela and went primarily to the United States. Venezuelan FDI went mainly to petroleum refining and associated activities. Mexican investment was concentrated in the glass (Vitro) and cement (CEMEX) industries. Brazilian investment was found mainly in the autoparts and clothing industries and in trading companies. *Intraregional* FDI flows have traditionally been even scarcer. Examples include Mexican investments in Central America,[a] Argentine companies, such as Bunge y Borg or Alpargatas, that have established affiliates in neighbouring countries, and Brazilian engineering and construction firms that have carried out important projects in other countries of the region (Peres, 1993 and CEPAL, 1994b).

As of the beginning of the 1990s, the economic recovery of several countries of the region has revived the propensity to invest abroad (Calderon, 1993b). A significant part of those investments is undertaken in other Latin American and Caribbean countries.

One of the developments that has encouraged an important surge in intraregional investment is the privatization of state companies. Some leading Latin American companies are taking advantage of privatization opportunities in other countries of the region. Outstanding among these was the purchase of 80 per cent of the Argentine company SOMISA by a consortium made up of the Argentine group TECHNIT, the Chilean company Compaña de Acero (CAP) and the Brazilian companies USIMINAS and VALE DO RIO DOCE. Another striking instance was the sale of the QUELLAVECO copper deposits in Peru, in December 1992, for $12 million, to the Chilean company MANTOS BLANCOS, which has promised to invest more than $500 million. Also noteworthy is the sale of Peru's national airline AEROPERU to the Mexican company AEROMEXICO for $54 million and of the Peruvian gas distribution company SOLGAS to the Chilean company LIPIGAS for $9 million.

Chile has become the most active Latin American country undertaking FDI in the region (Calderon, 1994). The very low and selective presence of Chilean companies in other countries until not long ago is evolving rapidly due to the liberalization of the relevant legislation in that country: by the end of 1993, the stock of the Chilean FDI in the region amounted to more than $1 billion.[b] Over half of this stock is concentrated in Argentina, where there are more than 50 companies owned by or linked to Chilean corporations. A large part of this stock was acquired in 1992 through the participation in the Argentine privatization programme. According to the Argentine Ministry of Economy, 60 per cent of the income from sales of public companies during 1992 came from foreign investors. Chilean investors played an important role in this process; accounting for 6 per cent of the total sales, they were surpassed only by Spain (15 per cent), the United States (12 per cent), Italy (9 per cent) and France (7 per cent).

Important purchases by Chilean firms include a majority participation in Servicios Electricos de Gran Buenos Aires (SEGBA), and Gas del Estado ($72 million) as well as the already mentioned minority participation in SOMISA ($150 million). The Chilean presence in Argentina also extends to the services sector, including control of supermarkets (Jumbo, Unicentro and Ekono-Almac). In 1993, Peru attracted the interest of Chilean investors. As in Argentina, the most interesting opportunities have been those linked to the privatization of public companies and the substantial changes brought about by the adoption of liberal policies, such as the recent implementation of a new scheme of private pension funds. Chilean pension-fund administration companies have been well placed to take advantage of the liberalization of pension funds abroad and outward FDI at home because, over the years, they required know-how, putting them in an advantageous position *vis-à-vis* Peruvian and Argentine administrators of such funds.

Although intraregional FDI in Latin America is still incipient, it is growing and involves new countries and extends to new industries. Chile, which emerged as a major new home country for regional investment, has also been a host country to $12 million of inflows in 1992 and $126 million of inflows in 1993 (until September) from Argentina (JETRO, 1994, p. 164). The flows of FDI between Colombia and Venezuela have reached impressive amounts: from Venezuela to Colombia $32 million in 1992 and from Colombia to Venezuela $39 million in the same year, increasing from a level of $0.4 million in 1991 and $26 million in 1990, respectively (JETRO, 1994, pp. 145-146). If the macroeconomic stability and economic growth of the region continue, it may well be that intraregional FDI will expand, approaching proportions that are similar to Asian intraregional FDI flows.

Source: Based on an input by UNCTAD/ECLAC Joint Unit on Transnational Corporations.

a "Las empresas globales de México", *Revista Expansión*, 589, 24 (México, D.F., 29 April 1992).

b In the early 1990s, the legislation concerning outward investment was liberalized permitting Chileans to invest abroad. As rapidly increasing supply of foreign currencies caused by the inflows of foreign capital including FDI exerted the upward pressure on the exchange rate of the national currency, an outward investment was seen as a mechanism softening this pressure.

ties. The reformist mood has been widespread and, at times, exhibited itself in quite rapid policy and legislative changes. For instance, between 1982 and 1987, about one half of all African countries either introduced or made adjustments to their investment codes or guidelines in order to attract more FDI. The end of the 1980s and the start of the 1990s also saw many other countries among the other half introduce new investment laws or amend the old ones. In addition, countries with a previous reputation of hostility to FDI, such as Ethiopia, Guinea and Mozambique, introduced new legislation offering a wide range of guarantees and opportunities for foreign investors. But even countries that have traditionally been regarded as being more open to FDI, such as Kenya and Zimbabwe, went out of their way to revise their regulatory frameworks to be more attractive.

Despite this widespread liberalization of FDI policies , FDI flows did not respond impressively. Although the total value of FDI flows into Africa nearly doubled from an annual average of $1.7 billion during 1981-1985, to an average of almost $3 billion during 1986-1990, that increase did not give rise to much optimism concerning prospects for FDI in that region, not only because these investments were concentrated in few countries, but also because they were quite modest when compared to FDI flows to other regions of the developing world: average annual FDI flows into Africa as a proportion of all inflows in developing countries declined between these two periods from 13 per cent to 11 per cent (table II.18). In addition, during the early 1990s, flows into many African countries stagnated, while those to other developing countries continued to increase. As a result, Africa's share declined further to 6 per cent by 1992, thus underlining the marginalization of that continent in relation to FDI, apart from its marginalization in relation to international trade (Shafaeddin, 1993).

Investment flows into Africa have been concentrated in — and therefore largely determined by — flows to the oil-exporting countries. These alone accounted for over four-fifths of flows into Africa during the first half of the 1980s. At the beginning of the 1990s, their share declined, but remained around 70 per cent of flows into that region (table II.18). Within the group of oil-exporting countries, inflows are concentrated in Egypt and Nigeria, which together absorbed between 36 per cent (in 1991) and 84 per cent (in 1981) of all flows into Africa, or between 52 per cent (in 1991) to 89 per cent, respectively, (in 1989) of those to the oil-exporting countries. The underlining trend is a decline in the importance of these two countries (based on annual average

flows), from 65 per cent in the first half of the 1980s to 40 per cent during 1991-1992. That decline reflected a reduction of flows into Egypt in the aftermath of the Gulf War by more than a half between the above-mentioned periods, and a recovery of flows to Angola, Libyan Arab Jamahiriya and Tunisia during the early 1990s. However, not all — and in some cases not even the majority — of FDI in these countries is undertaken in the petroleum industry. While investment flows to Angola in 1991 exceeded $600 million and went mostly to petroleum exploration and mining (Economic Commission for Africa, 1993a, p. 22) the majority of those to Nigeria went to manufacturing (annually between 52 and 63 per cent of the number of approved projects during 1989-1991) (UNCTAD, Ad Hoc Working Group on Investment and Financial Flows, 1994, p. 39).

Investment flows into Africa as a whole are still so small in size that they are easily subject to year-to-year fluctuations in response to changes in flows to few countries. The peak that FDI flows to Africa reached in 1989 — nearly $5 billion, or 18 per cent of total flows to developing countries — would wrongly suggest that Africa took part in the worldwide FDI boom during the second half of the 1980s. Around 90 per cent of the $2.1 billion increase in Africa's FDI inflows in 1989 were concentrated in two countries, Nigeria and Liberia; flows to them registered historic highs in 1989, not repeated after that year.

Investment flows into Africa have been weak compared to other developing countries because Africa as a whole does not compare favourably as regards the location-specific advantag-

Table II.18. Foreign-direct-investment flows into Africa, 1981-1992
(Billions of dollars and percentage)

Region/country	*1981-1985* *Annual average*	*1986-1990*	*1991*	*1992*
Africa	1.7	2.8	2.7	3.0
Africa's share in: (Per cent)				
All countries	3.4	1.8	1.7	1.9
Developing countries	12.9	11.4	7.0	5.9
Oil-exporting countries [a]	1.4	2.1	1.8	2.2
Egypt	0.7	1.1	0.3	0.5
Nigeria	0.4	0.7	0.7	0.9
Other countries	0.3	0.8 [b]	0.9	0.9
Share in Africa's total [c]: (Per cent)				
Oil-exporting countries	82.3	72.7	67.8	71.0
Egypt	40.6	37.7	9.3	15.1
Nigeria	23.6	25.5	26.3	29.5
Other countries	17.7	27.3 [b]	32.2	29.0

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994, and annex table 1.

a Algeria, Angola, Cameroon, Congo, Egypt, Gabon, Libyan Arab Jamahiriya, Nigeria and Tunisia.

b Figure is inflated by unusually high investment in Liberia in 1988-1990 ($290 million, $656 million, and $225 million, respectively), most likely in flags-of-convenience facilities. Inflows to "other Africa" net of Liberia were as follows: 1988, $407 million; 1989, $714 million; 1990, $695 million.

c Figures may not add to total because of rounding.

es that it offers. In addition, a number of factors that favoured an increase of FDI to other developing countries, such as privatization programmes and debt-equity swaps, play only a limited role in Africa (table I.13).

A number of basic factors influence the investment climate in Africa for foreign as well as domestic investors:

- Continuing civil conflicts, political crises and natural disasters (especially drought) are obviously not conducive to investment. The group of countries affected by these circumstances is quite large. At least five countries remain mired in conflicts: Angola, Liberia, Rwanda, Somalia and Sudan. Another group of countries is emerging from prolonged periods of conflict: Chad, Eritrea, Ethiopia, Mozambique and Uganda. Countries recently affected by drought include Algeria, Libyan Arab Jamahiriya, Morocco, Tunisia and Zimbabwe. Last but not least, strikes and protests against unpaid wages and stipends or against economic policies were organized in 1992 in about a dozen countries (Economic Commission for Africa, 1993b; United Nations, 1993, pp. 41-45). Most of the countries afflicted by wars as well as social or political conflict have received virtually no new FDI or have experienced prolonged periods of disinvestment. Notable exceptions include Angola which was able to attract quite considerable FDI inflows during 1991-1992.
- Domestic markets are typically relatively small. Most economies in sub-Saharan Africa have an average GDP of $3.5 billion (or $340 per capita) while North African economies have an average GDP of $25 billion (or $1,120 per capita) (Economic Commission for Africa, 1993b; United Nations, 1993, pp. 41-45). Attempts to address this problem through regional integration schemes have either collapsed or proved ineffective in terms of affecting intraregional trade and creating larger economic areas.
- Growth rates are substantially lower compared to other developing countries and even declining (e.g., in 1991, 1.9 per cent; in 1992, 2.1 per cent; and in 1993, 0.1 per cent) (table II.12). The lack of dynamism prolongs the problem of the small size of domestic markets.
- Poor, and in many cases deteriorating, physical infrastructure, especially in telecommunication and transportation, and the lack of capital to improve it, act as a disincentive to FDI. Added to that are often inadequate institutional and financial infrastructures, such as banking and financial institutions.
- The high level of indebtedness continues to make the debt of many African countries difficult to manage. The debt problem is aggravated by balance-of-payments difficulties caused in particular by the sharp decline of commodity prices. Therefore, a number of African countries suffer chronically from foreign exchange shortages. This makes it very difficult to guarantee that FDI income and profits can be repatriated — a key aspect of a favourable investment climate.
- Slow progress in a number of countries in introducing market- and private sector-oriented economic reforms undertaken within the framework of structural adjustment programmes hinder FDI.
- Lack of or low level of skills and general technological capabilities, combined with relatively high production costs inhibit FDI. By the mid-1980s, costs of production in sub-Saharan Africa were frequently as much as twice as high as those in low-income countries in Asia. For example, the cost of rail transport was 2.8 times higher, and wages of unskilled workers in the construction industry 1.4 times higher in sub-Saharan Africa than those of low-income countries in Asia (World Bank, 1989, table I.1, p. 27). Since productivity levels in Africa were generally lower than in low-income Asian countries, high production costs further weakened the attractiveness of Africa as an investment location. In the early 1990s,

however, many African countries regained their attractiveness in this respect after a series of devaluations of their currencies.

In clear distinction from Africa as a whole, and a sizeable group of countries afflicted by a few or several of these adverse factors, stands a small group of countries that has done well in terms of attracting FDI flows. Table II.19 shows, in addition to the ranking of the largest host countries in Africa by the *absolute* size of FDI inflows, rankings by the *relative* size of inflows (per capita and per unit of GDP) and by increases of inflows (between the second half of the 1980s and the early 1990s and during the 1980s). The ranking of countries by the absolute size of inflows produces an expected outcome: during the early 1990s, five out of the six largest host countries were oil-exporting, led by Nigeria. The only exception in this group is Morocco, one of a handful of African countries experiencing a continuous increase of flows during the three periods under consideration. Other measures produce a group of smaller non-oil exporting countries that have been able to attract FDI inflows in quantities that are large relative to the size of their populations or their economies, or which have distinguished themselves by very rapid growth rates for a number of years. Some of these countries are the least developed countries. For example, $21 million of annual flows does not bring the Seychelles even close to the list of the largest host countries in *absolute* terms; but these flows represent $302 of flows per capita and $84 per $1,000 of GDP, which gives this country the lead (together with Equatorial Guinea), among the host countries ranked by the *relative* importance of FDI.

In terms of attracting relatively significant and/or growing amounts of FDI, Botswana, Côte d'Ivoire, Morocco, Namibia, Swaziland and Zambia fared particularly well during the 1980s and early 1990s (table II.19). A number of countries on the list of countries with increasing flows (Ghana, Senegal, Swaziland and Tunisia) experienced a serious decline during the mid-1980s (leading to negative flows for Senegal and Swaziland). For them, the fast growth of inflows at the end of the 1980s and the beginning of 1990s is merely a revival of the lost dynamism of flows from the beginning of the 1980s. A case in point is Ghana where FDI was strongly curtailed from $16 million annually during 1980-1982 to $2-5 million in the mid-1980s, likely in response to an investment climate that was perceived as negative, but subsequently revived as the country undertook efforts to improve it.

While oil and other natural resources have been a major factor in attracting FDI to a few of these countries (e.g., Angola, Namibia and recently Equatorial Guinea), many others — in addition to having the fundamental factors right — have been able to use specific locational and other advantages to boost their attractiveness. For example, Lesotho and Swaziland benefited particularly from their special status as members of a common monetary area, with potential as a base for exporting both to the region (as members of the Preferential Trade Area) and the European Union (as signatories to the Lomé Convention). Mauritius has particularly benefited from FDI by firms based in Hong Kong seeking to export to Europe and elsewhere. Capitalizing on its success, the island is seeking foreign investors in banking and finance, with a view to becoming an offshore financial centre and to diversify the sources of its FDI inflows. Morocco and the Seychelles benefited from very large investments in the tourism industry. Morocco has been trying to make the most of its economic achievements, cheap labour and closeness to Europe by establishing a low-cost manufacturing base for exports to the European Union.[60] Kenya — among the top ten in the growth list during the 1980s — derived significant benefit from a high level of re-investment of corporate earnings at a time when foreign exchange controls were a constraint on the transfer of dividends and management fees. Botswana is an example — not frequent among African countries with similar characteristics — of a country that, over the years, has been successful in using FDI for the development of its natural resources and its transformation from a low-income country into a middle-income one (UNCTAD-DTCI, 1993a, pp. 66-67). These country-specific factors most likely have been more important in attracting FDI — especially

Table II.19. The largest host countries to foreign-direct-investment inflows into Africa, various measures

Size of inflows[a] *(Millions of dollars)*		*Inflows per capita*[b] *(Dollars)*		*Inflows per $1000 of GDP*[c] *(Dollars)*		*Increase in inflows, early 1990s*[d f] *(Per cent)*		*Increase in inflows during the 1980s*[e f] *(Per cent)*	
Nigeria	805	Seychelles	302	Equatorial Guinea	206	Benin	1 335	Comoros	9 913
Angola	476	Equatorial Guinea	88	Seychelles	84	Namibia	1 055	Guinea	2 270
Morocco	372	Swaziland	60	Swaziland	64	Libyan Arab Jamahiriya	866	Liberia	1 049
Egypt	356	Namibia	56	Angola	61	Angola	582	Mozambique	1 038
Tunisia	252	Angola	52	Namibia	39	Mozambique	382	Gambia	661
Libyan Arab Jamahiriya	170	Botswana	41	Sierra Leone	37	Morocco	289	Mauritius	636
Namibia	81	Libyan Arab Jamahiriya	37	Gambia	33	Tunisia	241	Swaziland	604
Botswana	51	Tunisia	31	Nigeria	25	Ghana	143	Sierra Leone	518
Swaziland	45	Mauritius	16	Tunisia	20	Gambia	134	Zambia	486
Côte d'Ivoire	21	Morocco	15	Botswana	19	Algeria	60	Madagascar	394

Source: UNCTAD, Division on Transnational Corporations and Investment, based on annex table 1 and UNCTAD, 1993c, table 6.1, pp. 432-433.

a 1991-1992 annual average.

b 1991-1992 annual average by 1990 population.

c 1991-1992 annual average by 1990 GDP.

d Increase in annual average between 1986-1990 and 1991-1992.

e Increase in annual average between 1981-1985 and 1986-1990.

f Excluding countries with negative flows (disinvestment) in 1981-1985 or 1986-1990, i.e., that have a "minus" denominator.

during the 1980s — than fiscal and legislative reforms, since, of these countries, only two (Lesotho and Mauritius) had introduced specific incentive regimes by 1989.

The success of these countries demonstrates that it is wrong to assume that Africa as a whole is an inhospitable FDI location. Rather, differentiating analyses are required to determine the specific locational advantages that individual countries have and that can become the basis for a mutually beneficial relationship between TNCs willing to explore investment opportunities and governments prepared to do whatever is in their power to create a favourable investment climate. At the same time, external assistance, particularily offered development assistance, will remain crucial to help create the basis for self-sustained growth and an FDI-friendly environment (UNCTAD, 1993a).

Conclusions

Foreign-direct-investment flows into developing countries grew rapidly in the 1990s, but these flows remain unevenly distributed among developing regions and countries. The fastest growth in these flows in the 1990s occurred in China. Other Asian countries with rapidly growing economies and a well-trained, relatively low-paid labour force have been the main recipients of

investment flows. Countries with improved macroeconomic performances and privatization schemes under way, allowing foreign investors' participation, accounted for much of the growth of FDI into Latin America. Most African countries, in particular the least developed countries in that region, with low growth rates, small markets, unstable economic or political conditions, unresolved debt overhangs, few economically viable public enterprises to privatize and lacking a skilled, even if low-paid, workforce, have seen their FDI flows, already at low levels, decline or stagnate.

C. Central and Eastern Europe

Introduction

Since 1989, the countries in Central and Eastern Europe — which, by convention, also includes the Republics that comprised the former Soviet Union in Asia[61] — have embarked, one after another, on a process aimed at transforming their centrally planned economies into market economies. As part of this process, all countries have opened up their economies to FDI, albeit in varying degrees. Their policies towards FDI were triggered by their capital needs (a number of them lacked easy access to international capital markets due to their sizeable foreign debts), and, in particular, the expectations they had concerning the role that FDI — and the technology, trade, management practices and training associated with it — can play in economic development (Csaki, 1992). These expectations were reinforced by international organizations which even considered FDI "crucial in the transition" (International Monetary Fund, World Bank, OECD and EBRD, 1991, p. 75) and further fuelled by the economic crisis which has been aggravated by the "transformational depression" (Szamuely, 1993). This section addresses the question of how far these expectations have been met.

1. Foreign-direct-investment trends

(a) Inflows

Investment inflows did, indeed, increase rapidly, but from an almost zero base. In 1991, total FDI inflows amounted to $2.6 billion, to reach $4.6 billion in 1992 and an estimated $5 billion in 1993 (comparable with $5 billion inflows to Mexico alone in the same year, table II.20). (By comparison, FDI flows into developing countries increased from $39 billion in 1991 to $80 billion in 1993.) As of 1 January 1994, cumulated FDI stock amounted to an estimated $13 billion. This stock was invested in an estimated 50,000 foreign affiliates. Based on committed (but not actually implemented) FDI projects, the total inward stock would amount to some $19 billion in some 100,000 foreign affiliates (tables II.21).[62] The difference between registered and operational foreign affiliates is partially due to the fact that many registered foreign projects are implemented very cautiously due to uncertainties regarding the domestic economic and political environment. Not surprisingly so, the ratio of operational to registered FDI projects was the highest in Hungary (80 per cent) and the lowest in Belarus (30 per cent) (OECD, 1992a, p. 77).[63] During the period between 1 October 1991 and 31 March 1993, greenfield investments accounted for less than 10 per cent of the total FDI funds announced or actually invested, or both (table II.22).[64] The average size of foreign affiliates in the region is small. While affiliates in developed countries average $18 million in invested foreign equity capital and developing country affiliates average $4 million, foreign affiliates established in Central and Eastern Europe have an average investment of $260,000. In Hungary, only 4 per cent of the projects involving foreign investors had investments exceeding $1 million. In Romania, 95 per cent of FDI projects had foreign capital of less than $50,000 (OECD,

Table II.20. Foreign-direct-investment inflows in Central and Eastern Europe, 1990-1993

(Millions of dollars)

Country	1990	1991	1992	1992 Total stock [a]	1992 Per cent	1993
Albania	..	-1	1	-	-	..
Belarus	..	..	7	7	0.1	..
Bulgaria	4	56	42	102	1.2	..
Former Czechoslovakia	207	600	1 103	2 167 [b]	26.4	..
Estonia	..	..	58	58	0.7	..
Hungary	..	1 462	1 479	2 944 [b]	35.9	832 [c]
Kazakhstan	..	..	100	100	1.2	..
Latvia	..	..	14	14	0.2	..
Lithuania	..	..	10	10	0.1	..
Moldova, Republic of	..	..	17	17	0.2	..
Poland	89	291	678	1 289 [b]	15.7	29 [d]
Romania	..	40	77	117	1.4	..
Russian Federation	..	..	700	700	8.5	..
Ukraine	..	..	200	200	2.4	..
Uzbekistan	..	..	40	40	0.5	..
Former Yugoslavia [e]	67	119	64	439 [b]	5.4	..
Total	367	2 567	4 590	8 204 [b]	100.0	5 000 [f]

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994 and annex tables 1 and 3.

a Estimated as cumulative inflows.

b Includes FDI prior to 1990 (in the former Czechoslovakia, $257 million, in Poland, $231 million, in the former Yugoslavia, $189 million; and in Hungary, $3 million).

c Until third quarter of 1993.

d Until first quarter of 1993.

e Also included in developing countries.

f Based on preliminary estimates.

1992a). Thus, the total amounts of investment capital that have actually flowed to the region are quite limited.

This distribution of flows within the region has been highly uneven. Inward FDI stock is heavily concentrated in the former Czechoslovakia (mostly in the Czech Republic), Hungary and Poland. As of 1 January 1993, these countries alone accounted for more than three-fourths of the FDI stock in that region; the Russian Federation accounted for less than one-tenth (table II.20). The implication is that large parts of the region have not (or barely) been touched by FDI and, hence, cannot count on it for the transition process. In part, this reflects the divergence in economic performance and progress in reform, with the Czech Republic, Hungary and Poland having made the most progress in transforming their economies.

Table II.21. Cumulative foreign-direct-investment registrations in Central and Eastern Europe, 1991-1993

(Number of cases, millions of dollars and percentage)

	1991		1992		1993		
Country	*Number*	*Millions of dollars*	*Number*	*Millions of dollars*	*Number*	*Millions of dollars*	*Per cent*
Bulgaria	900	130.0	1 200	170.0	2 300	200.0	1.0
Former Czechoslovakia	4 000	1 076.0	-	-	-	-	-
Czech Republic	-	-	3 120	1 573.5	5 000	2 053.0	10.6
Slovakia	-	-	2 875	231.2	4 350	380.0	2.0
Hungary	9 117	3 137.0	17 182	3 680.0	21 468	6 005.7	30.8
Poland	5 583	479.5	5 740	1 545.6	6 800	2 100.0	10.8
Romania	8 022	268.7	20 684	539.8	29 115	755.0	3.9
Former Soviet Union	4 206	4 462.2	15 300	5 566.5	27 200	6 800.0	34.9
Commonwealth of Independent States	2 593	4300.0	8 007	5 250.0	17 200	6 300.0	32.3
Russian Federation	2 022	2 827.4	3 252	2 850.0	7 989	3 153.2	16.2
Ukraine	400	440.0	2 000	480.0	2 800	600.0	3.1
Belarus	283	..	714	265.5	1 250	340.0	1.7
Estonia	1 100	84.2	2 662	142.0	4 150	220.0	1.1
Latvia	295	45.0	2 621	84.5	2 850	150.0	0.8
Lithuania	220	33.0	2 000	90.0	3 000	140.0	0.7
Former Yugoslavia [a]	..	..	..	..	..	..	..
Slovenia	1 000	650.0	2 815	962.2	3 300	1 200.0	6.2
Total	32 828	10 203.4	68 916	14 268.8	99 533	19 493.7	100.0

Sources: Economic Commission for Europe, 1993a and 1994.

a Also included in developing countries.

To the extent that the countries of the region have benefited from FDI, it is primarily through linkages with Western European firms, with Japanese firms — among the leading investors worldwide — playing a conspicuously low role. According to data of the Economic Commission for Europe (that include also committed FDI), the countries of Western Europe were responsible for 92 per cent of FDI in Slovenia, 78 per cent in Hungary and Estonia, 45 per cent in Lithuania and 35 per cent in Belarus. The members of the European Union as a group (in particular, Germany, Italy and the United Kingdom) were the dominant investors in Hungary, Poland, Romania and Slovenia (table II.23). The countries of the European Free Trade Association dominate investments in Estonia and the Slovak Republic. Investors from India, Iran, Pakistan, the Republic of Korea and Turkey play a major role in the central Asian republics of the former USSR. Intraregional FDI figures prominently in some of the central Asian Republics of the former Soviet Union, where foreign affiliates originating in other economies in transition play a major role in Belarus, Lithuania, the Russian Federation and Estonia. Czech investors account for 11 per cent of foreign capital in the Slovak Republic (ECE, 1993a).

As regards the sectoral distribution, manufacturing has attracted half or more of foreign capital (with the exception of Estonia). In some countries in the region the stock in manufacturing is concentrated in a single undertaking. For example, both the Czech Republic and Poland have each more than half of their industrial FDI in a single project in the automobile industry (Volkswagen/Skoda and Fiat/FSM, respectively). The share of FDI in services is also quite

Table II.22. Number of foreign-direct-investment projects in selected Central and Eastern European countries, by type of transaction, 1 October 1991 to 31 March 1993 [a]

(Number of projects, millions of dollars and percentage)

Country	*Acquisitions*		*Joint ventures*		*Greenfield investments*		*Total investments*	
	Number of projects and percentage							
	Number	*Per cent*	*Number*	*Per cent*	*Number*	*Per cent*	*Number*	*Per cent*
Azerbaijan	-	-	7	100	-	-	7	100
Czech Republic	62	34	60	33	59	33	181	100
Hungary	121	36	121	36	92	28	334	100
Kazakhstan	-	-	43	74	15	26	58	100
Poland	48	30	46	28	68	42	162	100
Russian Federation	11	3	285	71	106	26	402	100
Total	242	21	562	49	340	30	1 144	100
Excluding Kazakhstan and Azerbaijan	242	22	519	48	325	30	1 079	100
	Millions of dollars and percentage							
	Millions of dollars	*Per cent*	*Millions of dollars*	*Per cent*	*Millions of dollars*	*Per cent*	*Millions of dollars*	*Per cent*
Azerbaijan	-	-	2 565	100	-	-	2 565	100
Czech Republic	880	63	444	32	66	5	1 390	100
Hungary	1 093	35	1141	36	929	29	3 163	100
Kazakhstan	-	-	9 118	100	-	-	9 118	100
Poland	3 135	56	1 706	31	722	13	5 560	100
Russian Federation	1 167	11	9 239	88	152	1	10 559	100
Total	6 275	19	24 213	75	1875	6	32 361	100
Excluding Kazakhstan and Azerbaijan	6 275	30	12 530	61	1 869	9	20 672	100

Source: Anthony Robinson, "Ex-Soviet bloc attracts $42bn", *Financial Times*, 28 September 1993.

a Includes tentative, announced and concluded transactions.

considerable. In Estonia, trading activities account for 47 per cent of all investments. Trading activities also figure high in the Slovak Republic (23 per cent) and in Poland (16 per cent). Financial services figure prominently in the inward FDI stock in Hungary (ECE, 1994).

Overall, the ability of Central and Eastern Europe to attract sizeable investment flows and to utilize FDI in the transition process has been hindered by several factors. First, the overall domestic environment in most of these countries, with declining domestic output, high inflation rates, inconvertible currencies and underdeveloped infrastructure and financial services, is not conducive to attracting sizeable investments. The economic and political situation is not always

Table II.23. Composition of cumulative foreign-direct-investment registrations in Central and Eastern Europe, by country of origin, 1993[a]

(Percentage)

Country	*United States*	*European Union*	*European Free Trade Area*	*Central and Eastern Europe*	*Canada*	*Developing countries*	*Other countries*	*Total*
Belarus [b]	8	27	6	50	..	5	5	100
Czech Republic [c]	28	55	11	..	..	..	7	100
Estonia [c]	5	9	68	14	1	1	3	100
Hungary	5	54	24	5	1	-	12	100
Lithuania	13	26	18	39	3	-	1	100
Poland	39	51	8	1		-	11	100
Romania	10	63	4	3	7	7	7	100
Russian Federation[b]	14	31	18	15	2	7	14	100
Slovakia	15	37	31	12	2	4	-	100
Slovenia [c]	1	68	24	2	-	-	5	100

Source: same as for table II.21.

a As of second quarter 1993. Based on registration statistics in millions of dollars.
b Number of foreign affiliates.
c As of third quarter 1993.

stable and the regulatory framework pertaining to land and property ownership by foreign firms is often unclear. Second, the recession in the European Union and investment competition from the developing countries could have also contributed to the slow growth of FDI in Central and Eastern Europe. Third, in a number of countries, the actual process of building a market economy, privatization and creating the necessary institutional framework has not advanced significantly.

(b) Relative importance and impact

Given the low level of FDI and its uneven distribution, the relative importance of FDI in the host countries of the region is small, albeit with a few exceptions. The average contribution of foreign affiliates to the gross domestic product in Central and Eastern Europe was 3 per cent in 1992.[65] Similarly, foreign affiliates are estimated to have contributed only 0.9 per cent to the 1992 gross social product of the Russian Federation and only 0.3 per cent to the gross social product of Ukraine (OECD, 1992a). Only in Estonia, Hungary and Poland did enterprises with foreign participation play a more significant role, with 11, 17 and 7 per cent of enterprise sales, respectively (ECE, 1994, p. 15). In relation to population, FDI stock is the highest in Hungary ($407 per capita), the former Czechoslovakia ($199), Estonia ($80) and Poland ($51). On the basis of committed foreign capital, this ratio is $572 per capita in Hungary and a remarkable $600 in Slovenia.

Estonia, Hungary and Poland are also notable exceptions as regards the share of foreign affiliates in employment which, for the region as a whole, is low, averaging less than 0.5 per cent: foreign affiliates in the three countries accounted for 3.0, 4.5 and 2.3 per cent of total employment, respectively (ECE, 1994, p. 15). In general, the employment-creation effects of FDI, apart from those stemming from greenfield investments, have often been overshadowed by employment-reduction effects associated with the modernization of privatized state enterprises. General Electric, for example, cut the work force in its Tungsram affiliate in Hungary by almost half since

its acquisition, resulting in lay-offs of more than 8,000 employees. Likewise, the restructuring of the Hungarian company Lehel, which was acquired by Electrolux in 1991, resulted in the loss of 1,600 employees or 34 per cent of total employment.[66] Lay-offs of this kind were, however, often the first step in increasing productivity and re-establishing profitability, both conditions indispensable to survive in a market economy.

In spite of the relatively low average role of TNCs in Central and Eastern Europe, the impact of FDI on the economies in transition may have been larger than the actual size and relative importance of these investments suggest. In particular, FDI in key industries seems to have contributed to economic recovery. In Poland, for example, economic recovery is fostered by the increase in domestic automobile production fuelled by foreign investment in the automobile industry (by Fiat and General Motors).[67] In Hungary, only two out of 19 engineering-product groups (household refrigerators and fluorescent tubes) reported an increase in physical output over the 1989-1992 period; in both cases, the principal domestic producers had been acquired by TNCs (Electrolux and General Electric) (Török, 1994, p. 9). Likewise, in brewing — the best performing subsector of the Hungarian industry — five out of seven main breweries are owned by foreign companies (Török, 1994, p. 11).

Furthermore, TNCs from Western Europe especially have helped establish new trade linkages between Central and Eastern Europe on the one hand, and the European Union and the European Free Trade Association on the other, sometimes in the framework of regional core network strategies (UNCTC, 1991). For example, Ford's electrical components now come from its Hungarian affiliate, which became an integral part of the company's manufacturing operations in Europe (helped by the introduction of higher quality standards and control systems in Hungary). A similar export-oriented strategy focusing on the Western European market has been pursued by Skoda (Volkswagen's affiliate in the Czech Republic); Japan's Daikan affiliate in Hungary is expected to follow suit.[68] Similarly, Asea Brown Boveri's affiliate in Poland now provides electrical engines on a globally integrated basis.[69] As a result, the share of foreign affiliates in foreign trade appears to be quite high in a number of countries. In exports, it is the highest in Poland (10 per cent), followed by Ukraine (7 per cent), the Russian Federation (5 per cent) and Belarus (3 per cent). Foreign affiliates accounted for 15 per cent of total imports of Ukraine, 7 per cent of Belarus and 6 per cent of the Russian Federation (ECE, 1994). To the extent that trade plays an important role in promoting growth and facilitating the adjustment process, it appears that the role of TNCs has been somewhat larger than what other indicators suggest regarding the importance of FDI in Central and Eastern Europe.

Another important contribution of TNCs is the transfer of modern technology and management practices to foreign affiliates and supplier firms (UNCTAD, Ad Hoc Working Group on Interrelationship between Investment and Technology Transfer, 1994, p. 20). Examples include Ford and Suzuki in Hungary, Volkswagen/Skoda in the Czech Republic and Renault in Slovenia. The Volkswagen investment in Skoda, for example, involved not only technology transfer to improve production quality generally, introduce more standard features and new luxury items, but also provided blueprints and design for a new range of models.[70] In the case of Renault, a series of technology transfer contracts were signed between Renault's major European component suppliers and domestic companies to help them upgrade the quality of their products to Western European standards.[71] Technology can also be transferred through franchising by TNCs, which is gradually emerging in the countries of the region, particularly in hotels and fast-food. An important element of franchising agreements are typically strong quality control programmes and support in quality improvements to local franchisees (Tomzack, 1994, pp. 32-34). Human resource development and local labour-force training to help in the acceptance of Western quality

standards in both manufacturing and services industries is, in fact, a common impact of FDI in the region. In order to increase the quality of output, Fiat in Poland undertakes training of all employees in specifically designed schools.[72] Also in Poland, Citibank spends $400,000 on training each year.[73]

The transfer of such soft technologies has been complemented by the provision of "unique" services that used to be unavailable (or unknown) in the formerly centrally planned economies.[74] With the opening up of their economies, management consulting, advertising, real estate services, insurance brokerage and re-insurance services, as well as financial intermediation and credit card services (Coleman, 1994, p. 17) began mushrooming in most countries of the region.[75] After foreign firms were licensed, local companies too began offering these services.[76]

* * *

Overall, the direct role of TNCs in Central and Eastern Europe has been fairly small and uneven. But part of this unevenness has been that FDI has also been relatively important in a number of industries and areas that are central to the resumption of growth and the transition process.

2. Foreign direct investment and the transition

Beyond these direct impacts, FDI and TNCs also play an indirect — though difficult-to-measure — role in the establishment of a market economy, be it in Central and Eastern Europe or elsewhere (see box II.10 for a discussion of the role of TNCs in this respect in China). In the case of Central and Eastern Europe, their impact on institution-building, privatization and competition illustrates this role (McMillan, 1993).

(a) Institution-building

In a number of the economies in transition, the legal framework for a market economy did either not exist, especially in the Republics that comprised the former Soviet Union, or what existed was largely outdated or inadequate. With the desire to introduce market-economy principles, the establishment of such a framework became, therefore, of paramount importance. At the same time, this is a slow and painful process, further complicated by the absence of relevant experience. The desire to attract FDI exerts additional pressures in this regard because TNCs are used — and prefer — to operate within a legal framework conducive to FDI. This, and the actual presence of TNCs therefore provides an impetus to create new or updated laws in such areas as company laws, bankruptcy, taxation, accounting (see box II.11) and the repatriation of earnings. At the same time, the broader infrastructure of a market-oriented environment needs to be created, including a well-functioning financial system.

Indeed, FDI laws often constituted the first step in a series of market-oriented legislation and can be the core of that legislation around which other basic laws evolve. This especially has been the case in the Baltic Republics, Bulgaria, Romania and the Russian Federation, where laws relating to FDI and foreign business presence constituted one of the first legal steps towards market-oriented legislation (OECD, 1992a). For example, in Romania, one of the first market-economy related legislations was the "Decree Concerning Measures for Attracting Foreign Capital Investment to Romania" of 14 March 1990. Only subsequently, laws concerning business organizations, profit tax, unfair competition and the reorganization of state enterprises were

adopted (UN-TCMD and ECE, 1993). The evolution of the legislative framework is less advanced in Albania, Belarus, Kazakhstan and Ukraine, where FDI legislation still provides the legal base for business and investment (OECD, 1992a). By contrast, the Czech Republic, Hungary and Poland adopted separate commercial legislation dealing with monopolies, bankruptcies, securities, stock exchanges etc., which form the legislative base in these areas not only for domestic but also for foreign firms.

In general, the legislative framework for FDI has expanded quickly and has prompted, to varying degrees, additional legislation to support market-oriented reform. However, in some economies in transition, the newly established legal frameworks did not always result in a favourable legal environment for foreign business: new laws were enacted very quickly and often without considering their full implications; occasionally they had conflicting objectives; and their implementation suffered from inadequate transparency and conflicts of competence between local and central government institutions.[77]

(b) Privatization

The process of privatization is an inherent part of the establishment of a market economy. Transnational corporations can have direct and indirect effects on the creation of a private ownership structure. Directly, TNCs can provide the necessary financial resources for the purchase of state enterprises; as such they contribute to bridging the gap between savings and investment that is particularly acute in Central and Eastern Europe due to low savings rates, the savings erosion due to inflation and the underdevelopment of local financial institutions and capital markets (Odle, 1993). Indirectly, TNCs can encourage private entrepreneurship, especially through demonstration effects and forward and backward linkages. Successful privatizations, furthermore, can have a signalling effect, indicating to foreign investors the willingness of governments to accept and support private economic activity, which may further encourage inflows of FDI.

Foreign direct investment in Central and Eastern Europe has played an important role in privatization, albeit varying from country to country due to (among other things) differences in the legislative environment (e.g., restrictions on access by foreign investors) and the mode of privatization.[78] Between 1988 and 1992, an average of 67 per cent of FDI inflows into the region were related to privatizations (table I.13). In general, FDI plays a marginal role in small-scale privatization processes (i.e., of small shops and restaurants), where most countries emphasize domestic ownership and preferential treatment of enterprise employees (OECD, 1992a). The role of FDI in medium and large-scale privatization processes is, for the time being, limited in some countries, either because countries apply preferential conditions for enterprise employees andor citizens in their privatization schemes (such as the Czech Republic, the Russian Federation and Ukraine) or because uncertainties regarding their privatization approaches and the vagueness of their privatization legislation tend to discourage foreign investors (as is the case in Albania, Belarus and Bulgaria). In some countries, the privatization process has virtually come to a standstill due to political uncertainties and differing policies pursued by different institutions.

Only in those countries that actively encourage foreign participation in their privatization programmes of medium and large-sized firms (Hungary and Poland) does FDI figure prominently as a source of finance (OECD, 1992a; Sader, 1993). In Poland, revenues from privatization involving foreign investors from 1988 to 1992 amounted to $490 million, which accounted for approximately 45 per cent of total FDI in Poland (Sader, 1993, p. 37; and annex table 1). In Hungary, from 1988 to 1992, FDI from privatization amounted to $2.3 billion; FDI through privatization thus accounted for approximately 78 per cent of all investment in that country (Sader, 1993, p. 36; and annex table 1). In the former Czechoslovakia, while giving preferential status to citizens in the privatization process, FDI-related proceeds from medium- and large-scale

privatizations in 1988-1992 accounted for approximately $1.9 billion or 87 per cent of all FDI inflows during that period (Sader, 1993, p. 36; and annex table 1).

In some countries, foreign participation in privatization is particularly prominent in infrastructure industries that require massive capital and technology inflows, e.g., telecommunications. Basic telecommunication services and related services are now attracting foreign involvement in Estonia, Hungary and Latvia (ECE, 1993b). In contrast, Belarus, Bulgaria, the Czech Republic and the Russian Federation do not yet allow foreign capital in the privatization of their basic telecommunications services — only long distance services and upscale services, such as mobile phones, are open to FDI.[79]

Not all aspects of the privatization process are considered positive in the countries in Central and Eastern Europe. Some privatization schemes have been criticized for selling off state assets to foreigners too cheaply or corruptly.[80] Furthermore, as TNCs adjust the profile of the acquired firms to their own strategies and needs, they sometimes limit the production of the acquired firms. Privatization may therefore result in the termination of production lines that were previously considered profitable. General Electric, for example, closed the production of vacuum equipment, electronic components, floppy disk and magnetic tape at its Hungarian affiliate, Tungsram, some of which were considered profitable operations by that affiliate (Smart and Kasriel, 1994, p. 25). Similarly, the privatization of the Hungarian cement industry resulted in foreign ownership that prevented affiliates from exporting (Rojec, 1994, p. 26). The resulting conflicts can lead to policy reversals. In this context, the Czech Republic, Hungary and Poland, as well as others, have revoked their initial tax incentives for foreign investors and are now pursuing a more cautious policy towards foreign involvement in privatizations (Svetlicic and Rojec, 1993).

While there is certainly scope for FDI through privatization in those countries of the region that have not yet embarked on full-scale privatization or have, for the time being, barred foreign participation from that process, it should be recognized that the scope for foreign involvement in those countries that have already actively encouraged FDI involvement in privatization is limited by the availability of attractive assets. In Hungary, for example, the pace of FDI through privatization is already slowing down. While, in 1992, almost 80 per cent of privatization revenues in that country came from abroad, in 1993 that share dropped to 50 per cent. This has been attributed to the fact that most of the Hungarian consumer-goods companies have been sold by now and only a few of the remaining companies are attractive to foreign investors.[81]

The demonstration effects of FDI and the encouragement of private entrepreneurship through foreign business presence arise from both the demand for, and the supply of, market inputs by TNCs, in particular as regards banking, accounting and other intermediate business services. The demand of TNCs for advertising services has, for example, led to the establishment of domestic advertising agencies in Poland which are now competing with the affiliates of Western advertising TNCs. In the automobile industry, competition by domestic automobile manufactures led to an ever increasing network of dealerships,[82] while, at the same time, the demand for improved quality provided an impetus in the restructuring (and privatization) of supplier firms in that industry.[83]

(c) Competition

An important role that TNCs can play in the establishment of a market economy is through the introduction of competition into local markets. Exposing domestic monopolies to a more competitive environment is a means to improve allocative efficiency and to facilitate the free determination of prices. The potential role of FDI in this respect is significant, as barriers to market entry are high and state monopolies are strong in Central and Eastern Europe.

Box II.10. Foreign direct investment and the transition to a market-based economy: the experience of China

While the role of FDI in the transition process to a market-based economy has not yet fully manifested itself in Central and Eastern Europe, there is, indeed, some evidence from China that offers some useful insights in this respect. Market-oriented reforms have been carried out in China since 1979. The principal aspects of these reforms include: establishing a market-oriented institutional framework; diversifying the ownership structure by promoting non-public enterprises; deregulating the economy according to the principles of a market system and, encouraging competition to break up the State monopolies; reforming public enterprises; restructuring the financial sector and the fiscal system; and integrating China into the world economy through the gradual liberalization of its trade and investment regimes. Within the broader context of economic reforms currently under way, the following specific examples indicate the contribution that FDI can make to the transition process:

- **Establishing a market-oriented institutional framework**

Foreign direct investment generates constant pressure for institution building. In China, it has stimulated and, in some occasions, led the move towards establishing a market-oriented institutional framework. This has been apparent in the liberalization of foreign-exchange controls and the reform of China's accounting system and, to a lesser extent, in the establishment of the regulatory framework for the protection of intellectual property rights (laws on patents, trademarks and copyrights).

Foreign direct investment has played a catalytic role in the process of liberalizing foreign exchange controls. Transnational corporations consistently considered controls on the repatriation of earnings and capital a serious — if not the most serious — limitation on their operations in China. Accordingly, on numerous occasions and in numerous ways, they expressed their strong desire for a liberalized foreign-exchange regime. There was even a crisis in the mid-1980s, when a number of foreign affiliates were finding it difficult to continue their operations due to a lack of foreign exchange. The Government dealt with it on an ad hoc basis by providing these enterprises with large amounts of foreign exchange as an immediate remedy. Subsequently, the Government established foreign exchange adjustment centres, or "swap markets", to make foreign exchange available to foreign affiliates. As the Government became increasingly aware of the importance of avoiding an overvalued exchange rate and abandoning the preferential treatment awarded to foreign firms, it gradually opened these swap markets to domestic firms. This was an important step forward in relaxing foreign exchange controls. At the beginning of 1994, another important step was taken to change from a "dual exchange rate system" (the official fixed rate and the swap market rate) to a "single managed floating rate", based mainly on market supply and demand. It is now the intention of the Government to move towards full convertibility of the currency.

The reform in the accounting system is another example. China had its own accounting system, one that was incompatible with that required for a market economy. That system caused some confusion for the operations of foreign affiliates, particularly joint ventures, in the early 1980s. In March 1985, China promulgated an accounting system for joint ventures which was close to international standards. The successful experiments with international accounting standards in joint ventures prompted China to abandon its traditional accounting system completely and adopt a new accounting system consistent with international standards. Similarly, a system for verifying certified public accountants was established in the mid-1980s, specifically aimed at facilitating the accounting system for joint ventures. As the traditional supervisory function of accountants in domestic enterprises was giving way, certified public accountants with experience gained through work with joint ventures were requested to extend their work to domestic enterprises. While the accounting reform was mainly generated by the country's overall efforts to change over to a market economy, FDI did play a catalytic and demonstrational role in accelerating the process of reform in this area.

- **Diversifying the ownership structure**

China has not embarked on a comprehensive privatization programme to the same extent as other countries in transition. Instead, it has promoted private sector development, aimed at changing the ownership structure of the economy from predominantly State-based ownership towards a mix of ownership, characterized by the coexistence of public, collective and private ownership. Foreign affiliates, including joint ventures with domestic firms, have contributed to achieving that objective by initiating the process of ownership diversification. There are now over 50,000 foreign affiliates in operation in China. Although the impact of FDI on changing the ownership structure of the economy has not been significant overall, it has been remarkable in a number of important manufacturing and services industries. In tourism, for example, there are about 500 foreign-invested luxury hotels accounting for 29 per cent of China's total capacity and 49 per cent of the total foreign exchange revenues generated by hotels.[a] The automobile industry is another example: the majority of the top automobile manufacturers in China are now joint ventures with foreign investors.

The diversification of the structure of ownership has had important implications for economic growth. The average annual rate of growth of output during the period 1986-1990 was 7 per cent for State enterprises, 18 per cent for collective enterprises and 74 per cent for foreign affiliates. Of the total industrial output in 1992, public enterprises accounted for 48 per cent and collective enterprises for 38 per cent. Private enterprises accounted for 13 per cent, of which 65 per cent was attributed to FDI. In retail trade, these shares were even higher: 41 per cent was accounted for by public enterprises, 28 per cent by collective enterprises and 31 per cent by private enterprises.[b]

- **Stimulating competition**

To enable markets to function efficiently, the organizational structure of the economy needs to be reformed fundamentally. The entry of foreign enterprises with competitive advantages is one of the most effective means of breaking up monopolies and stimulating competition. The entry of TNCs into China has reduced industrial concentration and the monopoly of the large State enterprises and has stimulated competition in a number of key industries. As a result, State enterprises now face active product-market competition and have to respond to the presence of the new market entrants by improving their own efficiency. Competition has been stimulated not only in industries that typically attract substantial domestic market-oriented FDI, but also in export-oriented industries, such as textiles and clothing, electric appliances, food processing, footwear and travel goods. The development in toy manufacturing is an example for both cases. There are now over 300 toy producers funded by foreign investment, accounting for over 10 per cent of the industry. These foreign affiliates are competing with about 2,600 domestic toy manufacturers. As a result, quality of output and productivity increased rapidly, making China one of the efficient toy producers in the world. China is now one of the largest toy exporters in the world, with a market share of 25 to 35 per cent in the major importing countries (33 per cent in the United States, 29 per cent in Germany, 30 per cent in Italy and 32 per cent in France) (China Economic News, 1993). Competition is also taking place among foreign affiliates in China. In the automobile industry, affiliates of Volkswagen (Germany), Chrysler (United States), Peugeot (France), Toyota (Japan), General Motors (United States), Isuzu (Japan), Ford (United States), Fiat (Italy), Renault (France) and Citroen (France) etc. are competing with each other, as well as with over 100 major domestic manufacturers, producing automobiles and spare parts.

While recognizing the positive effect of FDI in stimulating competition in China, tax incentives and other preferential treatment given to the FDI have caused distortions against domestic manufacturers which are already lagging behind in many respects. Although these effects are caused by FDI promotion rather than by FDI itself, they do result in market distortions.

- **Reforming enterprises**

In the context of a socialist market economy, FDI has played a unique role in rejuvenating and reforming public enterprises in China. This has been accomplished either by contributing directly to these enterprises through joint ventures, or by providing lessons and experiences through operational demonstration and backward and forward linkages.

One of the Government's policies concerning enterprise reform is to encourage foreign investors to establish joint ventures with Chinese public enterprises. What is important is that, in addition to capital and technology, foreign investors contribute new management practices (including incentive schemes, production organization, accounting, risk management etc.) to their partners that are in line with the business culture of a market economy. As a rule, joint ventures do, indeed, adopt, either partly or entirely, the management systems used by their foreign partners. As an overwhelming majority of the 50,000 foreign affiliates are joint ventures between foreign investors and Chinese State enterprises, the impact of FDI in rejuvenating these public enterprises is considerable. For example, Liaoning Province, China's major industrial base, is home to one-tenth of the country's large and medium-sized enterprises. As of June 1993, one-fourth of these enterprises were joint ventures with foreign partners.[c]

- **Integrating China into the world economic system**

Foreign direct investment has contributed to the integration of China into the world economy through joint ventures with domestic firms. These ventures have played a central role in establishing organized linkages. Foreign investors have brought in the necessary technology to produce products of export quality, the skills and attitudes to ensure the delivery and the dependability necessary for export marketing and knowledge of export markets. At the same time, they have helped to promote exports, as they are normally more conversant with their home and other foreign markets and have their own well-established marketing networks. In 1993, foreign affiliates generated $25.2 billion of foreign exchange, accounting for 27.5 per cent of total national exports. China's outstanding performance in international trade over the past 15 years (with an annual growth of 12 per cent during 1980s and 17 per cent in the past 3 years) has been, to a considerable extent, facilitated and prompted by FDI.

The effects of FDI extend beyond the immediate sphere of the activities of TNCs, spreading indirectly to other areas of the economy. In the early stages of reform, FDI was viewed by the Government of China as an experimental ground for trying out market-oriented mechanisms, with the rationale that some of the successful ideas could be applied subsequently to the entire economy. The lessons learned from foreign affiliates with respect to ownership, management, organization, policies and procedures are reflected in ongoing domestic enterprise reform in China. Features of foreign affiliates that have demonstrated their usefulness are being adopted nation-wide in what are called "contract management systems" and "management responsibility systems". These features include, among others, the separation of ownership from management, greater freedom to hire and fire labour, profit centres in enterprises and incentive systems for managers and workers. Joint stock companies are being created, particularly as a mechanism to form large enterprise groups. Transnational corporations have been used as model for the internationalization of domestic firms. The presence of foreign firms has also helped to build a new business culture. New business standards introduced by FDI are, to some extent, disseminated through the forward and backward linkages of foreign affiliates.

Source: based on Zhan, 1993.

a "FDI in tourism industry in China", *International Business* (January 1994).

b Statement by Ma Kai, Deputy Director-General of the State System Reform Commission, at the International Conference on Transnational Corporations and China (Beijing, September 1993), mimeo.

c "Retooling large state enterprises in Liaoning", *China Economic News*, 40 (1993), p. 15.

Box II.11. Foreign direct investment and accounting reform in formerly centrally planned economies

In the course of the former Soviet Union's initial opening to FDI in the form of joint-venture legislation and the establishment of free economic zones, different accounting standards quickly became a major obstacle in attracting FDI (Menshikov, 1989). Incompatibilities in accounting systems regarding the recognition of revenues, expenses and certain liabilities, depreciation methods, valuation of assets and, most importantly, the determination of profits (especially in light of profit taxes) turned out to be major hurdles in the setting-up and implementation of foreign investment projects (Ruffing, 1989).

In order to overcome this problem, the authorities recognized that the introduction of an accounting law that was closer to Western accounting standards was necessary. Central to this task was to modernize the basic manual for bookkeepers (Chart of Accounts) in accordance with international standards, including the definition of relevant concepts and the provision of updated instructions. It became also apparent, however, that, as a complement, an independent accounting profession appropriately suited to prepare (sometimes for the first time) accounting records of business enterprises needed to be developed, since accountants were an integral part of the system of enterprise management, not professionals trained to provide financial and managerial expertise.

Both reforms were implemented with the help of the United Nations which, since 1990, provided technical assistance in several projects on accounting reform and the retraining of accountants (Sauvant, 1990). It became quickly apparent, however, that these efforts were not only important for foreign affiliates and the attractiveness of the country to FDI. Rather, in the light of the broader changes that were taking place at that time, the undertaking soon took on an experimental dimension for broader purposes, namely the introduction of a market-oriented economic system. The transition from a centrally planned to a market-oriented economic system required in fact a thorough modernization of accounting methods, since accounting is basic to business in any market economy. Without an appropriate accounting system, the State, firms, investors and the general public are in no position to evaluate business performance. Accounting reform therefore became a priority in the transitional process of the Soviet Union in particular and the countries of Central and Eastern Europe in general. Most of the countries in transition have enacted full-fledged laws for introducing Western accounting principles (UN-TCMD and ECE, 1993).

The benefits of competition introduced by FDI in the region in terms of price decreases, quality of output and productivity increases are profound in those services industries that were neglected under the centrally planned economic system. In advertising, for example, competition that was originally introduced by large Western advertising companies, such as Young & Rubicom, McCann-Erickson and others, is now becoming more intense through the entry of other foreign firms as well as the creation of new domestic companies. For example in Poland, this has induced advertising agencies to offer lower prices and better services (Rohwedder, 1994). The licensing of foreign companies also introduced competition in the Czech Republic's insurance market, where the former monopoly provider, Ceska Pojistovna, has lost 20 per cent of its market share.[84]

The impact of FDI is, however, by no means straightforward and depends on many factors, among others, the willingness of Governments to promote competition and the willingness of TNCs to compete:

- In the automobile sector, FDI was linked to demands by foreign investors for protected domestic markets over extended periods; thus, Japanese investment in the Hungarian automobile industry was conditioned on high tariff protection of domestic automobile production.[85] Similarly, in the Czech Republic, Volkswagen's engagement in Skoda

(originally put at $6.1 billion, but scaled down to half that amount in the meantime)[86] was linked to protective tariff measures on imports.[87]

- In Hungary, the former State oligopolistic markets in paper and cardboard products, detergents, cosmetics and cement turned into *de facto* monopolies because foreign investors acquired most or all of the domestic companies in the respective industries. Foreign investors temporarily reduced or ceased production in response to their failure in achieving customs protection or the introduction of non-tariff barriers (especially in detergents and cement) (Török, 1994, p. 12).[88]

Transnational corporations have also been criticized in some countries as aggravating the economic crisis (Svetlicic and Rojec, 1993). The exposure of domestic industrial capacity to the process and cost levels of the world market resulting from foreign business presence rendered it sometimes idle and useless, incapable of competing in world markets as well as in domestic markets. As a result, demands for a "sensible protection" of domestic industry have recently surfaced in a number of countries of the region.[89] The resulting limitation of the activities of foreign affiliates is noticeable, for example, in the Russian Federation, aggravated by the political situation in that country.[90] Governments have to be vigilant, therefore, if they want to reap the advantages from competition that FDI can offer.

* * *

Thus, apart from direct effects, TNCs have a number of intangible and indirect effects on the transition to a market economy and especially on the establishment of a market-oriented infrastructure. While difficult to measure, it may well be that, for the time being, some of the most important effects of FDI are in this area.

Conclusions

Despite the growth of FDI in Central and Eastern Europe, inflows into that region remain small by world standards. The transformational depression of domestic economies and the inadequate regulatory framework are partly responsible for the lack of significant investor interest and the low levels of FDI inflows into the region. Although FDI has a tangible and intangible role to play in domestic economic recovery and the transformation to a market economy, neither needs nor expectations have been met. Consequently, these processes need to rely, first and foremost, on domestic resources and efforts.

But it may well be that the relative contribution of FDI may increase in the future. After all, the region is potentially very attractive to foreign investors: many countries of the region are industrialized, middle-income economies with markets ranging from a few million to 150 million consumers with pent-up demand for goods and services; some countries are rich in natural resources and have considerable human resource endowments and relatively low labour costs; and proximity to the European Union market is an advantage that could entice investments in the framework of regional core network strategies of TNCs. But for that potential to be realized, the factors identified earlier in this section as preventing an upsurge of FDI inflows need to be tackled. Even then, however, it is not likely that the result would be a large-scale transfer of production capacities from developed countries to Central and Eastern Europe. Rather, what is more likely is a longer-term process of an incremental increase in production located there, partly to satisfy local markets, partly as a part of integrated international production.

Finally, there is an aspect of the role of FDI in the transition process which, to date, has received little attention: for the countries of Central and Eastern Europe to become competitive in the world economy, it is not only important that they attract FDI and benefit from the assets associated with it; they also need to insert themselves actively — and competitively — in the world market and the emerging integrated international production system by undertaking their own FDI, building on the already existing (small) outward stock of about $1 billion (UN-TCMD and ECE, 1993 and UN-TCMD, 1992b). While this may appear far-fetched at the present time, the logic of a full integration of the region into the world economy requires that attention be paid to this aspect of the integration process at one time. And the level of development of a number of countries in that region suggests that this is a distinct possibility once the economic situation in Central and Eastern Europe shows noticeable improvements.[91]

Notes

1 The declining trend was also reported by the Ministry of Finance for FDI figures based on an approval or a notification requirement: -16 per cent decline in fiscal year 1990, -27 per cent in fiscal year 1991 and -18 per cent in fiscal year 1992. Prior to 1980, firms wishing to invest abroad had to obtain approval from the Government. Now they should only notify the Government of their intention to invest if investment value exceeds 10 million yen. Foreign-direct-investment data collected from approvals or notifications are normally higher than those on the balance-of-payments basis.

2 *Nihon Keizai Shimbun*, 31 March 1993, quoted these figures from the Ministry of International Trade and Industry; and Japan, Ministry of International Trade and Industry, 1990.

3 JETRO, 1993a; and JETRO, "Outline for the 10th survey of European operations of Japanese companies in the manufacturing sector", press release, 24 March 1994.

4 Data on share prices are from International Monetary Fund, 1994a.

5 Surveyed in mid-1992. About 60 per cent of the TNCs covered in the survey that do not plan to make FDI until 1995 give this reason. See Export-Import Bank of Japan, 1993.

6 *Weekly Toyo Keizai*, 10 April 1993, pp. 90-95 and Toyo Keizai Shimposha, 1989, pp. 169-174.

7 *Nihon Keizai Shimbun*, 9 May 1993, p. 1.

8 There is another region that received more FDI flows in fiscal year 1992 than in 1991 — Western Asia. However, the absolute amount of FDI is small, only one-ninth of the level of FDI outflows to South, East and South-East Asia in fiscal year 1992.

9 "Japanese firms in South-East Asia. The second wave", *The Economist*, 7 May 1994, pp. 71-72.

10 *Nihon Keizai Shimbun*, 14 April 1994.

11 In the 1990 survey looking into investment prospects in 1991-1993, the rate was 20 per cent for each of the destinations. See Export-Import Bank of Japan, 1993.

12 For example, the ratio of sales by Japanese affiliates abroad to sales by all Japanese companies in fiscal year 1992 was 6.7 per cent, compared to 24 per cent for the United States (1989) and 17 per cent for Germany (1987). Data from Japan, Ministry of International Trade and Industry, 1990, and "The 22nd survey on Japanese business activities abroad", *News from MITI* (Tokyo, June 1993).

13 Japan Institute for Overseas Investment, 1994. The share of Japanese TNCs that planned to invest in the following three years at the mid-1989 survey was 84 per cent. For this survey, see Export-Import Bank of Japan, 1990.

14 In 1990 only 7.8 per cent of sales by foreign affiliates in the United States were exported. This is a very small share. Even in Japan, which is known for its very small stock of inward FDI, this share is higher and amounted to 11.2 per cent in fiscal year 1990. Data from United States, Department of Commerce, 1993a, and Japan, Ministry of International Trade and Industry 1992.

15 The largest decline in inflows to the manufacturing sector was recorded in the chemicals and allied products industry ($11 billion) between 1989 and 1992 (see table II.5). The reasons for this decline are different from those in the machinery industry because this industry generated the largest income among

industries during this period. The decline in inflows to this industry is largely explained by the absence of large cross-border mergers and acquisitions that inflated inflows in the late 1980s.

16 "Beat of the heartlands", Financial Times Survey: Locating in North America, *Financial Times*, 28 October 1993, p. 1.

17 Total private investment in eastern states of Germany amounted to DM 72.4 billion in 1991, DM 93.8 billion in 1992 and DM 113.2 billion in 1993, a good part of which was largely financed by companies from the western states of Germany. JETRO, 1993b, p. 274 and JETRO, 1994, p. 268.

18 "Beat of the heartlands", *Financial Times*, op. cit.

19 Labour cost per hour in manufacturing in Germany was $26.4 in 1991, while it was $15.6 in the United States. Data from International Labour Office, 1993a, table 22, pp. 957-960.

20 Barbara Harrison, "The incentives that pass the test", Financial Times Survey: Locating in North America, *Financial Times*, op. cit., p. 15.

21 Based on a survey by JETRO, New York, 1988.

22 "Western ventures helping East's phones to ring," *New York Times*, 21 December 1993; "Hungarian telephone stake is won by Deutsche Telekom-Ameritech Group," *The Wall Street Journal*, 20 December 1993.

23 The data on FDI in this industry cannot be disaggregated into the data for developed and developing countries in these years.

24 Commission of the EC, *Panorama of the EC Industry*, various issues.

25 At the bottom of the recession, in 1991, output in the United Kingdom declined by 2.3 per cent while that in France continued to increase by 1.2 per cent (table I.10).

26 For example since 1988, foreign companies establishing an affiliate in France have no longer been required to obtain prior approval from the Government (see, "France extends a warmer welcome to foreign investors", *Business Europe*, 2 February 1990, pp. 1-2). In 1992 prior approval requirements related to cross-border mergers and acquisitions in France were reduced. Furthermore, in 1993, a 20 per cent ceiling on foreign ownership of privatized companies was abolished for TNCs from the European Union. France also started promoting itself as an attractive FDI location. Within this effort the Invest in France Mission was established as an arm of the Ministry of Economy in 1992.

27 See Emma Tucker, "France bucks trend as foreign investment rises", *Financial Times*, 1 March 1993, and "France's foreign affair", *The Economist*, 12 February 1994.

28 "Euro-skepticism slows down on inevitable process", Financial Times Survey: International Mergers and Acquisitions, *Financial Times*, 19 October 1992.

29 "Cross-border M&A", *Mergers & Acquisitions*, 27 (May/June 1993), pp. 57-60.

30 Tony Jackson, "Footloose across Europe's frontiers", *Financial Times*, 9 March 1993.

31 Ibid.

32 "Starting over", *Eurobusiness* (December 1993/January 1994), pp. 50-52.

33 For further explanation of new methods of production by firms, see Dunning, 1994; "New mood in mergers", *Eurobusiness* (December 1993/January 1994), pp. 62-63.

34 To a certain extent, the distinction between portfolio and direct investment is a definitional one.

35 For recent developments in the external financing of developing countries, see UNCTAD, 1993a, pp. 49-69.

36 "Asia's wealth", *Business Week*, 29 November 1993.

37 *Nihon Keizai Shimbun*, 19 January 1994.

38 There are 47 developing countries recognized by the United Nations as least developed countries. For a listing, see UNCTAD, 1994a.

39 Liberia, a flag-of-convenience country, accounted for 43 per cent of FDI flows into the least developed countries of Africa during 1988-1992.

40 See Paul Handley, "The old and the bold: far reaching economic reforms draw mixed reviews", *Far Eastern Economic Review*, 4 November 1993, pp. 30-31.

41 However, the growth of investment flows into the Pacific islands was more rapid, rising from an annual average of $210 million during 1986-1990 to $381 million in 1991 and to more than $500 million in 1992.

42 Real wage increases are nominal wage increases divided by consumer prices index. Data on wages are from the International Labour Office, 1993a and on productivity from World Bank, 1990, table 7, pp. 190-191 and World Bank, 1993b, table 7, pp. 250-251.

43 For example, the Statute for Industrial Upgrading that came into effect in 1991 in Taiwan Province of China provides incentives to TNCs engaging in research and development, the enhancement of productivity, training, the establishment of international brand names and the use of environmental protection systems.

44 The Bank of Japan, 1990 and 1993. This concurs with approval/notification data reported by the Ministry of Finance, according to which that share decreased from 59 per cent in fiscal year 1989 to 30 per cent in fiscal year 1992.

45 "Lee can do", *The Economist*, 21 August 1993.

46 For example, PGI (Singapore) announced its intention to set up a manufacturing plant (electric and electronic equipment) and its European research-and-development headquarters in Scotland. See, James Buxton, "First Singapore company comes to UK", *Financial Times*, 16 November 1993.

47 Reported outflows were $4 billion in 1992. It was probably inflated by the inclusion of local funds that are "roundtripped" through Chinese affiliates abroad or other entities in order to be reinvested in China. See box II.3.

48 *Nihon Keizai Shimbun*, 3 December 1993, p. 9.

49 *Nihon Keizai Shimbun*, 20 December 1993. The share of intraregional trade in total trade based on exports was 68 per cent for the European Union and 43 per cent for the North American Free Trade Area in 1992.

50 William Keeling. "The capitalist spirit is unleashed", *Financial Times*, 30 November 1993, and Victor Mallet, "Investment for Vietnam", *Financial Times*, 13 January 1994, p.4.

51 Mark Clifford, "Send money: North Korea appeals for investment in free-trade zone", *Far Eastern Economic Review*, 30 September 1993. It is reported that most FDI is attributed to Democratic People's Republic of Korea and Republic of Korea residents in Japan (JETRO, 1993b, p. 249).

52 Calderon, 1993a. See also UNCTAD-DTCI, 1993a, pp. 50-54.

53 These non-conventional types of FDI have given rise to concerns that the change in ownership of assets will not contribute to increasing capital formation upon which future growth depends (Kosacoff and Bezchinsky, 1993; Fanelli and Machinea, 1993). Although this may, indeed, be the case, neither does conventional FDI (with the exception of greenfield investments) necessarily add to the domestic capital stock. In fact, if proceeds from debt-equity swaps are being used to reduce debt, this can free up domestic savings for investment purposes.

54 SECOFI, "La inversión extranjera en Mexico", *Comercio Exterior*, 43 (March 1993), p. 213. See also Ortiz, 1993.

55 See "Colombia: opening the door to foreign investment", *Institutional Investor*, 18 (December 1993), p. 4. See also "Fin de siesta", *AméricaEconomia*, 79 (December 1993), p. 40.

56 The following investments were announced by automobile producers in Brazil and Argentina as of the end of 1993: Ford $1,600 million, General Motors $1,500 million, Fiat $755 million and Kia $500 million; see *AméricaEconomia*, Special Number, 1993-1994, pp. 23-24.

57 It should also be mentioned that a number of small economies in the region, mostly in the Caribbean, are linked to the European Union through the Lomé Convention. Although this Convention provides access to the European Union on a preferential basis and contains a number of provisions aimed at stimulating FDI, it is not a free trade agreement. Another extra-regional forum — the Asia and Pacific Economic Cooperation organization — admitted Mexico as a member in 1993, and Chile is expected to be admitted in 1994. While it obviously does not carry as much importance as a free trade agreement with extra-regional partners, it does underline the growing international orientation of Mexico and Chile.

58 It is worth mentioning that Brazil does not belong to the North American cluster in the context of the clustering of international trade and investment (chapter III).

59 For a detailed examination of FDI in Africa, see UNCTAD-DTCI, 1994d and UNCTAD-DTCI, forthcoming.

60 "Morocco courts foreign investors", *International Herald Tribune* , 12 November 1993.

61 By convention, Central and Eastern Europe includes Albania, Armenia, Azerbaijan, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, the Federal Republic of Yugoslavia, Georgia, Hungary, Kazakhstan, Kyrghyzstan, Latvia, Lithuania, the Former Yugoslav Republic of Macedonia, the Republic of Moldova, Poland, Romania, the Russian Federation, the Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. The former Yugoslavia is also included in the developing countries.

62 The compilation of data on FDI differs from country to country and sometimes even within countries where they are compiled by several government agencies (statistical offices, national banks, foreign investment promotion agencies etc.). The differences in criteria used (including or excluding in-kind investments, reporting initial and/or committed investments and/or tentative investments) and the time-span applied (different reporting phases, different criteria for the disbursement of investments) in the compilation of data may result in a considerable divergence in aggregated FDI statistics. As a result, the data are often not comparable and should be used with caution; see UN-TCMD and ECE, 1993, and ECE, 1994.

63 In addition, many of the registered foreign affiliates were established purely for fiscal purposes, a result of the favourable treatment that was granted initially to joint ventures in several countries. Here, the disbursement of funds originally promised never materialized. See Deloitte, Touche Tohmatsu International, 1992.

64 According to a *Financial Times* survey covering 18 months from 1 October 1991 to 31 March 1993, that included tentative, announced and concluded transactions. See Anthony Robinson, "Ex-Soviet bloc attracts $42bn", *Financial Times*, 28 September 1993.

65 Data for Albania, Bulgaria, Czech Republic, Hungary, Poland, Romania and the Slovak Republic.

66 Nickolas Denton, "In from the cold", *Financial Times*, 19 November 1993.

67 "Automotive survey", *Business Central Europe*, 2, 8 (February 1994), pp. 31-42; and Anthony Robinson, "Survey of world car industry", *Financial Times*, 9 September 1993.

68 "Automotive survey", *Business Central Europe*, op. cit.

69 See Anthony Robinson, "Profitable vision", Financial Times Survey on Poland, *Financial Times*, 18 March 1994, p. II.

70 "Skoda — playing hard to get", 30 June 1990, *The Economist*, p. 69; and EIU, 1994a.

71 "Automotive survey", *Business Central Europe*, op. cit.

72 Ibid.

73 Christopher Bobinski, "Lame ducks are the target", Financial Times Survey on Poland, *Financial Times*, 18 March 1994, p. III.

74 For a discussion of unique services, see Lipsey and Zimny (1993).

75 For example, after insurance restrictions were lifted in the Czech market in February 1992, several Western insurance companies established a presence in that country (among others, Nationale Nederlanden (Netherlands), Sedgwick (United Kingdom), Marsh & McLennan (United States)), primarily to service TNCs. See "Insurance options increase", *Business Eastern Europe*, 22, 29 (19 July 1993), p. 8; see also "In need of a net: a survey of insurance", *Business Central Europe*, 1, 6 (November 1993), pp. 33-47.

76 In the case of advertising, see Rohwedder, 1994, pp. 24-25; for insurance, see "In need of a net: a survey of insurance", *Business Central Europe*, op. cit.

77 In the Russian Federation, apart from the central Government, some of the autonomous Republics and regions have also adopted foreign investment and privatization legislation, sometimes with conflicting requirements (OECD, 1992a).

78 For an overview of privatization schemes, see, for example, Rondinelli, 1994 and Kiss, 1993.

79 See "Telecommunications survey", *Business Central Europe*, 2, 11 (May 1994), pp. 33-48.

80 Nickolas Denton, "Hungary builds capitalism without capital", *Financial Times*, 1 November 1993.

81 Nick Clegg, "Hungary's privatization falters after flying start", *Financial Times*, 19 October 1993; and Nickolas Denton, "Hungary builds capitalism without capital", *Financial Times*, op. cit.

82 "Automotive survey", *Business Central Europe*, op. cit.

83 For the latter, see Jonathan Gafni's case study on Rychtar Tools s.p., a supplier of compact jacks for SkodaVolkswagen's automobile production (Gafni and Niles, 1994).

84 "In need of a net: a survey of insurance", *Business Central Europe*, op. cit.

85 "Automotive survey", *Business Central Europe*, op. cit.

86 Volkswagen's original commitment included an investment of $5.3 billion by the turn of the century; to double Skoda's annual production to 400,000 cars a year by 1997; to help Skoda develop a new range of models; to make available to Skoda its purchasing and parts network, while allowing the company to retain its own identity; and to clean up pollution of factory sites. "Skoda — playing the hard to get", *The Economist*, op. cit.

87 See "Automotive survey", *Business Central Europe*, op. cit. Import duties range from 15.2 per cent on European Community-made cars to 19 per cent on all other automobiles.

88 Production in paper and cardboard fell by 17 per cent, in detergents and cosmetics by 27 per cent and in cement by 33 per cent.

89 Leyla Boulton, "Gaidar urges more government protection for Russian industry", *Financial Times*, 24 November 1993, p. 16.

90 Leyla Boulton, "Inflation fall is boost for Yeltsin man", *Financial Times*, 8 December 1993, p. 3.

91 The region's gross domestic product in 1992 was approximately $900 billion, roughly equivalent to that of the United Kingdom ($1,100 billion). The United Kingdom had an outward stock of $287 billion in 1991.

Chapter III

Globalization, integrated international production and the world economy

Introduction

The two preceding chapters, together with earlier *World Investment Reports,* have documented the growing importance of foreign direct investment (FDI) and the central role that transnational corporations (TNCs) have acquired in the world economy. This chapter raises the question whether these developments, as part of a wider globalization process, are beginning to change the character of the world economy.

The world economy can be described along two distinct, but interrelated, dimensions: *market* exchanges and *production* activities that link consumers, producers and suppliers within and across national economies. The extent to which these economic agents engage in cross-border relations varies with market size and location, technological and other domestic economic advantages, and the openness of the policy framework and the links established through markets or production activities can involve many elements, in particular, capital flows, goods, services, people, technology, information and ideas. International integration describes the spread and deepening of these linkages across national boundaries.

These two dimensions encompass different *geographical spaces* — national, regional and global. There has been a persistent historical tendency for the world economy to become more closely integrated across all these spaces. Strong affinities among neighbouring countries — or *regionalization* — often provide the context for initial cross-border linkages and a higher degree of international integration. By extension, *globalization* refers, literally, to the limit of international integration, as a growing number of national economies become mutually interconnected through cross-border flows of goods, services and factors of production. Perhaps more importantly, globalization also describes a qualitative process of governing an increasingly complex pattern of cross-border linkages.

International economic integration is often seen as the spread of market linkages through greater trade and factor flows, and government action to reduce obstacles to these flows is the main stimulus to increased integration. However, this type of *shallow integration* ignores participation in the international division of labour at the level of production. *International production* refers to a firm controlling productive assets in more than one country, whereby control is typically established through FDI, but can also be exercised through various non-equity forms. As such, international production goes beyond arm's length market exchanges by internalising cross-border exchanges related to productive assets located in different countries under the common governance of TNCs. As soon as FDI becomes a chosen vehicle for establishing cross-border linkages, the character of international economic integration changes from shallow to *deep integration*. However, deep integration differs from shallow in ways other than the chosen channel of establishing cross-border activity. Because FDI, unlike market-based exchanges, does not end with the initial transaction, it establishes a more lasting linkage between economic agents located in different countries. Consequently, and this is a central contention of this chapter, the type of strategy adopted by TNCs matters very much to the nature of deep integration and, by implication, to the way in which deep integration and shallow integration interact to establish a wider globalization process. Corporate strategies related to international production initially involve the common governance by TNCs of a limited number of corporate functions, often in the framework of a vertical division of labour, and as more and more functions are included under the common governance — both along vertical and, increasingly, horizontal lines — international production takes on a more *integrated* character.

One difficulty in discussing these developments is that the post-war period has been characterised by a plethora of changes and shocks at the macro- and micro-economic levels, many of which are only tangentially (or not at all) related to the strategies of TNCs. Disentangling all these developments is beyond the scope of this chapter. The focus is rather on the changing role of TNCs within the globalization process from a long-term perspective and, in particular, the qualitative evolution of international production. Section A identifies some of the forces behind globalization and explains why the period 1870-1913 can be regarded as a benchmark of international integration. Section B reviews the conditions, namely, the regulatory frameworks, technological changes and favourable growth environment, behind the rebuilding of international economic integration over the past 50 years. Section C describes the evolution of shallow integration. Section D deals with the growth of international production. Crucially, quantitative changes in international production have been accompanied by changes in the strategies and organization of TNCs that are leading to qualitative changes in international production and, in particular, the emergence of an integrated international production system, discussed in section E. But this process is uneven; Section F argues that, within this gradual process of systemic change, geography and governments still matter and diversity still persists. The final section considers how the development of integrated international production can lead to an internationalization of domestic policy issues — a characteristic feature of globalization.

A. Globalization: a long-term perspective

1. The expansion of markets, the evolution of firms and the process of international integration

In a sense, all economic activity takes place within national boundaries (Krugman, 1994; Kuznets, 1966). More significantly, decisions with a bearing on economic growth and competitiveness — such as the decisions to invest and innovate — have traditionally been discussed as the product of national firms under the auspices of their national States. Accommodating the steady growth of cross-border economic activity has produced considerable disagreement among economists. On the one hand, international trade theorists have assumed a world of complete markets and perfect competition to explore the benefits of shallow integration in the absence of TNCs and FDI, where the choice between flows of factors and goods is essentially arbitrary.[1] On the other hand, industrial organization theorists have assumed a world where firms must constantly choose between trade and FDI in their drive to expand activities across borders, and deeper integration reflects the strategic decision of firms to a world of cross-border market failures with significant transaction costs, in which the control over assets located in different countries certainly matters.

In recent years, these two perspectives have begun to converge on a view of the world economy with porous borders, in which TNCs are catalysts of fundamental change. In particular, the growth and complexity of cross-border economic linkages are embedding the national organization of economic activity within a global system of processes and transactions. However, the extent, nature and implications of this change continue to be strongly contested — indeed, sceptics continue to see the current process of deeper integration as little more than the simple continuation of long-standing trends.[2] Thus, before describing these changes and assessing their possible consequences for the world economy, it is helpful to approach the globalization process from a longer-term perspective.

The historical outlines of a world economy can be traced to the expanding trade routes of the "long sixteenth century" (Wallerstein, 1979). But its modern form lies in the eighteenth century transition from an agrarian to an industrial world. The early stages of industrialization were confined largely to products manufactured and sold within national economies; but increased specialization and capital accumulation quickly outgrew the limits of domestic markets. A new world economy slowly emerged as the potential gains from innovation and growth at the firm level coincided with and reinforced the growth and spread of markets. The geographical spread of economic activity did not, however, spontaneously create all the necessary links between firms and markets to ensure that globalization would be a smooth and uninterrupted process. In fact, the history of the world economy has been characterized by distinct periods of integration and disintegration (Maddison, 1989; Panic, 1988). Unexpected political and economic events have undoubtedly influenced the uneven globalization of the world economy. Moreover, routine and inertia have inhibited the development of economic activity, including its spatial distribution. But, more importantly, the strength of international economic integration has reflected the extent to which pressures exerted through the interaction of markets and firms have been complemented by an appropriate enabling institutional environment. Many of the institutional conditions enabling firms to integrate their activities across national borders have themselves retained a strong national focus. These include appropriate macroeconomic conditions, technology and innovation systems and various public investments (e.g., in education and infrastructure) that promote long-term competitiveness and capital accumulation. It is also through national institutions that the potential gains (or losses) from increased international economic integration are distributed. Consequently, the globalization process, in addition to involving the interde-

pendence of shallow and deep integration, has also involved a continuous interaction between firms, markets and states.

For much of the nineteenth century, the interplay of these national and international forces created a turbulent world. The unchallenged industrial leadership of the United Kingdom translated into political control across large parts of the world economy. The birth of new nations and the consolidation of older powers was a difficult process, often reinforcing industrial and military ambitions (Polanyi, 1957). But as military conflicts subsided and economic challenges rose, a period of political stability and consolidation coincided with an unprecedented spread of cross-border linkages. The period 1870-1913 has, in particular, been seen as one in which a virtuous circle of rapid economic progress and international integration established a core global economy (Keynes, 1971). Because the period is generally considered as representing a high point of integration, it provides a useful benchmark against which to measure contemporary changes in the world economy (see also Henderson, 1992; Panic, 1992).

2. 1870-1913: a benchmark of international integration

During the half century preceding the First World War, international integration was facilitated by an open regulatory framework (Morgenstern, 1959, p. 17): short- and long-term capital movements were unsupervised; the transfer of profits was unhampered; the gold standard was at its height and encompassed almost all the major industrial countries, as well as most smaller agrarian nations (Mckinnon, 1993, p. 3; Maddison, 1989); citizenship was freely granted to immigrants; and domestic institutions exerted minimal influence over the direct allocation of resources. The period 1870-1913 has been described as a "golden age" of international economic integration (Bloomfield, 1968, p. 1):

- In the core economies, exports outgrew domestic output and exports per capita rose not only in these countries, but also in a small number of developing countries (most spectacularly in Latin America).[3] Still, the pace of international integration of product markets seems to have been slower than during the preceding fifty years, the combined result of rapid import substitution in industries with a previously high export ratio and rising trade barriers, primarily against textiles.[4] But weakened trade integration was more than compensated by greater factor flows.
- The international integration of labour markets reached unprecedented levels. Intercontinental migration from the European periphery to the expanding North and South American economies — above all the United States — predominated. Between 1870 and 1915, 36 million people left Europe, two-thirds to the United States. But the process was more widespread. Intra-continental flows were significant in Asia; on one estimate, the number of Chinese and Indian emigrants — predominantly to Burma, Indonesia, Malaysia, Sri Lanka and Thailand — in that period exceeded European emigration (Lewis, 1978, pp. 183-184). Intra-European flows also reached significant levels, with large numbers of migrants from Austria, Hungary and Italy seeking (often, temporary) work in France, Germany and Switzerland (Ferenczi, 1929, pp. 223-227).
- Alongside increased international flows of labour were growing flows of capital. According to one estimate, the total stock of long-term foreign investment had, by 1914, reached $44 billion; the United Kingdom accounted for the largest share of this investment, more than France and Germany — the second and third largest investors — combined.[5] Formal restrictions on the flow of capital were almost entirely absent, and the historical evidence points to a considerable integration of financial markets during the period 1870-1913 (Morgenstern, 1959; Zevin, 1988).[6] Finally, the extent of cross-national ownership of securities (including government and private bonds and stocks) reached a remarkably high

level during that period. For instance, the share of foreign securities traded in London in 1913 was 59 per cent of all traded securities; in France, the corresponding share was 53 per cent in 1908; in some of the smaller European exchanges, that share was even higher (Morgenstern, 1959, pp. 512-528).

But alongside these elements of shallow integration, the period 1870-1913 also witnessed the rise of international production through FDI. That investment was a growing component of long-term capital flows. By 1914, the stock of FDI, by one estimate, had reached $14 billion, or one-third of world foreign investment. The United Kingdom was the leading home country, accounting for perhaps 45 per cent of the total, with the United States responsible for, perhaps, another 20 per cent (Dunning, 1983). The United States was the single largest host country, but substantial FDI flows went to developing countries in Latin America, China and the less-industrialized regions of Europe; by 1914, the majority of FDI stock was concentrated in developing countries. [7]

Thus, shallow and deep integration were both clearly visible throughout the period 1870-1913. The nature, scope and impact of international economic integration, however, were very much the outcome of national differences, not a sign of their diminishing importance.[8] During that period, the shift of resources from agriculture into industry accelerated in the group of economies that constituted the core of the world economy. Within industry, the dominant role of traditional sectors (such as textiles, clothing and iron and steel) using long-established technologies was challenged by entirely new industries (such as the emerging engineering industries, steel production and chemicals), characterized by more capital-intensive production techniques. Along with these structural changes came new ways of organizing production (the assembly line), new corporate structures and strategies suited to large-scale production and a new geographical division of labour (Lewis, 1978; Chandler, 1990). Technological advances reinforced these structural changes and accelerated international integration. New modes of transportation and communications (e.g., steamships, railroads, telegraph and cables) simultaneously altered the scale and organization of modern production activities, opened new markets and shrank the world.

These dynamic changes certainly reinforced the trend towards shallow integration. International trade grew even against the backdrop of rising tariff barriers, particularly those on manufactured goods, and the transportation revolution made possible unprecedented movements of labour, although economic circumstances dictated limited destinations. But, their most significant impact was on the growth of long-term investment, arguably, the single most important element of integration during the period 1870-1913:[9]

- The capital intensity of new industries stimulated large international movements of capital to a small group of newly-industrializing countries in North America and Europe where the required resources could not be mobilised internally;[10] in a number of these countries, foreign investments represented a very high share of gross domestic fixed investment.[11] These investments were mainly in the form of bonds with very long maturities and were made predominantly in public projects, such as railways, and were often matched by large amounts of government funds (Panic, 1992, p. 97).
- The primary sector accounted for 55 per cent of the total stock of FDI in 1913; 30 per cent was accounted for by transportation, trade and distribution and only 10 per cent by manufacturing (Dunning, 1983, p. 89). Although the geographical spread of FDI was greater than portfolio investment, the expansion of production activities abroad through FDI was also influenced by geographical factors. While the search for primary resources was a global process, the majority of manufacturing FDI was concentrated in Europe and North America.[12]

From this brief description it would appear that shallow and deep integration produced two rather different globalization paths in the period prior to the First World War. On the one hand,

for a large group of countries (and territories), international integration was the result of the expansion of primary exports, which were increasing more rapidly than trade in manufactures (Maizels, 1963). This was facilitated by FDI, labour flows and liberal commercial policies. International production in the primary sector was organized along vertical lines, involving a limited number of corporate functions and integrated through simple corporate strategies. However, FDI in the primary sector was also strongly complemented by investments in transportation and trade. The gains from integration accrued largely to the capital-exporting (commodity-importing) countries. During that period, some of the largest recipients of FDI (such as China and India) experienced a period of "deindustrialization"; other countries, however, such as Russia, those in the Austro-Hungarian Empire, as well as countries in Latin America that were industrializing, in part through FDI, continued to fall behind the core economies (Bairoch, 1982). In many cases, this path was reinforced by colonial governance structures.

On the other hand, in a few core countries where the pre-conditions for rapid industrialization were being successfully established, international economic integration further strengthened this process. Often behind rising tariff barriers for manufactured goods, capital exports (in search of profitable investments) complemented the efforts of these capital-importing countries to pursue industrialization strategies (Panic, 1992, chapter 3; Lewis, 1978, pp. 177-178). Foreign direct investment in manufacturing activities — although more limited than in the primary sector — by adding technological and managerial flows — further reinforced that process (Wilkins, 1994, pp. 37-39). However, and by contrast to international production in the primary sector, foreign manufacturing affiliates were typically stand-alone (Jones, 1993), that is, only very weakly integrated at the production level. Even in those industries — such as machinery and transport equipment — where the new mass production technologies encouraged investment in foreign production facilities, the existing technologies of coordination and supervision allowed only the simplest forms of integration (Chandler, 1986).

B. Rebuilding international economic integration

Between the beginning of the First World War and the end of the Second World War, many of the linkages established across the world economy over the preceding forty years were severed. Wartime controls persisted after 1918 and, although economic growth accelerated in the 1920s, the international financial system was marked by increased instability, outflows of long-term capital from industrial countries slowed dramatically and world trade failed to recover to its pre-war level. The international economic order crumbled in 1929 with the world recession and the insularity of national recovery strategies.[13]

Since the Second World War, during a period of unprecedented growth and macroeconomic stability, these linkages have been gradually rebuilt. Both domestically and internationally, post-war economic development has rested on the successful repair, expansion and regulation of market linkages. A new international economic order has slowly evolved, under which increased cross-border flows of goods, services and factors have reinforced the domestic consensus on economic growth. Two features of this order have been of particular importance to the renewal of the process of international integration: a facilitating international policy framework and technological progress. But, the wider impact of these features on international economic integration has been strongly conditioned by the strength of economic growth and a broad tendency for convergence (in terms of the structures of economic activity and productivity performance) across parts of the world economy over the past fifty years.

1. The new international policy framework

With the turmoil of the 1930s still very much in mind, a new international order to facilitate a more open trading arrangement and stable monetary conditions was an immediate concern of post-war policy makers:

- Initial efforts to create an International Trade Organization as part of the Havana Charter were stillborn. Instead, the promotion of *trade* was based upon a multilateral principle of reciprocity under the General Agreement on Tariffs and Trade (GATT). The successive rounds of GATT negotiations sought a more open trading environment through the steady diminution of border barriers and the removal of intentional discrimination against foreign goods, services and firms. Despite the undoubted increase in non-tariff barriers, notably in industries such as electronics and automobiles, the implementation of a wide range of bilateral and unilateral trade measures, in parallel with GATT rounds, further liberalized world trade. Measured in terms of tariff reductions, progress has been impressive (table III.1). With the conclusion of the Uruguay Round, the average tariff on industrial goods in developed countries will be below 4 per cent.[14] Such measures have proceeded furthest within regional trading blocs (although it is arguable as to whether such developments divert, rather than create, trade). Overall — and especially in light of the conclusion of the Uruguay Round, the establishment of the single European market and the implementation of the North American Free Trade Agreement — it is clear that the current international trading environment is more open than at any time since 1945 and, arguably, than before the First World War.
- A primary objective of the 1944 Bretton Woods agreement was to create a more orderly and stable basis for dealing with balance-of-payments problems and for regulating longer-term financial transactions between countries on the basis of fixed exchange rates pegged to the United States dollar. The aim was to provide the necessary financial lubricant for a reconstructed world economy. In the late 1950s, the restoration of currency convertibility among the leading industrial nations began a long-term trend in the direction of financial liberalization and increased international capital mobility. The Code of Liberalisation of Capital Movements and the Code of Liberalisation of Invisible Operations, adopted by the Organisation for Economic Co-operation and Development (OECD) in 1961, went some way to institutionalize this consensus. A series of regional initiatives, such as the European Community's directives on capital movements, has pressed further in the direction of a complete liberalization of financial markets, particularly since the late 1980s. Although the

Table III.1. Average tariff rates on manufactured products in selected developed countries, 1913, 1950 and 1990

(Weighted average; percentage of value)

Country	*1913*	*1950*	*1990*
France	21	18	5.9
Germany	20	26	5.9
Italy	18	25	5.9
Japan	30	..	5.3
Netherlands	4	11	5.9
Sweden	20	9	4.4
United Kingdom	-	23	5.9
United States	44	14	4.8

Source: Bairoch, 1993, table 3.3.

breakdown of the Bretton Woods system in the early 1970s created a more volatile international financial environment, the general trend has remained one of increasing liberalization of financial markets. Indeed, since the late 1970s, unilateral measures to dismantle barriers to financial flows, coupled with the proliferation of new financial instruments, has transformed the international financial system (UNCTAD, 1991; O'Brien, 1992).

- The international framework governing the flow of *technology* has, in part, been subsumed by other regulatory structures. Laws controlling mergers and acquisition, joint ventures, cooperation agreements and local-content legislation, in so far as they relate to technology transfer, have been liberalized in recent years. However, the flow of proprietary knowledge across borders has evolved separately from those governing other flows. Many of the international rules on intellectual property rights date back to the previous century. In the post-war period, the formation of the World Intellectual Property Organization (WIPO) in 1967 and various regional initiatives in Europe and Africa strengthened the framework on proprietary knowledge (Lesser, 1990, pp. 13-14). The proliferation of domestic legislation and bilateral and multilateral agreements during the 1980s, culminating in the inclusion of intellectual property rights in the Uruguay Round negotiations, anticipates a common system of intellectual property protection consistent with higher standards of protection in more developed countries and covering a wider range of instruments (UN-TCMD, 1993f). Parallel to this trend, much of the legislation — regional and national — introduced in developing countries in the 1960s and 1970s to screen and control the technology-transfer process has been relaxed or dismantled in areas such as royalty payments between parent firms and affiliates, authorization and duration of contracts, and registration procedures.

- The regulatory framework for *foreign direct investment* has evolved more unevenly than that for either trade or financial flows (Fatouros, 1994). A multilateral agreement on global investment principles was discussed in 1947 as part of the draft Havana Charter but failed to gain approval. In the following two decades, multilateral negotiations on the protection of foreign-owned assets were hindered by differences over a government's right to expropriate foreign property, and FDI legislation remained firmly grounded at the national level, with considerable variation in frameworks (Rubin and Wallace, 1994). Efforts to construct a more systematic FDI policy framework began in the mid-1960s, through bilateral investment treaties and expanding regional and multilateral negotiations. Bilateral investment treaties first emerged in the 1960s between European countries and their former colonies (predominantly in Africa). These have steadily grown in number — by January 1994 there were 570 such agreements — and have expanded in geographical scope over the past two decades (chapter VII). In 1976, OECD conducted multilateral negotiations over a broad range of investment issues, the outcome of which was the Declaration on International Investment and Multinational Enterprises. Efforts in the United Nations and the World Bank have pushed further in that direction. So did the Uruguay Round in the area of services and trade-related investment measures. Given the nature of international service transactions, the General Agreement on Trade in Services, in particular, introduces a fledgeling FDI regime for the services sector, thus covering more than half of worldwide FDI flows. Regional efforts to construct a more open FDI regime have been organized in the European Union and North America (the United States-Canada Free Trade Agreement and, more recently, NAFTA). All these efforts have been complemented — and in many ways been overtaken — by a rapid liberalization of restrictive national laws since the mid-1980s (chapter VII). As more countries liberalize, convergence to a common FDI framework is occurring in areas such as the right of establishment; national treatment; repatriation rules; and compensation payments.

- In contrast to capital markets, *labour markets* have remained largely closed at the national level. In general, tight controls on international flows of labour were introduced in the traditional migrant-receiving countries during the 1930s. The subsequent removal of these controls (with alternating periods of tightening and relaxing) over the period since the Second World War has been governed by economic conditions, as well as political and cultural legacies. More recently, however, regional initiatives, such as those within the European Union, the European Economic Area and NAFTA have eased restrictions on the mobility of labour, especially business and professional persons, and the Uruguay Round provides incipient rules for the negotiation of progressive liberalization of the temporary movement of persons supplying services.

Unlike the gold standard, this regulatory framework has been established through a purposeful process of institution building beginning at Bretton Woods, but gradually encompassing a growing body of international institutions. Over the past fifty years, this framework has created a more open — although uneven — environment for engaging in cross-border exchanges.

2. The enabling technologies

It is no accident that the major surges in international integration — during the period 1870-1913 and in the period since the Second World War — have been associated with new organizational and technological developments. These developments do not, of themselves, cause international integration, but without the ability to transcend geographical distance in the movement and organization of economic activities, it is clear that greater integration would not be possible (Brooks and Guile, 1987; Dicken, 1992b).

Many of the technological developments of the post-war period have improved existing technologies. The cumulative improvements in transportation technology have continued to reduce the time and cost of moving materials, products and people across space. For example, the evolution of the jet aircraft from turbo-prop to jet propulsion dramatically shrank global distances so that, for example, New York is now closer to Tokyo in terms of travel time than it was to Chicago in the latter half of the last century. Similarly, the advent of satellite technology from the early 1960s expanded the geographical reach of communication technologies. However, a key feature of the period since the Second World War has been the development and (since the late 1960s) the widespread diffusion of new technologies based upon the microelectronics revolution and, in particular, what has come to be seen as the major new generic technology: information technology. This defines a new techno-economic paradigm since the introduction of information technologies has "such pervasive effects on the economy as a whole that they change the style of production and management throughout the system" (Freeman, 1987, p. 130).

Information technology is the outcome of the convergence between two initially distinct technologies: communications technology, which is concerned with the transmission of information, and computer technology, which is concerned with the processing of information. Progress along both fronts has been remarkable. Through the collection, transmission and processing of information, the new telecommunication technologies are establishing truly global electronic highways (Henderson and Castells, 1987), and the reduced cost of transmitting information along these highways is making them accessible to an ever wider network of users. For instance, in the late 1960s the annual cost of an Intelsat telephone circuit was more than $60,000; twenty years later, it was $9,000 and in 1994 was under $5,000. Such developments have enabled companies to bypass national telecommunication systems and assimilate rapidly these technologies for their own use. Similarly, the speed, cost and capacity of computers has changed at a dramatic pace and there is little indication of this slowing down. But it is the combination of the two technologies — exemplified by satellite and optical fibre technologies, facsimile machines, computer-aided design and manufacturing systems — that is most significant for the processes of internationalization and

globalization of economic activities. Although reinforcing the international production of a number of activities that have traditionally contained a large information or knowledge component (such as financial activities), these technologies are transforming the nature and organization of activities which have traditionally given less weight to these components. In particular, these new technologies are increasing the knowledge component of traditional manufacturing activities, enabling firms to redeploy their production activities in a more geographically dispersed fashion, whilst maintaining rigorous quality controls, achieving low transaction and coordinating costs and guaranteeing organizational flexibility to ensure high levels of innovativeness and productivity (Dunning, 1994). As a result, the production process itself is being transformed.

3. Growth and convergence

The underlying causes of the rapid growth after the Second World War are undoubtedly complex, and beyond the scope of this chapter. But of particular importance to the process of international economic integration, rapid economic growth, for much of the past fifty years, has been accompanied by a gradual convergence in economic performance (Abramovitz, 1989; Baumol, 1986; Baumol, et al., 1989; Dowrick and Nguyen, 1989; Rowthorn, 1992). Its most visible manifestation has been a decline in the relative economic strength of the United States and the emergence of Japan as a leading industrial centre. Albeit more circumscribed, there is some evidence that the convergence in economic structures and consumption patterns has not been confined to the core economies alone (Dowrick and Gemmell, 1991; Blomström, et al., 1992).[15] The rise of the South East Asian "miracle" economies has been the most visible indication of a wider convergence "club". But for much of the past fifty years, structural changes across the developing world have evolved in a similar direction; manufacturing is now a more spatially dispersed activity and manufacturing exports dominate the trade and investment profiles of many developing countries (Scott, 1992, p. 15). Furthermore, structural changes have turned most countries into economies in which the services sector is the largest sector — in the case of all developed countries, accounting for over half of domestic output. This structural change has an increasingly important impact on the structure of the world economy and is becoming an increasingly prominent source of international transactions.

* * *

These factors have combined to reestablish the process of international economic integration that was lost during the period between the two world wars. To some extent, this process has been a continuation of trends established during the benchmark period 1870-1913; but it has also introduced important changes in the world economy, particularly in the sphere of international production.

C. Shallow integration

The size and geographical scope of cross-border market exchanges has, over the past fifty years, been strongly influenced by political developments. In particular, for much of this period, the centrally planned economies were integrated only very weakly into the world economy, and many of the newly independent nations of the developing world reacted to the enforced liberalism of the colonial era through more restrictive economic policy regimes. Nevertheless, the period since the Second World War has exhibited a clear trend towards more integrated world markets:

- Beginning in 1950, *international trade* grew rapidly — albeit from a low starting point — and considerably faster than output (although the higher productivity of the tradable-goods sector prevented the share of exports in the value of production from rising in Europe or Japan until the mid-1960s). Unlike the period before 1913, manufacturing exports were the fastest growing element of world trade. Between the early 1950s and the early 1970s, the global output of manufactures quadrupled, whilst world trade in manufacturing expanded eightfold — much of it inter-industry trade (Glyn, et al., 1991, p. 42; Forstner and Ballance, 1990; Lewis, 1980). Although the 1970s and 1980s have seen a return to rates of growth of world trade more similar to those in the period before the First World War (table III.2), still, with very few exceptions, most countries are more closely linked through trade today than they were twenty or fifty years ago, and integration through trade, in many cases, is greater than that reached before the First World War (table III.3). The geography of trade-based linkages is also considerably wider in scope, a reflection of the longer-term trend towards a rising ratio of manufacturing to total exports that accompanies economic development (Maizels, 1963). All developing-country regions have increased their share of total trade going to manufacturing (especially since the early 1970s) and have expanded the share of this trade destined for developed economies. Greater intraregional trade flows have, in part, encouraged this trend. Still, with the exception of Western Europe, extra-regional trade remains predominant (Lawrence, 1993).[16] Trade in services, which has expanded in recent years, has added a further layer of complexity to international trade

Table III.2. Growth of world trade and output, 1870-1990

(Average annual growth rate, percentage)

Item	*1870-1913*[a]	*1950-1960*	*1960-1970*	*1970-1980*	*1980-1990*
World trade	3.9	6.5	8.3	5.2	3.7
World gross domestic product	2.5	4.2	5.3	3.6	2.8
Difference	1.4	2.3	3.0	1.6	0.9

Sources: World Bank, 1991; UNCTAD, 1993a; Maddison, 1991.

[a] Includes Australia, Austria, Belgium, Canada, Denmark, France, Finland, Germany, Japan, Italy, Netherlands, Norway, Sweden, Switzerland, United Kingdom and the United States.

Table III.3. Trade integration, selected countries, 1913, 1950, 1973 and 1992

(Exports as a share of gross domestic product, percentage)

Country	*1913*	*1950*	*1973*	*1992*
France	13.9	10.6	14.4	17.5
Germany	17.5	8.5	19.7	24.0
Japan	12.3	4.7	8.9	9.2
United Kingdom	20.9	14.4	16.4	18.2
United States	6.1	3.6	3.6	7.1
Developing countries[a]	..	16.5[b]	17.8	19.8

Sources: UNCTAD, *Handbook on Trade and Development Statistics*, various years; OECD, 1994a; Maddison, 1989.

[a] As a share of gross national product.

[b] 1958.

Table III.4. International financial deepening: international banking in relation to world output, trade and investment, selected years

(Percentage)

Item	*1964*	*1972*	*1980*	*1985*	*1991*
As a share of world output					
Net international bank loans	0.7	3.7	8.0	13.2	16.3
Gross size of international banking market	1.2	6.3	16.2	27.8	37.0
As a share of world trade					
Net international bank loans	7.5	31.5	42.6	80.4	104.6
Gross size of international banking market	12.4	53.7	86.3	169.7	215.6
As share of world gross fixed domestic investment					
Net international bank loans	6.2	25.6	51.1	103.7	131.4
Gross size of international banking market	10.3	43.7	103.6	219.2	270.9

Source: Akyuz, 1994.

Table III.5. Integration of financial markets, selected years

(Billions of dollars and percentage)

Category	*Early 1970s*	*1990*
Cross-border interbank liabilities		
All countries (Billion dollars)	455	5 560
Share of borrowing banks in industrial countries	70	75
Share of lending banks in industrial countries	68	75
Cross-border bank credit to non-banks		
All countries (Billion dollars)	54	1 708
Share of lending to borrowers in industrial countries	31	58
Share of lending by banks in industrial countries	80	69
Cross-border bank deposits of non-banks		
All countries (Billion dollars)	75	1 695
Share of banks located in industrial countries	81	76
Share by residents of industrial countries	16	50

Source: Bloom and Brender, 1993, table 17.

relations, although it remains highly concentrated among developed economies (UNCTAD, DTCI, 1994e).

- A more liberal policy framework and technological progress have had their most dramatic effects on *financial markets*. The full convertibility of most European currencies in the late 1950s initiated a steady internationalization of financial markets; but it was only with the emergence of the Euromarkets that the process began to accelerate. The resulting internationalization of financial markets over the past two decades has been dramatic (table III.4). For 1992, the size of world financial markets was estimated at $43,000 billion, nearly a threefold increase over the decade (Akyuz, 1994). International assets (international bank assets, eurobonds, euoroequities etc.) accounted for 18 per cent of the total; in many countries, that share was considerably higher than the share of foreign trade in GDP. For developed economies, the ratio of cross-border bank lending to GDP was 4 per cent in the early 1980s; 10 years later it had reached 44 per cent (OTA, 1993, p. 151). Foreign ownership of Government bonds, foreign participation on national stock markets and daily turnover of foreign-exchange markets have shown equally impressive rates of internationalization over that period. Of perhaps even greater significance, the truly global firm — whose operations are unconstrained by the limitations of time or space — appears to have evolved furthest in financial services, such as securities, insurance and payment services (O'Brien, 1992, pp. 78-82). Although measures of financial integration are more difficult to construct than international trade movements (due to the incompleteness of the data and the unevenness of data collection) and direct comparisons with the period before the First World War are correspondingly difficult to make, the internationalization of capital flows appears to have been accompanied by the increased integration of capital markets,[17] especially among developed countries (table III.5).

- As regards international *labour flows*, the absolute numbers over the past 50 years, though substantial, have been dwarfed by increases in population. Although the new international division of labour has helped to stimulate new movements of workers, in reality, such movements affect only a small proportion of the world's labour force. Labour is still relatively immobile and labour markets are strongly segmented by location, skill or gender (Storper and Walker, 1989). However, there has been a significant shift in labour-receiving countries away from North America and Australia towards Western Europe and the Middle East. Europe is now the largest employer of foreign workers (some 6 million), followed by the United States and the Middle East (5 million each); a growing share of these workers is from developing countries (Widgren, 1990). But unlike the period before the First World War, most of these workers are unlikely to become permanent residents in these countries. Slower economic growth in the developed countries since the early 1970s and the tightening of immigration laws have meant that labour markets remain significantly less international than before the First World War.[18]

Since 1945, economic and political forces have combined to open up and reintegrate national economies into the world economy. This process, still in progress, has lasted longer and has involved more countries than before 1914. Together, liberalization, technological progress, economic growth and convergence help to explain the pace and sequence of post-war shallow integration from its initial focus on trade and related financial flows, to the dramatic acceleration of financial integration over the past two decades. With the exception of labour flows, the level of shallow integration appears to have at least reached that established by the beginning of the First World War. These same processes have also increased the scope of international specialization and production and help explain why long-term capital flows — unlike during the period before the First World War — have taken less the form of portfolio flows and more that of FDI and, correspondingly, why deeper integration through TNCs has played a more prominent role in the world economy, and increasingly so over the past two decades.

D. International production

During the inter-war period, FDI was, perhaps, less adversely affected by growing uncertainties than other international activities: between 1914 and 1938, the stock of outward FDI almost doubled, reaching over $26 billion. More significantly, that period marked the rise of the United States towards becoming the leading home country. Although the United Kingdom was still dominant in 1938, its share of total FDI stock fell from 45 per cent to under 40 per cent during the inter-war period, while that of the United States rose from under 20 per cent to 28 per cent (Dunning, 1983).

United States firms emerged from the Second World War with a clear lead in the technological and organizational assets that were the basis of international competitiveness. This lead stimulated an increase in their level of foreign operations and in the share of foreign operations in the total activity of United States' firms. Only a small number of other countries' firms with a long-standing experience in international production — such as those from the Netherlands, Switzerland and the United Kingdom — could match the international operations of United States TNCs. However, the process of growth and convergence among the advanced countries over the past 50 years, explicit government policies — particularly in Western Europe but also elsewhere — to foster large domestic firms and the gradual liberalization of FDI policy frameworks have given rise to a growing number of TNCs from an increasing number of home bases. These conditions have established an environment for the deeper integration of the world economy. The following developments deserve particular mention:

Table III. 6. The role of foreign direct investment in world economic activity, 1913, 1960, 1975, 1980, 1985 and 1991

(Percentage)

Item	*1913*	*1960*	*1975*	*1980*	*1985*	*1991*
World FDI stock as a share of world output	9.0 [a]	4.4	4.5	4.8	6.4	8.5
World FDI inflows as a share of world output	..	0.3	0.3	0.5	0.5	0.7
World FDI inflows as a share of world gross fixed capital formation	..	1.1	1.4	2.0	1.8	3.5
World sales of foreign affiliates as a share of world exports	..	84 [b]	97 [c]	99 [d]	99 [d]	122

Source: UNCTAD, Division onf Transnational Corporations and Investment, based on UNCTAD-DTCI, FDI data base, UN-DESIPA data base; Dunning, 1993a and Bairoch, 1994.

a Estimate.

b 1967 based on United States figures.

c Based on United States and Japanese figures.

d 1982 based on German, Japanese and United States data.

- Foreign-direct-investment flows increased throughout the post-war period, experiencing a particularly sharp up-turn during the mid-1980s. Correspondingly, the stock of FDI rose from $68 billion in 1960 to $2.1 trillion in 1993, an annual compound growth rate of 11 per cent. The relative importance of FDI flows in the world economy also increased, particularly as regards trade (table III.6), as well as in relation to domestic economic activity — including domestic investment (see Annex table 5). Since the late 1980s, FDI has grown more rapidly than international financial flows (Akyuz, 1994).
- By the early 1990s, there were some 37,000 TNCs (table I.1). The number of those based in 14 major developed home countries more than tripled during the past two decades, from 7,000 in the late 1960s to nearly 26,000 in the early 1990s. The total number of foreign affiliates stands at some 206,000, a dramatic acceleration over the 3,500 manufacturing affiliates established between 1946-1961 (Dunning, 1983). Most recently, international production by small and medium-sized enterprises and firms from developing countries has further expanded the universe of TNCs (UN-TCMD, 1993c).
- As a result of these developments, the sales of foreign affiliates have surpassed exports as the principal vehicle to deliver goods and services to foreign markets (table III.6). This alone — and even without taking into account the linkages between FDI and trade as well as the dissemination of technology — makes FDI one of the most important mechanisms of international economic integration.
- The accumulation of the global stock of FDI has been accompanied by its changing sectoral composition, with a discernible shift from resource-based and traditional manufacturing to high-technology and service industries. For much of the past 50 years, manufacturing has been the force behind the growth of FDI. However, since the mid-1970s, its share of the outward stock has fallen, and that of services has risen. The increasingly perceived need for an efficient services sector has added impetus to the rapid growth of FDI in that sector since, given the nature of most services, they typically need to be produced when and where they are consumed. Services held the largest share of the outward stock of major home countries in the early 1990s: its share was over 50 per cent for some of these countries (table I.7). This is consistent with patterns of broader structural changes in economic activity, although the match is not perfect (UNCTAD-DTCI, 1993a; Ozawa, 1992).
- Growth and sectoral changes in FDI have coincided with changes in its geographical distribution. Similar to the post-war pattern of international trade flows, FDI flows were initially concentrated in a small number of developed countries. But their sustained increase has coincided with a diversification of home and host countries. The dominance of the United Kingdom and North America as home and host regions that characterized the two decades after the Second World War has gradually diminished and has been replaced

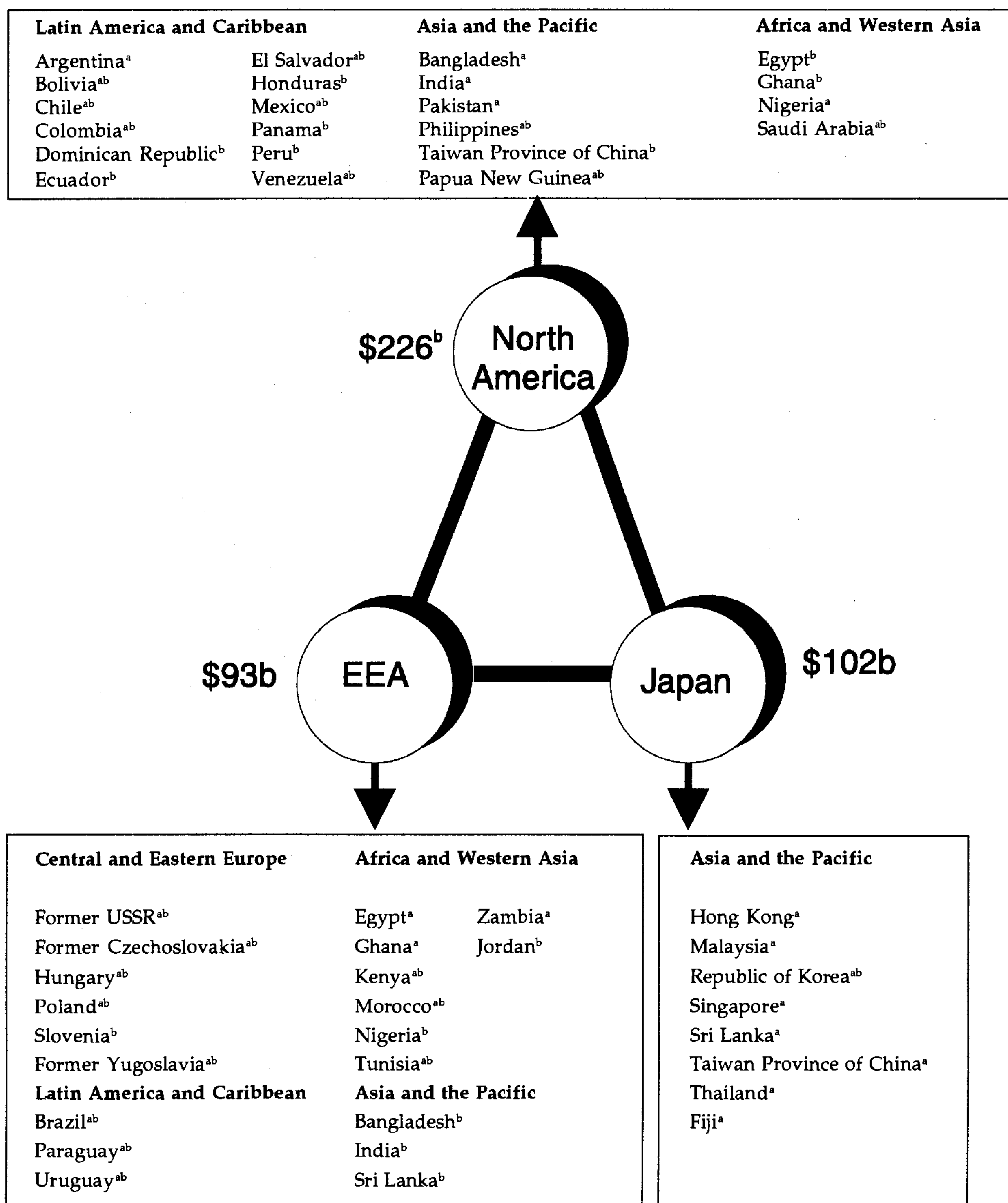
Table III.7. Share in world outward stock of foreign direct investment, by selected countries, 1914, 1960, 1978 and 1992

(Percentage of world total)

Country	***1914***	***1960***	***1978***	***1992***
France	12.2	6.1	3.8	8.3
Germany	10.5	1.2	7.3	9.2
Japan	0.1	0.7	6.8	13.0
United Kingdom	45.5	16.2	12.9	11.4
United States	18.5	49.2	41.4	25.3

Source: Dunning, 1983; annex table 4.

Figure III.1. The Triad of foreign direct investment and its clusters, 1991



Source: UNCTAD, Division on Transnational Corporations and Investment.

a In terms of average inward FDI flows, 1987-1991.

b In terms of inward FDI stock for 1991.

by a Triad pattern of FDI centred on the European Union, Japan and North America (table III.7 and figure III.1). In contrast to the period of integration before the First World War, developing countries have been far less central to these developments. Indeed, the share of developing countries in world FDI inflows declined steadily over the post-war period, although FDI continued to be a significant component of domestic capital formation in a number of countries and recent signs appear to contain the seeds of a sustainable increase of investment flows to developing countries (chapter I). Furthermore, the absolute increase of FDI stock in developing countries has left few countries untouched and, because of the shift away from investments in the primary sector, the spatial web of FDI is almost certainly more extensive than before the First World War. At the same time, a number of developing countries are clustered around one of the Triad members (figure III.1), that is, firms from one home country region account for the dominant inward FDI share of a given host country. Moreover, the spatial pattern of FDI over the past fifty years appears to have been less closely associated with trade patterns, compared with the period before the First World War. Thus, despite the pressures towards regionalization, FDI is still more idiosyncratic and less regionally concentrated than, for example, trade (UNCTAD-DTCI, 1993a, chapter VII).

Although the particularly rapid increase of FDI during the 1980s reflected a number of one-time and short-term developments, the underlying trend is grounded in longer-term and structural factors (UNCTAD-DTCI, 1993a). Still, FDI data do not capture the full extent of TNC

Table III.8. Exports by Japanese, Swedish and United States manufacturing transnational corporations and foreign affiliates, 1965-1990

(Percentage of world exports of manufactures)

	Japan		*Sweden*		*United States*	
Year	*Total*	*Foreign affiliates*	*Total*	*Foreign affiliates*	*Total*	*Foreign affiliates*
1965	..	..	1.6	0.2	15.0	4.8
1970	..	..	2.0	0.2	..	..
1975	11.0	0.8	2.0	0.3	15.4	6.4
1985	22.1	1.9	1.8	0.4	18.1	8.7
1990	14.6	1.7	..	..	16.0	8.7

Source: UNCTAD-DTCI, 1994f, forthcoming.

activity. In many instances they record only the initial entry of a firm into a foreign location; subsequent expansions by foreign affiliates are often not recorded in new FDI inflows. In addition, FDI is only one measure of the internationalization of production; output, sales, employment and assets provide alternative measures. Although reliable and comprehensive longitudinal data on all these measures are scarce, the following appears to be the trend since the Second World War (UNCTAD-DTCI, 1994f):

- International production rose steadily through the late 1970s, but has subsequently appeared to level off. Taking sales by foreign affiliates as a broad measure, TNCs from the United States showed a clear lead from the 1950s. But since the 1960s, firms from other developed countries began to reduce that lead. Indeed, TNCs from those countries, notably Japan, have partly compensated for the recent reduced pace of international production by TNCs originating from the traditional home economies, notably the United States. Thus, over the period 1977-1989, the combined share of affiliate sales by United

States and Japanese TNCs as a percentage of world gross domestic product has been constant (around 10 per cent). The addition of other home countries — such as Germany and Sweden — would, however, suggest a slightly rising trend over this period and, given the rapid rise of FDI flows since the mid-1980s, it could be conjectured that the overall relative importance of international production has begun to rise again. Foreign affiliate sales compared to exports, showed a marked increase in the second half of the 1980s (see table III.6). The importance of international production as a source of world employment is much smaller than that of output — an indication of the higher productivity of TNCs — but the trends are similar. Over the twenty years up to 1977, the share of overseas employment by United States TNCs in world employment rose by over 50 per cent, but declined subsequently. In the meantime, the share of German and Japanese foreign-affiliate employment in world employment, negligible in the 1950s, rose substantially — although, from the late 1970s, not enough to offset the decline in share of employment by United States affiliates (see also chapter IV).

- Despite the declining share of manufacturing FDI in the overall stock of FDI, on other measures manufacturing continues to take a lead role in the spread of international production; if sales of foreign affiliates are taken by themselves, their share in world exports of manufactured goods increased since the mid-1970s (table III.8).

Table III.9. The importance of transnational corporations in the economies of the United States, Netherlands and Japan, 1977, 1982 and 1989

(Percentage of equivalent domestic figure)

Year	Assets		Employment		Gross product	
	Total	Manu-facturing	Total	Manu-facturing	Total	Manu-facturing
United States						
1977	29	..	31	63	37	72
1982	36	..	30	63	38	73
1989	27	..	27	63	32	72
Netherlands	Total [a]	Manu-facturing[a]	Total	Manu-facturing	Total	Manu-facturing
1977	..	..	..	..	..	..
1982[b]	52	59	42	48	46	52
1989[c]	59	63	40	47	42	48
Japan	Total	Manu-facturing	Total	Manu-facturing	Total [d]	Manu-facturing[d]
1977[e]	21	38	7	16	23	30
1982[b]	24	38	8	16	24	31
1989	24	37	7	16	24	32

Source: UNCTAD-DTCI, 1993a, and UNCTAD-DTCI, data base.

a Denominator is the consolidated assets of non-financial companies (private companies and cooperative societies with assets exceeding 10 million guilders).

b 1983.

c 1991. d Sales. e 1980.

- Trends in international production are confirmed at the country level, although the influence of size and history takes on greater significance. Smaller countries show a greater

Table III.10. Degree of transnationalization of United States non-bank transnational corporations, by sector, 1983-1991 a

(Percentage accounted for by foreign affiliates in total TNC activities)

	Assets			*Sales*			*Employment*		
Year	*Primary*	*Secondary*	*Tertiary*	*Primary*	*Secondary*	*Tertiary*	*Primary*	*Secondary*	*Tertiary*
1991	80.1	22.9	23.7	83.5	31.8	29.3	78.0	30.2	22.4
1988	74.4	21.2	19.5	73.2	29.6	28.1	68.9	29.3	20.2
1985	72.1	18.5	16.8	78.8	23.9	24.9	69.8	28.7	18.8
1983	69.5	19.4	18.1	79.3	25.0	27.0	69.2	28.3	18.7

Source: UNCTAD, Division on Transnational Corporations and Investment, based on United States, Department of Commerce, *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates* (Washington, D.C., Government Printing Office), various issues.

a Measured by the share of foreign affiliates in total TNC (parent firms and foreign affiliates) activities.

role for international production than larger ones at a comparable level of development. Of importance for future trends, the take-off in international production is apparent in a number of newly industrializing economies; in some cases, such as the Republic of Korea and Taiwan Province of China, the pace of international production appears to have been particularly rapid during the 1980s.[19]

The level of international production reached over the past fifty years is not unprecedented historically, at least in terms of the share of the stock of FDI in world GDP. However, many more countries are now both home and hosts to TNCs, and FDI is playing a more significant role in the economies of most developed and many developing countries.

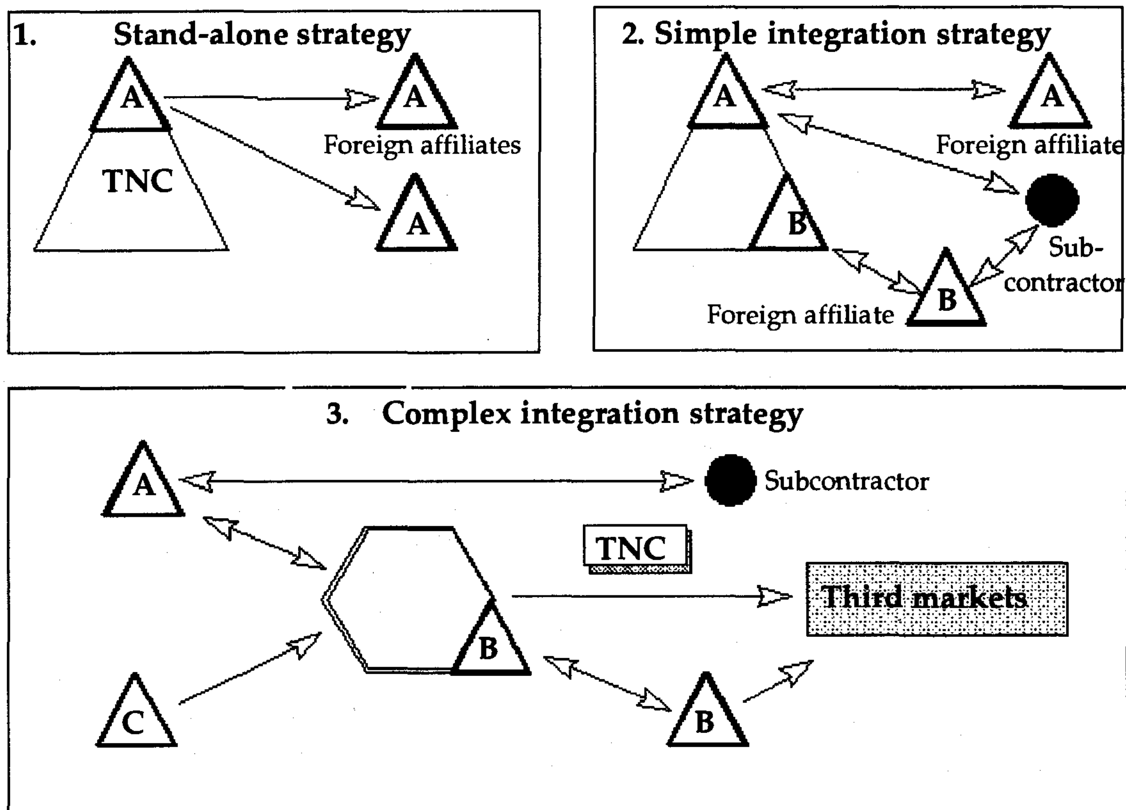
But far more important, because many TNCs in manufacturing and services are also large domestic firms with a significant share of domestic assets, employment and output, is the fact that the overall influence of TNC governance is unprecedented historically. Combining the domestic activities of TNCs in a particular country with the activities of foreign affiliates, gives an indication of this wider scope of international production (table III.9). Overall, as much as one-third of world output may now be under the direct governance of TNCs, with the indirect influence being almost certainly much greater (UNCTAD-DTCI, 1993a). Moreover, as the data for United States non-bank transnational corporations indicate (table III.10), while the share of foreign affiliates in total TNC activities rose considerably between 1983 and 1991 in all sectors, there remains a lot of scope for greater transnationalization in the secondary and tertiary sectors — certainly compared to the primary sector.

However, the influence of TNCs on the process of international economic integration is not only confined to production. Transnational corporations have also changed the nature and scope of shallow integration. The pressures increasing intra-industry trade — product differentiation, technological progress and global economies of scale — have been closely associated with TNC activity, as has the rise of trade in services. The internationalization of financial markets has also been closely associated with the spread of international production (Kregel, 1992). Finally, TNCs have often been the conduits for the transfer of technology and management practices (see chapter VII).

E. Integrated international production

Trends in international production indicate a persistent deepening of international economic integration over the past fifty years. However, they capture only a part of the fundamental changes associated with that process. The fact that the number of TNCs, FDI flows and affiliate employment are rising faster than their domestic counterparts, does not, in itself, indicate a *qualitative* change in international integration. However, it is precisely in this sense of integration that the current period contrasts most markedly with the 1870-1913 period. This qualitative shift

Figure III.2. International production strategies



Source: UNCTAD, Division on Transnational Corporations and Investment.
Note: A, B and C denote different functions/activities.

Table III.11. The strategies and structures of transnational corporations

Strategy	*Intra-firm linkages*	*Foreign affiliate type*	*Degree of integration*	*Environment*
Stand-alone, e.g., multi-domestic	Ownership, technology, finance; mostly uni-directional	Miniature replica of the parent firm	Weak	Host country accessible to foreign direct investment; trade barriers; costly communications and transportation
Simple integration, e.g., outsourcing	Ownership, technology, markets, finance, other inputs; mostly bi-directional; subcontracting	Rationalized producer of one or a few elements in the value chain	Strong at some points of value chain, weak in others	Open trade and FDI regimes, at least bilaterally; non-equity arrangements permissible
Complex integration at the regional or global levels, e.g., networks	All functions; mostly multi-directional	Product or process specialist; functional specialization	Potentially strong throughout value chain	Open trade, technology FDI and related regimes; use of advanced information technology; convergence in tastes, heightened competition, low communication and transportation costs.

Source: UNCTAD, Division on Transnational Corporations and Investment, based on UNCTAD-DTCI, 1993a, and Hamill, 1993b.

consists of a far greater degree of geographical and organizational integration of production and the emergence of an *integrated international production system* (UNCTAD-DTCI, 1993a). At the heart of this shift are changes in TNC strategies (figure III.2 and table III.11):[20]

- In the past, the foreign production of national firms was typically characterized by a clear division of tasks between parent companies and foreign affiliates. This division was a reflection of the fact that, in most cases (with the natural-resources sector being an obvious exception), foreign affiliates would follow a *stand-alone strategy*, replicating more or less in total the entire value chain of the parent firm (with the exception, typically, of technology and finance which were imported from parent firms), thus performing all tasks necessary for servicing the host country and/or neighbouring markets. In this respect, the initial acceleration of international production after the Second World War was the extension of corporate strategies already visible in the limited FDI flows in manufacturing during the period 1870-1913.
- However, some of the same pressures driving shallow integration — particularly liberalization and technological progress — steadily altered the way in which international production is being undertaken. The cost-competitiveness of standardized goods, the convergence of consumption patterns and falling transportation and travel costs have expanded the geographical reach of corporate strategy, enabling large oligopolistic firms — in industries such as automobiles, aerospace and electronics — to combine economies

of scale with the organization of low-cost suppliers on a worldwide basis. This has led to the adoption of *simple integration strategies,* where affiliates undertake — typically with technology obtained from the parent firm — a limited range of activities in order to supply their parent firms with specific inputs that they are in a more competitive position to produce. Such strategies have given rise to new forms of cross-border linkages (such as subcontracting relations) and allow for greater two-way flows of information, technology and value-added activities between parent firms and affiliates.

- A feature of both stand-alone and simple integration strategies is that production within a TNC remains quite fragmented and cross-border internalisation of economic activity is rather limited. However, enabled by the liberalization of the frameworks for international economic transactions, the spread of information technology, and driven by competition, TNCs have begun to redefine the way in which they manage and organize their worldwide productive assets. More specifically, as part of *complex integration strategies,* TNCs are turning their geographically dispersed affiliates and fragmented production systems into regionally or globally integrated production and distribution networks.

Since complex integration strategies substantially enlarge the scope of corporate functions being undertaken in an integrated manner across borders — in combination with the fact that TNCs account for a substantial share of world output — they introduce significantly new characteristics into the process of international economic integration.

1. Complex integration strategies and organizational structures

Global economies of scale have reinforced the dynamics of international oligopolistic rivalry already visible in simple integration strategies. On the one hand, concentration of global production has continued in several industries, and TNCs have adapted to this increasingly (but imperfectly) competitive world economy by creating regional and, in some cases, global markets for a particular product range (Levy, 1993). The tendency for consumption patterns to converge — at least in the developed economies — has reinforced the standardization of products across national boundaries. The entry of new firms from developed and developing countries has been facilitated by diminishing market barriers and the increasing technological sophistication of national firms, resulting in an intensification of international competition in many industries. On the other hand, while the entry of new firms and the decline in trade barriers has intensified international competition, many standard products must still be adapted to national and regional tastes. Together, these trends have pushed TNCs to seek new ways of gaining international competitive advantages and have required them to give much closer attention to the way in which different elements of their value chains are combined and coordinated. In particular, adapting to rapid technological progress — such as new information technologies and flexible production systems — has become an integral part of corporate restructuring in a global economy.

New corporate strategies have evolved in response to pressures of global markets and innovation. On the one hand, an almost exclusive emphasis on production costs has been replaced by a growing emphasis on product differentiation, through product quality, design and closer pre- and post-sales relationships. In a number of industries, established corporate advantages and predictable firm behaviour have been replaced by continuous innovation and cooperative agreements among firms in search of complementary assets, increased speed of market entry and risk sharing. This search for innovative assets is also becoming increasingly global in scope, drawing in an ever growing number of industries (Jacquemin, 1991). Under these conditions, firms — regardless of size — place growing emphasis on improving their knowledge base, building an extensive communication network, linking with a sophisticated business infrastructure and achieving the "synergic effects" of combining specialized and complementary knowledge across the value chain (Michalet, 1991, p. 80).

Table III.12. Growth in strategic alliance formation, 1980-1989
(Number and percentage)

Industry/region	1980-1984		1985-1989		Percentage change
	Number	Per cent	Number	Per cent	
Automobiles	26	100	79	100	203
United States-Europe	10	39	24	30	140
United States-Japan	10	39	39	49	290
Europe-Japan	6	23	16	20	167
Biotechnology	108	100	198	100	83
United States-Europe	58	54	124	63	114
United States-Japan	45	42	54	27	20
Europe-Japan	5	4	20	10	300
Information technology	348	100	445	100	28
United States-Europe	158	45	256	58	62
United States-Japan	133	38	132	30	-0.8
Europe-Japan	57	16	57	13	-
New materials	63	100	115	100	83
United States-Europe	32	51	52	45	63
United States-Japan	16	25	40	35	150
Europe-Japan	15	24	23	20	53
Chemicals	103	100	80	100	-22
United States-Europe	54	52	31	39	-43
United States-Japan	28	27	35	44	25
Europe-Japan	21	20	14	17	-33

Source: United States Congress, Office of Technology Assessment, 1993, figure 5.3.

At the same time, TNCs are searching for more effective ways for organizing and governing the range of assets they own in different locations. The shift to a more complex integration at the corporate level requires a breakdown of the value chain into discrete functions — assembly, procurement, finance, research and development etc. — and their location to wherever they can be carried out most effectively in light of the overall needs of the firm as a whole. For example, one unit located in one country may be responsible for research and development for the entire corporate system, another unit in another country for finance and a third unit in yet another country for marketing; all of them then form one corporate system with a unified strategy and a common governance.

As an increasing number of functions are organized within a framework of complex integration strategies, this form of international production requires substantial flows of technology, skills, finance (including royalties, dividends and intra-company funds) and goods and services. With regard to goods, these flows involve increasingly more differentiated products and take place not only between parent firms and their foreign affiliates, but also among affiliates. In fact, to the extent that the individual units of a TNC system assume responsibilities that are clearly defined as part of an intra-firm international division of labour, the distinction between parent firm and affiliates becomes less meaningful. As a result, the firm resembles more a network than a hierarchy. Moreover, such networks are not self-contained, but rather are connected with other corporate networks through a variety of linkages, ranging from subcontracting, to licensing agreements, to consortia and strategic alliances; at times, in fact, it may become difficult to determine the exact boundary of a particular firm. Network relationships — both within and

between firms — are an integral part of complex integration strategies, as such, forming a dynamic mixture of internalized and externalized activities, all of which require more horizontal linkages to ensure effective coordination.

Among these inter-firm linkages, strategic alliances are particularly important because they often bring large and otherwise competing firms together for specific purposes. Although strategic alliances are not a new phenomenon (Kindleberger, 1988), what is new is their increased frequency and their centrality to many firms' strategies. According to one study, cooperative agreements between United States firms and foreign firms outweigh the number of fully owned foreign affiliates by a factor of four (Gugler and Dunning, 1993, p. 124). Alliances are common in many industries, but they are especially prevalent in information technology, biotechnology, automobiles and new materials industries (table III.12). Essentially, these are industries that are characterized by high entry costs, scale economies, rapidly changing technologies and substantial operating risks (Morris and Heigert, 1987). The changing geographical pattern of strategic alliances between the United States and Europe, the United States and Japan and Europe and Japan (table III.12) suggests that there is no single trend of alliances becoming more important between pairs of countries. Thus, one of the most distinctive features of the new pattern of corporate strategies involves the increased use of cooperative arrangements between firms — transnational and domestic, large and small, public and private — to speed up market entry, gain access to technologies and share financial costs and risks. In contrast to FDI (in terms of greenfield investment), joint ventures and mergers and acquisitions, strategic alliances do not necessarily imply equity involvement. Rather, they involve sharing complementary assets between firms, to gain various advantages.

* * *

Complex integration strategies define a new best practice for corporate strategy and organization. Firms following this strategy are no longer merely an agglomeration of discrete units, but rather all individual units are subject to one unified strategy that governs the entire corporate system. Equally crucially, this best practice strategy applies to each corporate function, with the additional possibility that the implementation of each function for the corporation as a whole can be of a vertical or a horizontal nature, depending on what configuration contributes most to the profitability of the entire corporate system. For the same reason, the geographical coverage of each function can vary; some functions can be integrated globally (e.g., finance), others regionally (e.g., production) while again others may remain entirely local (e.g., training of workers). A firm pursuing complex integration strategies needs to be seen, therefore, as consisting of an integrated set of corporate functions, each with (potentially) varied geography. In this strategy, intra-firm transactions of goods and services play, by necessity, an important role. Furthermore, because each element of the production chain is highly dependent upon all other elements within the system, information and coordination requirements are high. In this respect, advances in information technology have played a pivotal role in turning the potential for operating and effectively coordinating spatially dispersed functions into a reality for many TNCs. The resulting product is a complex bundle of inputs, produced in a variety of locations, assembled in host or home countries for sale in those countries or anywhere in the world. To identify such a product with a single country becomes, therefore, less and less meaningful — a fact that may make it increasingly meaningless to identify a product as "Made in [name of country]" but rather requires an identification as "Made by [name of firm]". In a sense, TNCs seem to be in the process of replicating at the international level the degree of integration of production achieved at the national level, especially in their home countries.[21]

Given their highly transnational nature, manufacturing TNCs have often been the first to be re-engineered for complex integration strategies. High volume industries, such as automobiles and chemicals, are replacing the simple outsourcing of parts and components on a regional basis with a more intricate regional or global integration of various elements of their production chain. The contrasting success of the "world car" in the 1970s and the 1990s provides telling evidence of the advance in complex integration strategies (Dicken, 1992b; UNCTAD-DTCI, 1993a). But firms in a number of more traditional industries, such as textiles and furniture, have also begun to reorient themselves in a similar manner. Although slower to take-off (given the inherently limited tradability of many services), a number of service TNCs have advanced their integration strategies further than many manufacturing TNCs. Indeed, the large information component of many services and the strong complementarities between many service functions makes them particularly suitable for this type of integration once the application of computer and information technologies raises their tradability (UNCTAD-DTCI, 1994e; Sauvant, 1986). Financial services are at the forefront of this development, but other services — such as research and development, some legal services, accounting, data entry and software — are following suit. In many respects, the traditional sectoral boundaries are becoming increasingly irrelevant to complex integration strategies. Indeed, most TNCs integrate both service and manufacturing functions, internalizing this traditional division within the value-added chain of the firm (Reich, 1992).

2. Towards an integrated international production system

The discussion so far has dealt with the strategy and organization of individual firms. The aggregation of complex integration strategies across a large number of TNCs brings about the emergence of an integrated international production system. The potential size of this system and its geographical configuration is determined by the size and spread of international production described in the preceding section, and is estimated to account for about one-third of world output. But even though more and more firms pursue complex integration strategies under the pressures of competition, such strategies coexist with stand alone and simple integration strategies. *Integrated* international production encompasses therefore only a part of international production. But, crucially, it reaches deeper into the fabric of international economic relations. As a result, it places economic activities that were previously subject solely to national control also under the common governance of TNCs. As this form of governance becomes more widespread and encompasses a larger share of world output, the nature of the world economy changes: national economies — still subject to domestic governance structures — are no longer linked through markets alone, but rather are increasingly integrated at the level of production, with this production (and attendant transactions) under this governance of TNCs. In addition, the linkages established through the governance are further strengthened by the flow across borders of norms, values and routines (business culture) that are becoming of central importance to international competition in a more integrated world economy.

Naturally, this integration at the level of production finds its expression in intra-firm exchanges of both tangible and intangible assets. Virtually no data exist on exchanges of intangible assets, especially services performed within corporate systems. Data on international technology payments are, however, indicative. To the extent that these are measured by the payment of fees and royalties, data for the United States and the United Kingdom suggest that some 80 per cent of such exchanges are done on an intra-firm basis, that is, within corporate systems, and over 90 per cent in the case of Germany (table III.13). In the case of the United Kingdom, this has been a spectacular rise since the mid-1980s. Even more significantly for the scope of deep integration, in the case of the United Kingdom and United States over 90 per cent of exchanges with developing countries take place between parent firms and affiliates. (As noted earlier, the sharing of technology occurs, to varying degrees, in the framework of all three types of corporate strategies described above.)

Table III.13 Germany, United Kingdom and the United States: technology receipts, 1986-1992

(Millions of national currency units and percentage)

	Germany [a]			United Kingdom [b]			United States [c]		
		Receipts from all affiliated enterprises			Receipts from all affiliated enterprises			Receipts from all affiliated enterprises	
Year	Total receipts	Percentage	Percentage in developing countries	Total receipts	Percentage	Percentage in developing countries	Total receipts	Percentage	Percentage in developing countries
1986	1 698	92.1	..	845	54.7	..	7 927	75.5	96.3
1987	1 792	90.8	..	997	65.6	..	9 914	77.0	96.4
1988	1 898	93.2	..	1 132	64.8	..	11 802	77.6	96.3
1989	2 104	91.0	..	1 303	66.9	..	13 818	79.3	96.4
1990	2 434	92.3	..	1 420	70.5	95.1	17 069	80.2	96.3
1991	2 419	94.3	..	1 563	76.3	95.5	18 479	79.9	96.2
1992	..	..	..	1 990	76.3	94.2	20 238	79.6	96.2
1993	..	..	..	2 077	79.7	..	..	..	..

Source: UNCTAD, Division on Transnational Corporations and Investment, based on Deutsche Bundesbank, *Monthly Report*, 44, 4 (April 1992), p. 33; United Kingdom, Central Statistical Office (CSO); United States, Department of Commerce, 1993f, tables 4.1 to 4.4 and 1992b, tables 4.1 to 4.3, pp. 94-96.

a Includes receipts from patents, inventions and processes.

b Includes receipts of royalties on printed matter, sound recordings or performing rights as well as technological royalties.

c Includes royalties and licence fees.

Table III.14. United States and Japan: intra-firm trade, 1977, 1982 and 1989
(Percentage of total exports or imports)

Year	*United States*		*Japan*[a]	
	Exports	*Imports*	*Exports*	*Imports*
1977	36	40	24[b]	32
1982	33	37	31[c]	18
1989	34	41	33	29

Sources: Bonturi and Fukasaku, 1993; UNCTC, 1988a, p. 92.
[a] Refers to Japanese TNCs only.
[b] Refers to 1980.
[c] Refers to 1983.

As far as the exchange of tangible assets is concerned, some data exist on intra-firm trade, including the changing composition of such trade (Gray, 1993). Apart from the long-established intra-firm trade in natural-resource products (that was already a feature of international firms before 1914), intra-firm trade in intermediate products and services is primarily a phenomenon of the past few decades. In the early 1970s, intra-firm trade was estimated to account for around 20 per cent of world trade; by the early 1990s, that share was around one-third, excluding intra-TNC transactions in services (UNCTAD-DTCI, 1993a, pp. 164-165). In particular, the absolute level of United States intra-firm trade has increased sharply in recent decades (Levy, 1993): the value of United States intra-firm exports increased by nearly two-thirds between 1977 and 1982 and by over 70 per cent between 1982 and 1989. By 1989, intra-firm exports and imports were one-third and over forty per cent, respectively, of all United States trade and one-third of Japanese exports and 29 per cent of imports (table III.14).

Of possibly greater importance to the future direction of international production, there has been a significant change in the product composition of intra-firm trade. The importance of intra-firm trade in natural resource-based commodities has declined (consistent with broader trends in trade) over the past fifty years, and intra-firm trade in manufactured goods grew during the 1970s, particularly in medium and high-technology industries that have undergone rationalization on a world scale (automobiles, household appliances, radio and television equipment, office machinery, instruments and pharmaceuticals). This trend is reflected in the higher level of intra-firm imports for manufactures compared to other products (Levy, 1993, p. 35). This shifting composition is also apparent in the rising share of intermediate products in intra-firm exports from parent companies (table III.15).

The question, nevertheless, remains as to why intra-firm trade in the United States has not continued to increase in relative importance given the emergence of integrated international production. This can be attributed to the externalization of various functions in the value-added chain, which takes many forms, of which international sourcing is the most significant. Outsourcing has become an increasingly important practice in most industries, as TNCs focus more closely on core activities and purchase various intermediate goods and services from other firms. The international sourcing of inputs has grown steadily in all developed countries for which data are available (table III.16). In the case of international sourcing, the principal firm (normally a TNC) coordinates and often controls the relationship with its suppliers. In many industries, the trend

is towards much closer, longer-term relationships between firms and their principal suppliers. The latter are increasingly being given greater responsibility by TNCs for the quality and design of the sourced product, and increasingly committing know-how and resources to ensure that their suppliers have the appropriate technology and capabilities to be effectively integrated within their own value chain (UNCTAD-DTCI, 1994g). Although in industries such as automobiles the

Table III.15. Share of intermediate products in exports from Swedish transnational corporations, by industry, in total exports and to manufacturing affiliates, 1974-1990

(Percentage)

Industry	*1974*	*1978*	*1986*	*1990*
Chemicals				
Share to affiliates	21	46	55	78
Total exports	4	7	5	17
Metals				
Share to affiliates	35	51	28	23
Total exports	4	7	9	11
Machinery				
Share to affiliates	36	23	20	28
Total exports	7	5	4	5
Electronics				
Share to affiliates	35	34	36	62
Total exports	9	5	7	5
Transportation				
Share to affiliates	72	75	66	95
Total exports	10	18	12	25
Other				
Share to affiliates	26	33	64	39
Total exports	1	2	7	4
All industry				
Share to affiliates	44	45	47	64
Total exports	6	8	8	14

Source: Andersson, et al., 1993.

number of preferred suppliers is being reduced, the relationship between them and TNCs is becoming closer. As a result, a complex, multi-tiered structure of supplier firms and subcontractors is emerging.

3. Conclusions

Transnational corporations are pursuing complex integration strategies in response to competitive pressures in the expectation of greater efficiency. The overall size of the integrated international production system that is emerging as a result is still difficult to gauge, but a number of indications suggests the emergence of TNCs that are visibly global in their operations in industries such as automobiles, microelectronics, consumer electronics, household appliances, office machinery, instruments, pharmaceuticals and financial services. These are industries in which the basic structural indicators of the way production is organized and markets are served

Table III.16. Ratio of imported to domestic sourcing of intermediate inputs, selected countries
(Percentage)

Country	*Early 1970s*	*Mid- and late 1970s*	*Mid-1980s*
Canada	34	37	50
France	21	25	38
Germany	..	21	34
Japan	5	6	7
United Kingdom	16	32	37
United States	7	8	13

Source: Levy, 1993.

point to a systemic global (or regional) form of integration. In these industries, the value-added chain is, in whole or in part, geographically fragmented; but the individual functions of the chain, whether internalized or externalized, remain under the control and coordination of the major TNCs. In these industries, the leading firms have — or strive to have — a direct presence in each of the three Triad members. Within those areas, production and distribution are being rationalized and restructured, particularly where, as in the case of the European Union, internal barriers to the flow of factors, as well as intermediate and final products, are being dismantled.

However, it would be wrong to suggest that it is only in these clear cases of "global" industries that the tendencies towards deeper international integration and an integrated international production system occur. Examples of the same tendencies can be found in other industries that, overall, do not possess the attributes normally identified with global industries. Textiles, apparel and furniture industries each contain elements of integrated international production, even though they have a high degree of organizational fragmentation. Leading textile companies, such as Coats Viyella (United Kingdom), a company that grew through major acquisitions over the past few years, pursue integrated international production strategies. Japanese textile firms and general trading companies (*sogo shosha*) have, since the 1960s, adopted integrated production strategies in textiles and apparel within East and South-East Asia. Levi Strauss (United States) also operates in an integrated manner in an industry in which, for the most part, production is organized in small units geared to specific geographical markets. The furniture industry is probably even less integrated overall than the apparel industry and yet companies like IKEA (Sweden) have created extremely sophisticated integrated international production and distribution systems that incorporate large numbers of small subcontractors (mostly in Central and Eastern Europe).

These developments describe a profound change in the manner in which the integration of the world economy is governed. In the past, common governance has typically referred to an established and recognized macroeconomic framework that organized the process of international economic transactions, specifically, the gold standard before 1913 and the Bretton Woods institutions after the Second World War. In both cases, deep integration was also present, but the strategies adopted by private-sector actors seeking new ways of organizing and governing production activities across national boundaries faced significant constraints as a result of which deep integration was limited and confined mostly to vertical integration within natural-resource firms. Today, the emergence of an integrated international production system is taking place in the context of greater macroeconomic uncertainty and instability. But, conversely, as many of the constraints on deeper integration have been relaxed, firms have taken advantage of the possibilities of cross-border interactions and have strengthened international governance at the production level.

The relative importance of international production in the world economy is reaching that achieved before the First World War. But, unlike the period 1870-1913 when international production was concentrated in the primary sector and based upon simple but strong vertical linkages, international production has its roots in the manufacturing sector and has a potential to be integrated in more complex ways. Beginning in a limited fashion before the First World War, international production in manufacturing was initially less integrated than in the primary sector. However, from these early stand-alone affiliates, integrated international production in the manufacturing and services sector — to the extent that this traditional division can still be used — has begun to evolve along both horizontal as well as vertical divisions, reflecting the functional breakdown of different components of the value chain and implying greater geographical scope. As a result, a substantial share of global output is being reorganized under the common governance of TNCs, leading to an integrated international production system. As part of this reorganization, attendant international economic transactions (especially trade and technology transfers) are being taken out of the market and internalized within TNC networks. Organized by TNCs, deep integration and parts of shallow integration are becoming intertwined in the broader context of globalization. In the process, the nature of the world economy is undergoing a fundamental change: from being a collection of independent national economies linked primarily through markets, the world economy is becoming, for the first time, an international production system, integrated increasingly through numerous parts of the value-added chain of production.

F. The uneven landscape of integrated international production

Despite the operation of powerful forces creating a higher degree of global integration of economic activities, it should not be assumed that there is a smooth, even or inevitable evolution towards a uniform system of integrated international production. Technological developments in transport and communications have not removed the influence of space — geography still matters. Furthermore, TNCs continue to operate on a rough surface of regulatory complexity and uneven factor availability, and do so in a variety of ways — governments still matter. In addition, TNCs originate in specific places and, through the influence of routine and inertia, carry with them some of the attributes acquired there. Consequently, a high level of diversity continues to exists.

1. Geography still matters

To begin with — and notwithstanding their geographical reach — TNCs are still substantially creatures of their domestic environments. Certainly, the argument that TNCs have, in effect, become de-nationalized (Reich 1992; Ohmae 1990) is only a partial interpretation of the real world (Hu, 1992; Krugman, 1994). As has been observed: "However great the global reach of their operations, the national firm does, psychologically and sociologically, 'belong' to its home base. In the last resort, its directors will always heed the wishes and commands of the government which has issued their passports and those of their families" (Stopford and Strange, 1991, p. 233). In fact, the boards of directors of most TNCs continue to be predominantly of home-country origin; TNCs still continue to gain some clear advantages from their long-standing involvement with their "domestic" economies; and "mutual interest" between TNCs and their home-country governments continues to be strong (Hu, 1992; Streeten, 1992).

Equally important, technological changes have not removed the relevance of location for many production activities; in fact, in some cases, rapid technological changes, including organizational innovations, such as lean production, in which trust and reliability are at a premium, appear to reinforce geographical differences (Levy, 1993; Krugman, 1993). Furthermore, local and regional economies of agglomeration have not disappeared. High value-added

functions continue to be attracted to locations with the right mix of complementary industries and skills. Thus, even as capital becomes more mobile, TNCs and their affiliates continue to derive their competitive advantages in part from interacting with the local economy.[22] Consequently, "differences in national economic structures, values, cultures, institutions, and histories contribute profoundly to competitive success. The role of the home nation seems to be as strong as or stronger than ever. While globalization of competition might appear to make the nation less important, instead it seems to make it more so" (Porter, 1990, p. 19).

The influence of geography is apparent in FDI flows. Foreign-direct-investment flows are consistent with a more dispersed pattern of production (as more factors come to influence the location of FDI and TNCs can more effectively assess the range of locational options), or a more concentrated pattern (if TNCs are attracted to areas with already established advantages). Most likely both tendencies can occur simultaneously. The concentration of FDI inflows in ten developing countries has already been noted — this trend has, if anything, become even more pronounced with the recovery of FDI flows to developing countries in the past several years; market size — exemplified by the recent increase of FDI into China — remains a significant influence on the concentration of these flows. Nor has the evolving pattern of FDI flows escaped the formation and strengthening of regional economic blocs; countries undertake a disproportionate share of their investment in the economies of their regional partners. Canada, for example, had 71 per cent of its FDI stock in the United States and Latin America in 1990. Italy had 74 per cent of its investment stock in the European Union in 1990 (Petri, 1994). The intraregional share of investment is not quite as high in East Asia as in Europe and North America, but is still high when compared to the region's overall investment relationships. For the regions indicated in table III.17, the share of investment conducted with regional partners is higher than the share of those partners in world investment in general (UNCTAD-DTCI, 1993a).[23]

In light of the complex integration strategies pursued by TNCs, the emerging pattern of FDI flows within the European Union, which has advanced furthest — both *de facto* and *de jure* — towards an integrated economic space, provides an important indication of the likely concentration and dispersion of potential benefits. During the 1980s, in part anticipating the completion of the Single Market, inflows into the European Union rose significantly, accounting for over 50 per cent of world inflows and some of the countries, most notably Spain, have been particularly attractive locations. Still, the contribution of FDI to gross domestic capital formation is actually highest in those countries where incomes are already high and some of the poorest countries of the Union were noticeably unsuccessful in attracting a larger share of inflows. Moreover, an analysis of the location of FDI within some of these countries suggests that it is concentrated in wealthier locations (de Vet, 1993). From this brief discussion, it is clear that geography still matters in attracting FDI, and that FDI can act as much to reinforce differences between countries as to reduce those differences.

Table III.17. The intensity of foreign direct investment, by host region, 1990a

Region	*North America*	*Latin America*	*Europe*	*Africa*	*Western Asia*	*South Asia*	*East Asia*
North America	1.97	1.12	0.84	0.49	0.85	0.32	0.8
Europe	0.98	0.53	1.32	1.16	0.79	1.77	0.56
East Asia	1.28	1.09	0.5	1.10	1.12	0.28	1.94

Source: UNCTAD-DTCI, 1993a.

a The intensity ratio: share of host region in outward investment stock of a given country, divided by share of host region in worldwide FDI stock.

2. Governments still matter

The reshaping of today's world economy, no less than in earlier periods, is an interactive process between firms, markets and states (Dicken 1992b, 1992c, Yoffie 1993; Panic, 1993; Stopford and Strange, 1991). The importance of the state in influencing the strategies, structures and behaviour of TNCs and, therefore, the nature and extent of integrated international production, lies in its dual role as *regulator* of specific activities and as *container* of specific assemblages of political, economic, social, cultural and institutional attributes. But it is this particular assemblage of both components that is likely to mold domestic businesses and affect their international nature (Whitley, 1992a, 1992b): "host governments wield the power to limit the extent of, or even to dismantle, the MNC integrated manufacturing and trade networks with more regulations and restrictions on foreign investments and market access" (Doz, 1986, p. 39).

But governments can, and do, create, modify or even destroy comparative and competitive advantages. In imperfectly competitive markets, first-mover advantages, externalities and spillovers are still seen to require governments to intervene in favour of their domestic firms (Ostry, 1990, p. 60). In some countries, for example, in the United States, this has led to a growing demand for a more strategic policy stance. This shift is particularly evident with regard to high-technology industries that are seen to be at the centre of a country's competitiveness. Within the broad tendency towards greater deregulation, therefore, there are significant differences between individual states. And despite the undoubted changes that have occurred in its autonomy, the State remains a critical actor in the organization of the world economy and a major source of continued unevenness in the extent and form of integrated international production.

Still, the general trend in the national and international regulatory environment has been towards greater deregulation and more openness towards flows of trade and investment. But that does not mean that the regulatory surface has become uniform, even in industries, such as telecommunications, that are quite becoming transnational in nature (Victor and Yoffie, 1993). A level playing field certainly does not yet exist; there are still large differences in regulatory structures and attitudes between nations. From the perspective of integrated international production, the two most critical aspects of state regulatory policy for a TNC are access to markets and/or resources (including human resources) and rules of operation for firms operating within particular national (or supranational) jurisdictions (Reich, 1989). In both of these aspects, continuing liberalization of policy (see chapter VII) exists side-by-side with continuing, or even new, types of restrictiveness.

One of the most important recent developments in the international regulatory environment has been the strengthening of regional economic integration, notably in Europe (the process to complete the Single European Market by the end of 1992 and the subsequent development of the European Union) and North America (the Canada-United States Free Trade Agreement and the North American Free Trade Agreement). Such developments are designed to remove regulatory barriers to trade and factor flows and to harmonize some areas of legislation between member States. But the process is both complex and time-consuming. The move to a new, enlarged scale of regulation is far from straightforward; and, in the transitional period, regulations regarding access and operations often become more complicated. In effect, deregulation can become "reregulation", sometimes, as in the case of regional blocs, on a larger geographical scale. Thus, although the emergence of new, and strengthened, regional blocs greatly alters the nature of the international regulatory surface on which TNCs operate, it does so in complex, and often uncertain, ways. This applies also — and particularly so — in the area of labour markets (see Part Two).

3. Diversity still persists

Thus, despite the trend towards integrated international production, the extent of global integration and its actual form are subject to modification and reshaping by the existence of location specific differences. The geographical and functional integration of corporate activities and the emergence of an integrated international production system are far from uniform, even in the same industry and even in industries that are generally considered to be very integrated internationally (box III.1). Regional integration strategies continue to exert a considerable influence on FDI flows, albeit in complex ways. Indeed, the proliferation of different strategies, including those of the same TNC, is likely to be a characteristic feature of the evolving integrated international production system. Many firm- and industry-specific advantages remain tied to regional, national or sub-national levels, and concentration is still a persistent feature of the geography of production. This is true not only of many traditional industries, but also of high-technology and service industries.

G. Globalization and integrated international production

Globalization is often taken to connote fully integrated markets for final goods and services and for factors of production. This, which has been termed here shallow integration, implies the entry and exit of economic agents into markets, largely unhindered by political boundaries and regardless of their place of origin. Over the past fifty years, economic and political factors have combined to produce a level of shallow integration at least comparable to that reached before the First World War. The result is a considerably more complex pattern of international specialization and exchange than was present when the Bretton Woods institutions were established, a pattern, furthermore, that encompasses virtually all countries in the world.

But — a central theme of this chapter — globalization cannot be divorced from the actual process of producing goods and services. The kind of governance structure required to coordinate such a process across national borders is unlike that required for market exchanges because international production involves the internalization of transactions within TNCs. This process of deep integration includes qualitative changes in the organization of transnational activity leading to the creation of an integrated international production system encompassing a substantial share of world output. There can be no doubt that the strategies and structures leading to integrated international production can bring benefits at the firm level; nor can it be doubted that the higher degree of interdependence between activities located in different countries, organized in a manner to increase the productivity of the entire value chain, widens the geographical network of TNC activity.

These processes of shallow and deep international economic integration are closely linked — indeed the strength of globalization implies strong complementarities between the two processes. However, there is no *a priori* reason to assume that both are moving in the same direction along a more dynamic growth path for the world economy. Most attention has focused on how best to manage the process of shallow integration to facilitate economic growth; but new and difficult policy issues arising from deeper processes of integrated international production have now emerged and deserve the full attention of national governments and the international community.

The structural, technological and organizational changes accompanying integrated international production are likely to be prerequisites for renewed growth and increased employment opportunities at the national and regional levels. More speculatively, cross-national economies of scale, economies of scope and organizational learning certainly hold out the possibility of a new growth dynamic in the world economy (Whadwani and Shah, 1994). But, to date, this remains

Box III.1. The automobile industry

Historically, the geography of automobile production owed a great deal to its early national regulatory structures, especially tariffs. The existence of high tariffs on imported vehicles from the early days of that industry's development led to major investment decisions by the leading producers, notably the United States companies, to build or acquire assembly and manufacturing plants in each major export market. These decisions were reinforced by technical regulations that were highly differentiated between countries. The inheritance of this regulation-driven pattern has been a subsequent lengthy rationalization and restructuring of national operations to reposition firms in regional and global markets. Since the 1970s, however, largely because of the increasingly intensive competition from Japanese producers, the regulatory emphasis has shifted from tariff to non-tariff barriers. Voluntary export restraints have been advocated by the United States and by several European countries for Japanese automobile imports. These have, inevitably, helped to force Japanese automobile manufacturers to establish operations in the United States and Europe. In the European case, the regulatory environment has changed dramatically as part of the programme to complete the Single Market. Physical, technical and fiscal regulatory barriers to internal trade and investment are being removed, and this will certainly benefit those major automobile firms that currently have the most highly integrated European operations. This is because their ability to optimize their in-house and externalized component and vehicle-sourcing strategies will be greatly enhanced by the removal of internal physical and technical barriers.

An important additional regulatory mechanism focuses specifically on Japanese companies. The earlier bilateral "voluntary" agreements to restrict Japanese automobile imports operated by various European Union members have been replaced by a very complex (and contentious) transitional arrangement that freezes Japanese imports until 1999, but allows growth of Japanese production within the European Union. At the same time, the emphasis on local-content levels has been enhanced, even though there is no specific quantitative level embodied in the Treaty of Rome. In the United States, pressure to increase local content has helped to stimulate the arrival of more than 300 Japanese component manufacturers; so far, the same trend has not occurred in Europe.

It might be expected that the common competitive, technological and regulatory environment facing the major automobile producers, especially in Europe, would have led to a common strategic orientation. But this has not happened. Although, in order to compete with the Japanese, United States and European companies have adopted measures to introduce more flexible and lean production methods to rationalize and restructure their production networks and have engaged in strategic alliances, the actual extent of their international operations and degree of global integration varies enormously. In general, United States, European and Japanese automobile manufacturers have evolved substantially different strategies. GM and Ford (United States) are unequivocally moving towards globally (and regionally) integrated companies. The recent announcement by Ford to move to common governance of product, manufacturing, supply and sales activities along global product lines will, undoubtedly, reinforce integrated international production in the automobile industry (Done, 1994). But among the leading European producers, only Volkswagen can be regarded as pursuing a genuinely internationally integrated strategy. The Japanese companies, despite their recent international expansion, are far less global in their operations than the leading United States companies.

Source: Dicken 1992a, 1992c.

only a promise. Realizing the potential inherent in an integrated international production system and ensuring its sustainability will depend upon favourable demand conditions and the wider spread of benefits at local, national and international levels. However, because globalization is understood here as including both shallow and deep integration, it is necessary to take a more encompassing policy approach.

1. The domestic management of the integrated international production system

For the past two decades, globalization has been accompanied by uneven growth in the world economy and by growing economic uncertainty. The globalization of financial markets has led to a significant growth in capital mobility and speculative activity, has dissolved the traditional boundaries between banking and non-bank forms of corporate activity and has weakened the efficacy of traditional tools of macroeconomic management. Global competition has also disrupted the established industrial structures that facilitated unprecedented productivity growth in the 1950s and 1960s. Regional blocs have grown in significance with, still, uncertain consequences for the world economy. Corporate strategies have begun to adapt to these developments through closer linkages at the production level, but systemic vulnerability and uncertainty may limit their more widespread benefits.

Much like earlier periods of structural and organizational change, the transition to an integrated international system, itself, produces considerable uncertainty and disruption; the replacement of traditional skills, corporate down-sizing and plant relocation can all be seen as temporary adjustment problems arising from the establishment of this new system of production (see chapter IV). But even assuming that these adjustments are temporary, the system of integrated international production is particularly vulnerable to micro-economic and macroeconomic imbalances. Not only does integrated international production generate many more linkages, both vertical and horizontal (thus increasing complexity and, consequently, vulnerability to disruption), but also the high degree of specialization in an international division of labour implies that no firm or industry — or indeed national or regional economy — within this system can operate effectively without relying on many other firms and industries in the system. Furthermore, infrastructure and human-resource needs are particularly high under these circumstances; rates of investment may need to be higher than those prevailing under the simpler integration strategies of international production; and there appears to be a premium on maintaining such demanding — because of their intangible nature — institutional supports as trust and cooperation. Moreover, with such a high level of interdependence, shocks or disturbances in one part of the system are likely to be transmitted with considerable rapidity to other parts.

For much of the past fifty years, increased integration and the benefits associated with it were successfully organized and managed by national governments. The result of their efforts can be judged by the fact that, for any individual nation in today's world economy, it is difficult to conceive a reduction in international economic integration without significant welfare losses. It is equally apparent that, as States become more tightly interwoven in a world economy, they lose autonomy in some areas. The difficulties this poses have been apparent with the internationalization of financial markets and the reduction in the unilateral scope of government action to respond effectively to macroeconomic imbalances. International production also poses similar challenges. As a result of increased geographical scope of transnational activity, the higher share of economic activity organized within the boundaries of TNCs and growing interdependence of trade, investment and technology imply that the difficulties of managing the process of international integration can stretch the capacities of most governments.

Integrated international production will almost certainly challenge further the ingenuity of policy makers. Governments in both developed and developing countries have responded, in part, to these changes by focusing on the advantages of FDI and by adopting both a clearer and

a more systemic view of the need to link trade, technology and investment policies (Dunning, 1994). As a result, governments no longer see TNCs as part of the problem, but rather as part of the solution, which helps to make FDI a more effective tool for promoting economic growth and other economic and social goals. Finally, regional integration schemes build on the strong complementarities between investment and trade, reinforcing these linkages at the level of international production. However, any potential advantages from hosting FDI cannot be divorced from the links to other elements of the globalization process. Here, the effects are more uncertain.

Much of the new investment required to compete internationally is in capital-intensive technologies, requires large research-and-development expenditures and involves the simultaneous penetration of many markets to combat shortening product cycles. New investments are also required to modernize the organizational structure and skill profile of firms and industries. All this requires access to sizeable funds and a stable investment climate. But deflationary pressures, exchange-rate volatility and heightened uncertainty accompanying the internationalization of financial markets can adversely influence the long-term investment decisions at the heart of integrated international production by adding to the attractiveness of shorter-term (and often more speculative) investment opportunities and having financing issues assume an unduly large significance in corporate planning (Volcker and Gyothen, 1992; UNCTAD, 1987, p. 89; Cushman, 1985). Under these circumstances, the potential for misallocating resources may be particularly disruptive to integrated international production.

Thus, whilst desire of many countries to benefit simultaneously from their participation in world markets is perhaps unprecedented, it also gives rise to a *paradox in national policy making*. On the one hand, international linkages and interconnections have created a perception that effective national policies (and their implementation) for adapting to a more interdependent world economy have gained rather than declined in importance (Porter, 1990; Dunning, 1992). On the other hand, these same pressures make the identification and targeting of purely national objectives increasingly complex and have narrowed the scope for independent action. This dilemma touches upon all aspects of economic policy, leading governments to reconsider the way in which they approach economic policy as the achievement of well-defined objectives through a series of mutually separable policy means. Indeed, as a first step to a more coherent policy-framework, capturing the effects of increased economic integration requires making changes to traditional national accounting frameworks for international transactions (box III.2).

The policy paradox becomes all the more challenging because many more policy issues that were previously the responsibility of national governments — including national technological systems, labour-market regulations and competition laws — become open to international concern, the stronger the linkages established through integrated international production. To date, the challenge posed by the internationalization of domestic policy issues has had its most dramatic effect in areas where economic and social assets are closely intertwined, reflecting furthermore the fact that social assets tend to be more rooted in their local or national environments. This is particularly true of labour markets. Although TNCs help to organize the international division of labour and exert considerable influence over national patterns of industrial activity and employment (discussed in chapter IV), their impact on employment and workplace conditions is dependent upon macroeconomic, structural and technological factors that are mediated by domestic policies and organizations. The direct labour-market effects of FDI on employment are thus difficult to quantify. But international economic integration has widened the options available to TNCs in dealing with a dispersed labour force. Cross-border plant relocation is only the most visible — and drastic — option available to firms in their efforts to restructure under pressure from global competition; automation, diversification of product lines, product innovation and subcontracting have all been made easier by labour market deregulation and more decentralised negotiating and bargaining structures. The weakening of traditional

Box III.2. Transnational corporations and the balance of payments: supplementing the traditional framework

The rise of a more integrated international production system poses new challenges to those concerned to document the growing interdependence of economic activity. This is not simply a scholarly exercise. An appropriate accounting system provides one important element of a more effective policy framework.

Balance of payments accounts are designed to record transactions between residents of different countries. Traditionally, they have recorded the cross-border trade of foreign affiliates with their country of ownership and with other foreign countries, but they have not record affiliates' sales or purchases in their country of location. However, as the world economy has become increasingly characterized by integrated international production, there has been growing recognition of the need to supplement the balance of payments accounting framework to obtain a more complete picture of the activities of TNCs and, in particular, of the extent to which the delivery of goods and services to international markets is through sales by locally established affiliates (sometimes termed "establishment trade") rather than through trade in the conventional sense of resident-nonresident transactions (cross-border trade).

In an effort to meet this need, a number of proposals have recently been made for supplementing the standard balance of payments accounts with accounts explicitly incorporating information on sales through foreign affiliates.

The National Academy of Science proposal

A National Academy of Science (NAS) study panel proposed an ownership-based measure of net sales to foreigners (including foreign-owned affiliates) by domestically owned firms (including their affiliates abroad), whether conducted through cross-border trade or through local sales by their affiliates. With respect to data for the United States, which the NAS panel used in illustrating its proposal, the net sales measure can be derived as the sum of three items: net United States cross-border sales to foreigners by domestically owned companies, net sales to foreigners by foreign affiliates of United States companies, and net United States sales to United States affiliates of foreign companies. (Reflecting its ownership-based perspective, the NAS proposal defined "foreigners" to include United States affiliates of foreign companies and to exclude foreign affiliates of United States companies.)

Net United States cross-border sales to foreigners by domestically owned United States companies is computed in three steps. First, United States exports to foreign affiliates of United States companies and exports by United States affiliates of foreign companies are subtracted from total United States exports of goods and services to obtain an estimate of cross-border exports by domestically owned United States companies to foreigners (as defined). Second, imports from foreign affiliates of United States companies and imports by United States affiliates of foreign companies are subtracted from total United States imports to obtain an estimate of cross-border imports by domestically owned United States companies from foreigners. Third, the import measure is subtracted from the export measure to produce net cross-border sales to foreigners by domestically owned United States companies.

Net sales to foreigners by foreign affiliates of United States companies is computed in two steps: sales by foreign affiliates to the United States and to other foreign affiliates of United States companies are first subtracted from their total sales, and then their local (non-United States) purchases of goods and non-factor services are subtracted from the result. Net United States sales to (or if negative, as is the case, purchases from) United States affiliates of foreign companies are computed analogously.

The result of these computations are summarized and compared with balance of payments statistics in table 1. Using the standard balance of payments framework, the United States recorded a $28 billion deficit in trade on goods and services in 1991. Using the NAS net sales measure, in contrast, the United States had a positive sales balance of $164 billion, as positive balances on cross-border transactions and on transactions by foreign affiliates of United States companies were only partly offset by a negative balance on transactions by United States affiliates of foreign companies.

The net sales measure is useful for assessing companies' sales performance in global markets and can provide insights into the linkages between international trade and investment activities and the

Table 1. A comparison of United States international economic performance under different frameworks, 1991
(Billions of dollars)

	Residency-based frameworks		*Ownership-based frameworks*	
Item	*Gross-border trade in goods and services*	*Alternative residency-based approach, including both cross-border trade and net sales through affiliates*	*National Academy of Sciences proposal*	*Julius proposal*
United States sales to foreigners	581	632	816	2 523
United States purchases from foreigners	609	608	652	2 499
Balance	-28	24	164	24

Source: Landefeld, Whichard and Lowe, 1993.

domestic economy. However, because it does not align a country's sales with the use of only those factors of production that are either entirely located in or owned by residents of the country, it may give misleading signals if used to gauge the effect of changes in foreign affiliates' sales on home- or host-country income and employment. (In deriving net sales, purchases of goods and services from foreigners are deducted from sales, but payments to foreign capital and labour are not.)

The Julius proposal

Under another ownership-based approach suggested by DeAnne Julius, a foreign affiliate is treated not as a resident of the host country, as in the standard accounts, but as an extension of the investor country's firm. The affiliate's transactions with the host country are recorded on a gross basis, reflecting the ownership boundary between the firm and the rest of the host economy. Unlike the NAS proposal, local purchases by affiliates are defined to include not only payments for goods and non-factor services purchased from outside vendors, but also payments for labour and other factors of production employed within the firm. This netting of all receipts from foreigners against all payments to foreigners results in a trade balance equal, conceptually, to the balance on goods and services plus the balance on direct investment income in the balance of payments, a result which suggests that one way of viewing the Julius measure is as a more gross variant of the standard accounts. Whereas the balance of payments accounts reflect the net effect of subtracting the affiliate's purchases from its sales—specifically, the parent's share in the affiliate's net income—the estimates constructed by Julius show the purchases and sales separately.

The second respect in which the Julius approach differs from that of the NAS panel is in the recording methodology. Whereas the NAS panel used what is sometimes referred to as"directional" methodology, recording the net of sales and purchase separately for inward and for outward direct investment, Julius suggests recording transactions on what could be termed an "exportimport" basis. On this basis, foreign affiliates' local purchases of goods and services are recorded as a component of sales by foreign affiliates. This approach produces larger gross flows of sales and purchases of goods and services and are recorded as a component of sales by foreigners to the investor country rather than as a deduction

from total sales by foreign affiliates. This approach produces larger gross flows of sales and purchases than does the directional methodology followed by the NAS panel and thus depicts more completely the total magnitude of two-way transactions between United States and foreign-owned entities; however, it makes it harder than under the directional methodology to isolate and analyze the transactions of companies grouped on the basis of ownership. From the standpoint of the overall trade (or sales) balance, it is immaterial which method of recording is selected, for the choice of method alone has no effect on the balance.

Under the Julius method, total United States sales to unaffiliated foreigners (with "foreigners" defined, as before, from an ownership perspective) were $2,523 billion in 1991, compared with total sales by foreigners to unaffiliated United States persons of $2,499 billion; thus, the United States had a positive sales balance of $24 billion in 1991. While this balance equals the sum of the standard balances on goods, services, and direct investment income, it is produced by estimates that provide a considerably more detailed picture of the gross flows that produce the balance and of the channels of delivery that companies use to service international markets.

The alternative residency-based approach

A study by the United States Department of Commerce has suggested that, as an alternative to producing ownership-based estimates, the standard residency-based balance of payments accounts could be reconfigured to provide more information on ownership. In so doing, the varied needs of data users could be met without giving up the standard account's linkage to economic activity in specific economies and integration with broader national accounts. This approach retains the standard measures of cross-border trade in goods and services and of activity by affiliates (i.e., direct investment income). However, it records a number of details that show the data from a new perspective and allows a more complete analysis of ownership relationships and of the scope and importance of intra-firm trade than is allowed by the conventional presentation.

As in the standard balance of payments and in the NAS proposal, the results of affiliates' activities in their countries of location are recorded on a "directional" basis: net receipts by United States companies resulting from the operations of their foreign affiliates are recorded as a component of United States sales (exports) to foreigners, and net receipts by foreign companies resulting from the operations of their affiliates are recorded as a component of United States purchases (import) from foreigners. Although analogous to direct investment income, the "net receipts" terminology used in the presentation to represent the difference between affiliates' sales and purchases (each of which is explicitly shown in the Department of Commerce framework) is more suggestive of the underlying operations that generate the income. By retaining the residency concept, this approach maintains consistency with internationally recognized standards for measuring production and determining its location, and it keeps attention focused on the effects of direct investment activities on the domestic economy. However, it encourages the user of the international accounts to look beyond the information on cross-border trade alone and to recognize that the overseas operations of foreign affiliates constitute an integral part of the nation's economic interaction with the rest of the world.

Under this framework, the United States had exports (broadly defined to include net receipts from sales by affiliates as well as cross-border sales) of $632 billion, imports of $608 billion, and a net export, or sales, surplus of $24 billion in 1991. This is the same balance as produced under the Julius approach, a consequence of the fact that, in determining the balance, both approaches net out *all* payments to foreigners rather than, as in the NAS approach, only payments made outside the firm.

Sources: Landefeld, Whichard and Lowe, 1993; Kester, 1992; Julius, 1990.

institutional representation of labour may also make it easier for firms to respond to increased international competition through the option of rationalizing and reducing direct costs rather than seeking a longer-term — more expensive and riskier — commitment to invest in human capital and other created assets.

Given the nature of the integrated international production system, retraining and an effective welfare programme are as integral to it as to earlier systems. They are also as expensive, particularly at a time when a growing number of firms and industries need to adjust to new competitive pressures and a growing share of the labour force faces poor employment prospects. The widening mobility gap between capital and labour has, in part, contributed to the declining autonomy of national social and labour policies. For instance, taxes to ensure adequate social programmes may encourage the exit of the more mobile factors, further increasing the burden on the least mobile. The destructive potential of this logic lies behind European Union efforts to devise a transnational social policy. More generally, because the systemic interdependence of economic relations occurs across an increasing number of national borders to reach the global level, the governance pressures of integrated international production are likely to be particularly pronounced. But in important respects, existing policy frameworks — because they are still defined by national parameters — are inadequate for dealing with such pressures many of which are now international in character (Panic, 1988; Ostry, 1990).

2. The international management of the integrated international production system

Resolving the paradox facing national policy makers cannot be achieved at the national level. If anything, the increasing internationalization of domestic policy issues is likely to give rise, more than ever, to "system friction" (Ostry, 1992) between different but increasingly interlinked national economies and social systems. To deal with these frictions will require a process of convergence if governments are to refrain from protectionist responses or destructive policy competition.

Achieving convergence in this respect will almost certainly prove difficult and is unlikely to be successful without considerable cooperation. To an increasing extent, this reflects the degree to which new policy challenges accompanying the emergence of integrated international production involve the provision of what has been called "international public goods" (Kindleberger, 1986), that is, goods that require some degree of collective consent (and sometimes payment) at the international level if they are to be supplied at appropriate levels. As in the past, the appropriate provision of these goods will, in the future, depend upon positive leadership, adequate resources and a willingness to forgo some degree of national autonomy for a wider international interest. But in important respects, the challenges to international governance posed by an integrated international production system are even greater than those already experienced with the formation of an international trading and monetary framework. Not only are the issues to be addressed much wider — including labour and environmental standards, investment and technology policies and social provisions — and potentially more difficult to resolve, but in a world economy increasingly shaped by a Triad of regional groupings, where TNCs have increased in number and scope, the traditional place of a leading economy is effectively compromised. Under these circumstances, the dangers accompanying increased economic uncertainty should not be underestimated.

Although many of the new organizational responses within the framework of integrated international production have been responses to increased economic uncertainty and the growing interdependence of economic activities, these have been almost exclusively undertaken at the corporate level. A comparable response at the government level through greater coordination and cooperation efforts at the regional and international levels to address global macroeconomic imbalances, structural changes in the world economy and growing regional inequalities has been

Table III.18. The share of major regions and countries in world production, 1967-1989: gross domestic product at 1980 purchasing power

(Percentage)

Country/region	*1967*	*1973*	*1980*	*1986*	*1989*
United States	25.7	22.8	20.9	20.9	20.8
Western Europe	25.9	25.3	23.9	22.4	22.2
Japan	5.6	7.0	7.2	7.5	7.8
South, East and South-East Asia (including China)	11.0	11.8	13.8	17.4	19.3
Latin America	7.1	7.7	8.8	8.0	7.5
Africa (except South Africa)	3.1	3.2	3.4	3.2	3.0
Rest of the world	21.7	22.1	22.2	20.5	19.4

Source: van Liemt, 1992.

Table III.19. Forging ahead and falling behind in the new competition: research and development as a share of gross national product, 1970, 1980 and 1990

(Percentage)

Region	*1970*	*1980*	*1990*
World	2.04	1.85	2.55
Developed countries	2.36	2.22	2.93
Europe	1.70	1.81	2.21
North America	2.59	2.23	3.16
Developing countries	0.32	0.52	0.64
Africa	0.33	0.30	0.29
South, East and South-East Asia	1.02	1.41	2.08
Western Asia	0.31	0.97	0.76
Latin America and the Caribbean	0.30	0.44	0.40

Source: UNESCO, *Statistical Yearbook: Expenditure on Research and Experimental Development,* various years.

slow to materialize (Streeten, 1992; Cornford, 1993; OTA, 1993). In this respect, the real challenge of globalization "is to develop bargaining structures and attitudes conducive to reaching negotiated outcomes that avoid further segmentation, while accepting rapid structural and technological change and the advantages of a more open world economy" (van Liemt, 1992, pp. 468). This issue will be taken up in Parts Two and Three, in the specific context of employment, human resource development and industrial relations.

But the challenge of globalization is compounded by the fact that integrated international production is emerging in a world economy that is also being shaped by strong pressures towards divergence and, possibly, fragmentation. The share of world output produced by the developed countries steadily declined until 1980, with a corresponding increase in the share of all developing country regions and the former centrally planned countries. Over the past decade, this trend has slowed and important aspects have been reversed; stability in the developed countries' share of global output and the rise of South, East and South-East Asia contrasts with the decline of all other regions (table III.18). Similarly, the share of world merchandise exports, between 1982 and 1992, showed a spectacular rise of South, East and South-East Asia, smaller increases for North America,

the European Union and Japan and declines in all other regions of the world (de Jonquières, 1994). Perhaps even more troubling in light of its importance to integrated international production is the growing divergence among regions in expenditures on research and development (table III. 19).

* * *

Globalization is ultimately the product of decisions taken by firms. However, the potential gains from increased integration also depend upon cooperation among nations to reduce barriers and ensure smooth management of the integration process. The steady reduction of barriers over the past fifty years has meant that TNCs, as well as domestic firms, have been able to expand across borders through trade and other market-based linkages. But going beyond shallow integration, TNCs, by matching their assets with specific locational advantages elsewhere have, over the same period, furthered deeper integration. Recent changes towards deeper integration appear to be particularly rapid: the growth and spatial reconfiguration of FDI through the tripolar centres of the United States, the European Union and Japan; the growing interdependence of trade, technology and FDI; the emergence of integrated international production and corresponding forms of international corporate governance; and the profound shift in the policy stance of governments towards FDI, all point in the direction of a new force of globalization in the world economy.

However, given that the greatest advances in international economic integration appear to have taken place during periods of prolonged economic prosperity and convergence, when optimistic economic expectations and political security are most assured, the weak and unstable growth path in the world economy should serve to caution against an overly hasty assessment of the future course of globalization. In this case, the danger of exclusion of some countries (or areas within countries) is unlikely to disappear with the emerging integrated international production system, and is a major challenge facing the international community.

Notes

1 Even as international trade theory has relaxed some of its more unrealistic assumptions, it has not adequately accommodated the component of international production (see Hymer and Rowthorn, 1970; Panic, 1988; Lall, 1993b; Robson, 1993b). Consequently, the rise and growing influence of TNCs in the world economy is still, by and large, discussed outside this traditional framework (Dunning, 1993a).

2 See Kindelberger, 1988; Survey on Multinational Corporations, *The Economist*, 27 March 1993; Christopher Lorenz, "The transnational's identity crisis", *Financial Times*, 19 March 1993.

3 It is of some significance to note that, in the case of the United States (which became the world's leading economy during this period) although exports outgrew GDP (4.8 per cent and 3.9 per cent, per annum respectively) for the period 1870-1913 as a whole, this was from a very low base and the trend was reversed in the early twentieth century. See Maddison, 1989, table D-6.

4 Although quantitative restrictions on trade were absent, tariff protection could be considerable, particularly on manufacturing goods; see World Bank, 1991, p. 97. For a discussion of trade policy in this period from an historical and comparative perspective, see Bairoch, 1993.

5 Of this, $18 billion was held by the United Kingdom, $9 billion by France, $6 billion by Germany and $5.5 billion by Belgium. Of the total, $14 billion was invested in Europe, $10.5 billion in the United States and Canada, $8.5 billion in Latin America and the balance in Asia and Africa.

6 Covariations and correlations in interest rates, exchange rates and stock prices in leading markets were high and appear to have been higher than during any subsequent period. There are, however, serious limitations to the price criterion as a measure of international integration; see Panic, 1988, p. 25.

7 However, using simple GDP per capita figures, the distinction between developed and developing countries should be treated carefully for this period. Thus, Latin America (the largest host region in 1914) included Argentina with a GDP per capita higher than that of some of the Western European core economies, and other countries, such as Chile and Mexico, with levels comparable to some of the industrializing European periphery, such as Czechoslovakia and Hungary. However, the large share of FDI stock in Africa, Asia and some parts of Latin America was clearly located in what, today, are considered developing countries. Moreover, although precise historical data are lacking, the share of FDI in overall foreign investment appears to have been large — one estimate puts that share at anywhere between 44 and 66 per cent of total foreign investment, see Svedberg, 1978.

8 In broad macroeconomic terms, the period avoided sharp shocks or fundamental disequilibria; growth rates were respectable; inflation was persistently low; unemployment moderately high; and the business cycle in most countries showed increasing though manageable fluctuations; see Maddison, 1989.

9 Given the relatively simple technological and organizational conditions characteristic of much economic activity in the late nineteenth and early twentieth centuries, there were inherent limits to the extent of shallow integration (Panic, 1988, pp. 15-17).

10 On one estimate, when the United Kingdom began to industrialize in the early nineteenth century, the required capital per worker was equivalent to 4-5 months wages. By the time Hungary began to industrialize at the end of the century, that figure had reached 42 months wages (Pollard, 1981, p. 221).

11 Between 1880-1890, this share was 50.5 per cent in Australia, 47 per cent in Sweden and 12.6 per cent in Italy; between 1901-1910 it was 26.9 per cent in Norway; and between 1911-1913 it was 46.2 per cent in Canada (Panic, 1992, p. 101).

12 Although the links between FDI and other international flows among the core countries still require further research, it would appear that trade expansion and financial motivations were as important determinants of FDI as the desire to strengthen production linkages. The "free-standing" company was important for a large subset of United Kingdom (and possibly Dutch) TNCs. The free-standing company is not synonymous with the stand-alone affiliate, in that it did not evolve from domestic production activities but from financial activities. As Mira Wilkins described them: "The companies were registered in the United Kingdom and were established typically to do business in a single country abroad....Their founders hoped to unite the abundant capital of Great Britain with the potentially or actually profitable opportunity abroad. Each had a board of directors in Britain, charged with managing overseas business. The British Headquarters was, however, at least at origin usually limited to the part-time board of directors and possibly one full-time secretary. In short, the head office did not amount to very much", Wilkins, 1988, pp. 29-30. Trading companies figured prominently in Japanese FDI.

13 There was, of course, a major shift in the political and economic balance of the world economy. The developments prior to the First World War hastened the rise of the (more inward-oriented) United States economy, hand in hand with the corresponding fall of the (more outward-oriented) United Kingdom, changing the international equilibrium (see Keynes, 1971; Bloomfield, 1963).

14 GATT, *News of the Uruguay Round of Multilateral Trade Negotiations*, April 1994, p. 10.

15 The possibility that poorer countries will catch up with their wealthier neighbours is a long standing promise of the modern industrial world. The hypothesis simply stated suggests that growth rates vary inversely with the level of productivity and that, consequently, poorer countries will grow faster than richer ones. This potential for rapid growth reflects the investment opportunities of backwardness through the reallocation of resources from low productivity to high productivity sectors and the overall acceleration of productivity growth gained by capturing technological (and other positive economic) spillovers from leading countries. However, the question of which strategies and institutions are most appropriate to bring about a successful catching up, continues to divide researchers on growth and development.

16 The fastest growth in trade in the 1980s occurred between South, East and South-East Asia and North America and between South, East and South-East Asia and Europe (OECD, 1991, p. 10).

17 The full extent of financial integration is still being debated by economists; see Zevin, 1988; Panic, 1988; Roll, 1989; O'Brien, 1992. Unlike the period before the First World War, this increased integration of finance has coincided with a pronounced shift to short-term capital flows — short-term bank flows into the industrial countries rose by 700 per cent (Kregel, 1992) — and has been accompanied by a marked increase in the volatility of markets.

18 Expectations differ considerably regarding the future internationalization of labour markets. It is of some considerable interest to note the findings of the Commission of the European Communities (1993a,

p. 81) that, even within the European Community (arguably the most integrated international labour market in terms of its regulatory structure) "there is...very little movement of labour between Member States". For a contrasting view see Johnston, 1991.

19 Both these economies have become net outward investors sooner than Singapore which has played host to considerably larger amounts of FDI.

20 For an elaboration, see UNCTAD-DTCI, 1993a.

21 There are other signs that these developments are leading to the types of network relationships that have already been established at the local level in certain industrial districts (e.g. Emilia-Romagna in Italy) (see Piore and Sabel, 1984; UNCTAD, 1994b).

22 Wheeler and Mody (1992) found that agglomeration economies were the main locational determinant of outward FDI from the United States to industrialized countries.

23 At the country level, historical and political ties clearly affect investment and trade patterns. It would be difficult to account otherwise, for example, for the United Kingdom's intense trade and investment ties with Kenya and Ghana, or Japan's strong investment linkages with Peru.

PART TWO

EMPLOYMENT, HUMAN RESOURCE DEVELOPMENT AND INDUSTRIAL RELATIONS

Chapter IV

Transnational corporations and employment

Introduction

Transnational corporations (TNCs) are major organizers of economic activity and an important source of capital, technology, managerial and organizational know-how for both developed and developing economies. They can draw upon large resources and account for a significant volume of investment and value-added activities worldwide. As a result, TNCs play an important role as employers, generating employment opportunities directly as well as indirectly through backward and forward linkages and by simulating economic growth. Given their importance, TNCs also have a significant qualitative impact on the labour markets in the countries in which they operate.

Overall, TNCs are estimated to account directly for a total of over 73 million jobs worldwide, of which over 60 per cent are in parent companies, primarily based in developed countries, and 40 per cent in their foreign affiliates. About 12 million — more than a half of foreign affiliates' total — are directly employed in foreign affiliates in developing countries. However, TNC employment constitutes only a negligible proportion — about 3 per cent — of the world's labour force. Given that TNCs are primarily engaged in capital- and technology-intensive activities, their relatively modest direct contribution to overall employment levels in home and host countries is not surprising. At the same time, TNCs account for about one-fifth of paid employment in non-agricultural activities in developed countries and some developing countries, suggesting that

their direct contribution to employment in manufacturing and services is far from negligible. In addition to direct employment, considerable employment opportunities are indirectly generated by TNCs through a variety of linkages with subcontractors, suppliers and other enterprises in home and host countries. Estimates for a number of developing countries suggest that at least one-to-two jobs are generated indirectly for each worker employed by foreign affiliates.

Taking into account both direct and indirect employment, a conservative estimate of the total number of jobs associated with TNCs amounts to 150 million. Workers in TNCs, moreover, typically belong to the core workforce in modern, technologically advanced activities in manufacturing and services. Furthermore, the quality of employment provided by TNCs is at least as significant as the number of jobs directly and indirectly generated by them. Not least, the spill-over and catalytic effects of TNC activities have implications for the quantity and quality of employment in host and home countries through the development of human resources and the spread of technological, managerial and organizational advances that stimulate economic growth.

The distribution of jobs across countries and regions is influenced by the locational choices of TNCs. Although the bulk of their investment, production and employment is within their home countries, through their extended geographical networks they help to organize the international division of labour and influence national patterns of industrial specialization and, thus, patterns of employment in home and host countries. A distinctive feature of today's world economy is the greater ease with which factors of production can be shifted across national borders (chapter III). Given their resources, their capability to gather information worldwide and their capacity to manage geographically dispersed organizational structures, TNCs are at the forefront of the process of resiting economic activities. Under the growing pressure of global competition, the speed with which patterns of operations are changing in response to changes in locational advantages and comparative costs has increased considerably.

The recent rise in unemployment in a number of countries in the context of the growing globalization of the world's economic activity has focused the attention of policy makers on issues related to employment (box IV.1). The causes of unemployment are varied and complex, with many of them only marginally related to TNCs, and this chapter does not attempt to address them. Rather, its focus is on one specific aspect of the employment situation — the role played by TNCs in generating, displacing or relocating jobs, focusing particularly on the implications of the growing integration of their international production activities. This role assumes particular importance in the context of regional integration arrangements, such as the European Union, the North American Free Trade Agreement (NAFTA) and others that facilitate foreign direct investment (FDI) and international production by TNCs.

Any attempt to assess the employment effects of TNCs encounters various conceptual and empirical problems that defy a simple resolution. The discussion in this chapter considers the role of TNCs within a framework that takes into account the wide range of potential quantitative and qualitative effects of TNCs on employment in home, as well as host countries. In doing so, it not only attempts to provide a picture of recent trends and developments in employment by TNCs, but also to relate employment effects to the evolving strategies of TNCs, as reflected in the way in which international production is pursued and organized. A key observation of the chapter is that the shift towards integrated international production strategies and the growing complexity of the links between parent companies and their geographically dispersed affiliates are changing the ways in which TNCs distribute work in enterprises under their governance, as well as the nature of the interactions between TNCs and the surrounding economic environments. The potential labour-market implications of this new trend are still largely unexplored, but are receiving increasing attention from policy makers.

Box IV.1. The unemployment problem in developed and developing countries

The early 1990s are witnessing one of the most serious employment crises since the Great Depression of the 1930s. According to the International Labour Office, at the beginning of 1994 there were at least 120 million registered unemployed worldwide. Although this figure is by itself alarming, it does not include those who never registered as unemployed or those who stopped looking for a job because they regarded further search as futile. In addition, there were about 700 million workers that were underemployed, i.e., engaged in an economic activity that did not permit them to reach a minimum standard of living (ILO, 1994). A consensus has emerged among governments on the need to put employment as a priority item in the policy agenda.

Developed and developing countries alike are concerned about their employment situation, although the nature of the problem and the underlying factors differ considerably between the two groups of countries. To a considerable extent, the current high unemployment rates in developed countries reflect cyclical fluctuations in the level of economic activity. However, they also reflect structural problems related to labour-market performances, rapid technological change (including a shift towards less labour-intensive technologies) and shifting competitive positions of countries in world markets. In response to these factors, industries and firms in developed countries have undertaken a number of steps that are broadly referred to as "restructuring". By and large, restructuring has involved downsizing or shedding labour. In developed countries taken as a whole, an important -- perhaps the most important -- factor has been the growth of the labour force due to the increasing participation of women of working age (Glyn and Gregg, 1994).

The structural and longer-run factors are evident, for example, in the fact that, even after five years of steady economic growth, fuelled partly by plans for a single market in Europe, unemployment in the European Community still stood at 12 million persons or 8 per cent of the Community's labour force in 1991; these figures rose further to 17 million persons or 11 per cent of the labour force by end-1993 (CEC, 1993b). Employment creation has been much stronger in the United States, but a large part of new jobs were created in low-skill, poorly paid activities in services, with a considerable decline in real wages for unskilled workers. In developed countries taken as a whole, unemployment remained above 6 per cent and reached an estimated 35 million people jobless in 1994 (OECD, 1993a). This widespread unemployment is characterized by an uneven incidence across the various segments of the labour force: young and low-skilled workers, in fact, are primarily affected. In the European Community, a particular problem for all age groups is that a significant share of the unemployed have been off the employment rolls for more than one year (OECD, 1993a). The inability of countries to address fully the long-run and structural problems mentioned above with macroeconomic policies and labour market institutions that had served them well earlier during a period of rapid growth partly underlies the current focus on the issue.

In developing countries, the situation is often one of chronically high rates of unemployment and underemployment, reflecting poverty and low rates of development due to physical and human capital constraints and low technological capabilities, compounded in many cases by rapid population growth. Open unemployment rates present a highly inadequate picture of the position in developing countries, but even they are high: in sub-Saharan Africa, for example, all countries had double-digit unemployment rates during the mid-1970s to 1992. In Asia, countries like India and Pakistan have had unemployment rates above 15 per cent, despite respectable growth rates of gross domestic product during that period, and in Latin America, urban unemployment has been above 8 per cent. Only the East Asian countries have enjoyed low rates of unemployment, below 3 per cent, in the period mentioned above (UNDP, 1992, p. 35). These trends apply mostly to urban areas. Employment for the majority of the population of developing countries still means agricultural work with its seasonal fluctuations and, often, low productivity of the underemployed. In general, rates of growth of employment have been well below rates of growth of output. Thus, most developing countries continue to be concerned that opportunities for gainful employment grow more rapidly, contributing to the economic welfare and strengthening the social and political role of those benefiting from the new jobs.

The chapter is divided into four sections. Section A outlines the range of potential employment effects of international production and makes an effort to relate particular employment patterns to the three major phases of the strategic evolution of TNCs, that is, from stand-alone to simple integration and, finally, to complex strategies. Section B analyses employment data in an effort to offer a comprehensive empirical picture of the main trends of the size and geographic distribution of employment in TNCs. Section C reviews some evidence on the quality of employment in TNCs and how it affects labour markets, and takes a close look at the specific effects of the tendencies towards complex corporate strategies and the emergence of an integrated system of international production. Section D examines some labour market implications of the cross-border linkages that integrated international production has the potential to construct; although tentative, the discussion in that section aims at shedding light on some of the challenges that are likely to confront policy makers in developed and developing countries in the near future. The conclusions contain some observations with respect to the policy implications of the trends discussed in the chapter.

A. The employment effects of international production: a conceptual overview

1. The range of employment effects

The impact of international production on employment depends upon several factors. The type of the initial investment (or mode of entry) — greenfield or acquisition — by a TNC is one factor governing labour-market outcomes in a host country in the short-term. Greenfield investment involves the creation of new plant, equipment and employment. A merger or take-over, on the other hand, could imply that employment remains constant (or declines), since a firm has simply changed to foreign ownership. The sector and industry of the investment also matter in so far as some processes are more labour-intensive than others. Employment creation also depends on whether international production substitutes for domestic production, i.e., whether, for a given level of output, foreign firms drive local ones out of the market, or whether international production complements domestic investment and contributes to output growth by releasing financial, technological and managerial bottlenecks for the expansion of domestic activity. Employment effects over time may also differ. Employment contraction in an industry may result in the early stages of FDI in a host country, as domestic firms adjust to the competitive pressures exerted by foreign affiliates. However, employment prospects may improve at a later date as domestic firms adapt to the new competition and the activities of foreign affiliates exert a positive effect on the growth of output, for example, through the introduction of new products, technologies and approaches to management and work organization.

For many countries, the matter is further complicated at the national level by the need to distinguish between the separate effects of inward versus outward investment and between their respective direct and indirect employment consequences. For example, indirect employment creation through a foreign affiliate's forging of linkages in a host economy can be at least as significant as the jobs directly created by that affiliate. In contrast, if an affiliate switches to reliance on imports, FDI can trigger domestic restructuring with negative indirect employment effects in industries related to TNCs through backward and forward linkages.

In short, international production by TNCs has direct and indirect consequences for employment, with positive and negative dimensions often occurring at the same time and, for any national economy, these need to be evaluated separately for both inward and outward investment. Table IV.1 sets forth a range of *possible* outcomes of inward and outward investment for national labour markets. These potential effects apply not merely to the size of employment, but to the

Table IV.1. The range of potential effects of foreign direct investment on the quantity, quality and location of employment

Area of impact	Inward foreign direct investment				Outward foreign direct investment			
	Direct		Indirect [a]		Direct		Indirect [a]	
	Positive	Negative	Positive	Negative	Positive	Negative	Positive	Negative
Quantity	Adds to net capital and creates jobs in expanding industries.	Foreign direct investment through acquisition may result in rationalization and job loss.	Creates jobs through forward and backward linkages and multiplier effects in local economy.	Reliance on imports or displacements of existing firms results in job loss.	Creates or preserves jobs in home location, e.g., those serving the needs of affiliates abroad.	Relocation or "job export" if foreign affiliates substitute for production at home.	Creates or preserves jobs in supplier/service industries at home that cater to foreign affiliates.	Loss of jobs in firms/industries linked to production/ activities that are relocated.
Quality	Pays higher wages and has higher productivity.	Introduces practices in, e.g., hiring and promotion that are considered undesirable.	Spill-over of "best practice" work organization to domestic firms.	Erodes wage levels as domestic firms try to compete.	Skills are upgraded with higher value production as industry restructures.	"Give backs" or lower wages to keep jobs at home.	Boosts sophisticated industries.	Downward pressure on wages and standards flows on to suppliers.
Location	Adds new and perhaps better jobs to areas with high unemployment.	Crowds already congested urban areas and worsens regional imbalances.	Encourages migration of supplier firms to areas with available labour supply.	Displaces local producers, adding to regional unemployment, if foreign affiliates substitute for local production or rely on imports.	Some jobs may depart from the community, but may be replaced by higher skilled positions, upgrading local labour-market conditions.	The "export" of jobs can aggravate regional/local labour-market conditions.	The loss of "blue collar" jobs can be offset by greater demand in local labour markets for high-value added jobs relating to exports or international production.	Demand spiral in local labour market triggered by layoffs can lead to employment reduction in home-country plant locations.

Source: UNCTAD, Division on Transnational Corporations and Investment, based partly on Campbell, 1993.

a A more detailed explanation of the indirect effects is provided in table IV.12.

quality and location of jobs as well. Of course, each of the possible impacts shown in table IV.1 is but a static and partial statement of the potential labour-market outcomes of international production. It says little about the ultimate impact of international production on national labour markets, since that depends on macroeconomic factors specific to individual countries and industries, and the dynamic effects due to the reaction of firms in home and host countries to the changes in competition and industrial specialization engendered by the activities of TNCs. How domestic firms, national policies or labour markets might respond to particular patterns of inward and outward investment — and thus alter employment outcomes — cannot be predicted from the configurations of the various effects illustrated in table IV.1. The findings of some attempts at an assessment of the overall impact of international production by TNCs on employment in home and/or host countries and problems confronting that assessment are summarized in box IV.2. The complexity of the factors that determine the employment impact of FDI (drawing upon the experience of Japanese FDI in the United States automobile industry) is further illustrated in box IV.3.

In general, inflows or outflows of FDI are not necessarily associated in most countries with a net generation or displacement of employment to such an extent as to have a significant repercussion on the aggregate level of employment or, more precisely, to release or impose significant constraints on the macroeconomic management of the economy, the ultimate determinant of employment levels. This may apply differently across countries according to the size and degree of internationalization of an economy, with relatively small, highly internationalized economies, such as Sweden, Switzerland or Singapore, being more affected by the investment decisions of domestic or foreign TNCs. Whatever the size of an economy, however, international production can have important effects on industry structures, the composition of exports and the specialization of an economy, and it is through these channels that labour markets are mostly affected in the long term: "The primary impact of both inward and outward direct investment in employment is likely to be on its industrial composition, its skill mix, its quality and its productivity, rather than on its amount." (Dunning, 1993b, p. 368). In other words, it is not so much the level of FDI accruing to or leaving an economy that has major implications for employment, but rather, the quality of the interactions generated by the activities of TNCs in a country. Among other variables, the strategies underlying international production by TNCs and the organizational structures they establish play a role in explaining these interactions. It is to this question that the discussion now turns.

2. Linking corporate strategies to employment effects

The strategies of TNCs and the related organizational structures (chapter III) have potential implications for the direct and indirect employment effects of international production. Corporate strategies may influence the amount of employment in different ways (table IV.2). The effects arise, in part, through the consequences of the strategies on the firms' overall level of output. But irrespective of how and whether total output and employment are influenced, these strategies are likely to be associated with different patterns of direct and indirect employment creation or loss. Under stand-alone strategies, a new foreign affiliate may serve a market formerly serviced from the home country through exports. Some production and employment loss in the home country could be one direct result. But if a foreign investment is motivated by high tariffs on the home country's exports, *not* making the investment could result in an erosion of the firm's competitiveness, with negative consequences, ultimately, for home-country employment by the firm. In the services sector, however, FDI may be the only means of serving foreign markets, since many services continue to be non-tradable. For instance, establishing foreign affiliates by an insurance TNC will, most likely, not have negative consequences as regards its home-country workforce and may even boost domestic employment by creating jobs that provide services for the affiliates abroad. For the host country, a stand-alone affiliate may imply relatively stable or secure

Box IV.2. Assessing the employment impact of international production

There is no simple method of evaluating the impact of international production on employment in home and host countries. Part of the problem lies in the lack of data, aside from figures on direct TNC employment which, too, have significant limitations. There is an additional difficulty of modelling the full range of indirect employment implications. Furthermore, any measure of the employment impact should be weighed against the opportunity cost of what would have happened in the absence of international production. For instance, the acquisition of an enterprise by foreign investors is often followed by rationalization and employment reduction. At the same time, the acquisition may keep the enterprise alive. In a similar vein, outward FDI may imply a reduction in employment in the home country, as production and jobs are relocated elsewhere; but some of these jobs would have been lost even in the absence of investment abroad. Another major problem is to take into account the widespread and dynamic effects that the operations of TNCs bring to a host economy. A full assessment of the whole range of employment effects of international production requires an extended time framework; alternative scenarios to be used as benchmarks; and a complex dynamic model capable of taking into account all the interactions between the activities of TNCs, the nature of competition and the structure of the markets in which they operate, as well as the policies pursued by governments. No empirical study thus far takes into account all of these aspects.

Various attempts have been made to quantify the employment impact of FDI at the macroeconomic level for individual host or home countries. These studies have mainly relied on aggregate data on the number of jobs in TNCs, coupled with measures of the estimated employment effects associated with changes in the structure of the external trade engendered by the activities of TNCs in a host country.[a]

In general, positive employment effects have been found to be associated with inward FDI, although not necessarily to an extent commensurate with the size of FDI accruing to an economy. In the case of the United States, for instance, large FDI inflows in the 1980s were accompanied by a minor positive impact on employment and wage rates (McGuire, 1994; Glickman and Woodward, 1989). This was largely explained by the predominance of acquisitions as a mode of entry. Even in the case of greenfield investments, the net increase of employment in the newly established foreign affiliates must be weighed against some loss of jobs in local competitors and their suppliers.

Concerning the employment effects of outward FDI, the issue of an "export" of jobs has been widely debated in the United States and the United Kingdom, traditional home countries of the largest TNCs. Evidence for these two countries suggests that the employment impact has been "marginally positive to neutral", as the immediate loss of jobs is generally compensated by increases in employment as a result of enhanced competitiveness of the parent companies at home and the growth of their exports to their affiliates abroad (Dunning, 1993b, p. 364) . In this sense, international production has been complementary to the expansion of national production. Indeed, conceptually, it can be argued that the expansion of production abroad is largely a sign of competitive strength and the accumulation of technology and other proprietary assets by firms, and that these advantages filter back to the home economy not only in the form of additions to income, but also through multiplier and indirect effects on employment. In recent years, however, there has been a renewed interest in the issue of relocation of jobs following the high degree of transnationalization of firms from an increasing number of economies that has coincided with the spread of unemployment in developed countries. Indeed, in some countries such as Sweden, there is some evidence of a shift from complementarity to substitution between TNC production at home and abroad in recent years (see box IV.5). Whether this is a transitory phenomenon -- in the case of Sweden, the result of readjusting patterns of production by domestic TNCs to regional integration in the European Union -- or an indication of changing TNC strategies in light of structural changes at home and in the world economy cannot be fully judged at the present time.

a For a broad review, see Dunning, 1993b, and OECD, 1994b.

employment, since the motivation for the firm's presence is the country's market, rather than the more fleeting competitive advantage of low labour cost. The indirect consequences of an affiliate's presence, however, are not easily predictable. It is conceivable that an affiliate has such a strong competitive advantage that it causes more sluggish domestic firms to lose market share and jobs. On the positive side, the foreign affiliate may establish strong relationships with local suppliers and boost indirect employment.

The direct impact of a simple integration strategy on employment is somewhat different. Outsourcing labour-intensive activities from affiliates or subcontractors can involve a decline in home-country employment engaged in low value-added production and an increase in relatively low-skilled employment in the host country. Indirectly, the same strategy may increase higher value-added employment in the home country or help to secure jobs that may have been at risk as rising labour costs reduced a firm's competitive advantage. The direct loss of jobs from outsourced production is thereby offset somewhat; the overall employment effect for the home country depends upon the net balance between jobs lost by the decision to outsource and those created to service the expansion of international production. For host countries, direct employment creation is the usual result of simple integration strategies. Meanwhile, the multiplier (or indirect) effects of establishing a foreign affiliate will vary. The international division of labour that a simple integration strategy engenders probably does not displace existing local capacity in export-oriented activities (a negative indirect effect), but the degree to which indirect jobs are created by the affiliate's presence could be relatively substantial or quite minimal (as is frequently the case in export processing zones).

The quality of employment is also determined by corporate strategies. In stand-alone strategies, the majority of the occupational structure of a parent firm is reproduced in the affiliate. One exception to this pattern of occupational replication is that the highest value-added activities, such as research and development, usually remain with the parent company. Here it may be noted that, while stand-alone strategies tend to occupy an early chronological niche in the overall spread of international production, it cannot be said that the importance of these strategies has diminished: restrictions to trade and the resulting motivation for "tariff-jumping" investment are one factor underlying their persistence. More importantly, because of the non-tradability of many services, much FDI in the services sector follows the stand-alone pattern. Service firms have fewer opportunities than industrial firms to split up the production process into segments and move labour-intensive activities to developing countries to take advantage of lower labour costs. That is because many services still cannot be traded at arm's length, but rather have to be produced where and when they are consumed. As a result, foreign affiliates in services tend to reproduce abroad the factor proportions used in home countries, including the skill, research-and-development and capital-intensity levels of their parent firms, with positive implications as regards the quality of employment and the transfer of technology to services affiliates as compared with those in manufacturing (UNCTC, 1989b, chapter V).

In contrast, in separating the locations of production and consumption, simple-integration strategies introduce a complementary hierarchy of occupations across different national locations, that is, an international division of labour based on specific locational advantages of host countries. If, as is often the case in manufacturing FDI, those advantages relate to low-cost labour, the more skilled and highly paid jobs remain with the parent firm, while lower skilled jobs are organized around the affiliate. However, a suitable combination of higher wages and skills could result in some higher value-added jobs being located in the host country as well.

The location of employment also depends on firms' strategies. Foreign direct investment based on stand-alone strategies is frequently market-seeking and flows largely to the developed and the larger or higher income developing countries (or regions within countries). With some exceptions (discussed below), services-sector TNC employment is highly concentrated in devel-

Box IV.3. Japanese foreign direct investment in the United States automobile industry: an illustration of the complexity of the employment effects

Japanese FDI in the United States has been subject to public debate associated, among other things, with its repercussions on the labour market. In the automobile industry, according to some observers, Japanese automakers have transferred technology and skills, provided more training than domestic automakers, paid higher salaries, assured job security and increased labour productivity (Reich, 1991b). In contrast, Japanese automobile affiliates have been criticized by others as mere assembly outposts provoking job losses in the United States automobile industry (Howes, 1991). As these opposing views suggest, the actual picture is more complex than that presented by either of the above and provides a good illustration of the different ways in which TNCs may affect employment.

Relative to other foreign firms, Japanese manufacturing TNCs, including those in the automobile industry, have shown a greater propensity for greenfield investments, rather than acquisitions, with positive direct and indirect employment consequences. On the other hand, since Japanese work and production-organization methods require less employment for the same level of output than that required by domestic automobile producers, their cost advantages over domestic producers result in indirect, negative employment consequences for the latter.

As with many new investors, at the outset, Japanese affiliates in manufacturing relied greatly on parts and components supplied through imports from Japan, thus generating minimal positive indirect employment effects in the United States through backward linkages with local suppliers. Increasingly, however, local-supply linkages for parts and components are being established. Frequently, these linkages emanate from the establishment of Japanese auto-components affiliates in the United States; a "second wave" of the same mix of positive direct and negative indirect employment consequences as those associated with final-assembly firms is thus generated.

More efficient work organization and more broadly defined jobs with greater authority devolved to lower levels within the firm have been some of the positive, direct effects of Japanese affiliates on employment quality in the automobile industry. Indirect effects have also been positive as domestic firms have consciously emulated techniques of Japanese human resource management. On the other hand, Japanese practices differ greatly from the traditional work practices in that industry. It has been observed that "working smarter" in Japanese firms also means "working harder" (Sengenberger and Campbell, 1993). At the very least, the traditional "wage/effort" bargain struck in the domestic industry has changed. Many Japanese affiliates have remained non-union in an industry that was once 100 per cent unionized, leading to pressures for adjusting industrial relations. Finally, with reference to the "extended workbench" or "transplant" affiliates, an additional question is whether the highest value-adding jobs remain at home.

Japanese investments have generally tended to locate in non-industrial areas in the United States, creating new opportunities for industrial employment in underdeveloped regions where surplus labour from agricultural activities exists. At the same time, the positive effect of the GM/Toyota joint venture, NUMMI, was the revitalization of a traditional production site and re-employment of a laid-off workforce (Rubenstein, 1992, pp. 250-262). Locations selected by Japanese firms have often been those in which trade unionism is not firmly established.

There can be little doubt that the competitive stimulus provided by Japanese affiliates has hastened the revitalization of the United States industry. However, FDI in the United States automobile industry in the 1980s faced a relatively saturated domestic market in which gains in market shares by Japanese producers represented a loss of shares by domestic producers. Furthermore, competition from Japanese affiliates in the United States automobile industry in the 1980s may have provided a stimulus to outward investment by United States automobile producers. The loss of domestic market share may have encouraged domestic United States producers to focus more resources on their investments abroad, including those through the expansion of international sourcing of parts and components from the *maquiladora* in Mexico.

oped countries, where the largest markets for services are located. Simple-integration strategies, on the other hand, are mainly linked to resource- and asset-seeking (including labour-seeking) motives for FDI and often involve developing countries. The proximity of developing countries, or regions within those countries, to final markets in the developed world remains an important locational criterion for some simple-integration strategies — as is clear from the growth of the *maquiladora* in Mexico — but it is less important for some industries (e.g., textiles and electronics assembly) or certain business functions (e.g., data processing).

Labour-market outcomes of international production become more complex as the cross-border integration of production within TNCs increases (table IV.2, proceeding from left to right). Whether the issue is the quantity, quality or location of labour, the distinction between inward and outward employment effects becomes less separable and clear. In a simple-integration strategy, by which firms construct a complementary division of work and jobs across borders, inward employment effects (i.e., those in the host country) are appreciably more determined by home-country decisions than in the world of the stand-alone foreign affiliate. The outward employment effects (i.e., those in the home country) of simple- integration strategies are also more debatable than those of stand-alone strategies. In particular, the question of whether simple integration constructs a complementary division of labour across borders or whether, on the contrary, a host-country labour market substitutes for what had been home-country jobs has long been a point of controversy (Campbell and McElrath, 1990).

The need to consider inward and outward effects at one and the same time rises in proportion to the level of integration. It is thus in the emerging model of deep integration that distinctions between inward and outward labour-market effects are least clear-cut (table IV.2, extreme right). With respect to employment quantity, for example, one of the advantages of deep integration is that TNCs can achieve efficiency gains; the most that this might imply for a firm's workforce as a whole is a global or system-wide reduction in employment. This is because the consolidation of individual business functions in various locations of a firm's integrated system would probably have a rationalizing effect on total firm employment when compared, for example, to the replication of individual activities in a stand-alone strategy. But exactly where in a firm's system employment will decline or increase is more difficult to evaluate in terms of the traditional home versus host country or skilled versus unskilled labour distinctions. Deep integration implies that the location and quality of activities is less anchored in that traditional dichotomy. Rather, location (although still in large measure determined by proximity to final markets) becomes more responsive to a variety of created assets, of which employment quality may be a key aspect. Since individual activities might be located anywhere, it no longer seems to make sense to consider the home country as having a particular hold on the firm's highest quality jobs.

As indicated above, the emerging system of integrated international production may be expected to introduce substantial changes in the way in which TNCs influence employment and how to evaluate the overall employment effects of transnationalization. Obviously, these changes have only just begun, and uncertainty remains as to their magnitude and direction. Nevertheless, recalling the various elements of an integrated strategy, it is plausible to assume that a range of employment effects will result from the major tendencies associated with the new strategies, namely, a fuller or more pronounced geographical separation of production from consumption; a fuller or deeper integration across locations of a firm's value-adding activities; and a greater reliance on created assets, such as workforce quality and organizational innovation, as critical components of the ownership advantages of TNCs. The implications of these tendencies for the quality and locational distribution of jobs are more fully discussed in sections C and D, after a review of recent trends in direct and indirect employment in TNCs.

Table IV.2. Relating corporate strategies to employment effects

Item	*Stand-alone strategy*	*Simple-integration strategy*	*Complex or deep integration strategy*
Employment quantity	Local market-serving may mean a higher firm-wide level of employment since firm's employment structure is replicated in various local markets. Indirect employment creation through establishing local linkages with suppliers is a frequent pattern.	Foreign-affiliate employment is export-oriented and probably direct employment-creating, although some jobs will be lost in home-country units (while others may be gained). Indirect employment creation may be minimal since foreign affiliates rely on transformation of imported inputs.	Overall, in a firm, employment may decline if the firm is in transition from a former stand-alone strategy. One reason is that value-adding activities are no longer replicated across different locations, but rationalized and consolidated so as to reap efficiency and scale advantages. The balance between home and host-country effects is no longer clear since the integrated producer faces a new set of locational choices in which the home-country location cannot be assumed to have an advantage.
Employment quality	Replication of the parent firm's occupational structure in a foreign affiliate setting, with the exception of the highest value-added jobs (*viz.*, research and development, headquarters functions). Industrial relations often follow the national pattern as the foreign affiliate is more embedded within its host-country institutional framework.	Creates an international division of labour in which low-skilled, low value-added jobs may be predominant in the foreign affiliate. Avoidance of trade unions may be one outcome, as the integration strategy is based primarily on low labour costs, and integration increases system-wide vulnerability.	Deeper integration can imply a trend towards convergence in certain elements of the employment package in order to maximize the efficient performance of a firm's overall global system. Here, too, differences in quality assigned to home versus host-country locations are more difficult to predict. A certain labour market specialization in given affiliates does seem implied since an integrated producer may assign global or regional responsibility for individual activities to individual locations.
Location	Since the objective is primarily local market serving, the geographical dispersion of firm activities (and employment) will be within major market areas, and thus more concentrated. A country's trade-tariff policies may be one factor encouraging inward foreign direct investment in place of trade.	Since the objective is primarily resource- or asset- (e.g., low-cost labour) seeking, location decision may be more dispersed than with a stand-alone strategy.	The integrated producer may separate more fully the location of production from consumption of the final product. This is not to say that proximity to final markets is no longer an important location criterion, but it does imply that there is no longer any need to perform all value-adding activities close to the final market. Integrated production is more strategic asset-seeking and, given that the quality and cost of human resources are important considerations, it may imply a broader range of locational choices than the other two strategies.

Source: UNCTAD, DTCI, based on Hamill, 1993b.

B. Recent developments in employment in transnational corporations

1. Direct employment by transnational corporations: recent trends

(a) Global trends

During the past two decades, the magnitude of employment provided by TNCs has grown, along with the proliferation of TNC activities and the growth in worldwide flows and stocks of FDI. However, during the past decade, the number of persons directly employed by TNCs (that is, parent companies and their affiliates) has increased much more slowly than the nominal value of FDI flows and stock. While the growth of employment in TNCs was only moderately below that of FDI during 1975-1985, the divergence between the rate of direct employment growth corresponding to TNCs and that of the increase in the world stock of FDI widened after 1985 (table IV.3).

The level of global direct employment by TNCs is subject to cyclical fluctuations in economic growth and influenced by shifts in industrial composition and differential regional and country growth rates, as well as by changes in the organization of TNC activities. Several cyclical and structural factors adversely affected employment growth in TNCs during the past decade; they included slow economic growth in the developed countries in the early 1980s and again in the early 1990s, and a trend towards greater use of labour-saving technologies. In fact, data for a sample of 300 of the largest TNCs indicate noticeable cyclical fluctuations in direct employment which, at the end of the 1980s was lower than in 1980 and it is likely to have declined further following the slowdown in economic activity worldwide in the early 1990s (box IV.4).

Several factors related to the organizational strategies and forms of TNC activities may have contributed to the declining trends observed in employment in the largest TNCs:

- A decline in direct employment in TNCs may be associated with the transition to integrated international production, as firms restructure their activities in ways that increase efficiency across the whole production system.
- A second downward pressure on direct employment may have arisen from the adoption of new methods of work organization, such as "lean production" techniques (Sengenberger and Campbell, 1993), or through the application of advanced manufacturing technologies to traditional processes. Integrated strategies may lead to a more rapid diffusion of such labour-displacing organizational and technological innovation as a result of a greater interdependence across affiliates, since "best-practice" work organization must be diffused across the entire corporate system if individual elements of the system are not to produce a drag on the entire system.
- A third impact on direct employment could arise if corporations, in rethinking their intra-firm organization of corporate functions, replace in-house activities by inter-firm outsourcing and subcontracting arrangements. Integrated international production may thus be associated with an overall decline in direct employment, but an increase in employment indirectly generated among subcontractors and external suppliers.

It is important here to underscore that integrated strategies *per se* do not portend a decline in the level of employment within TNCs. Rather, it is the transition to such strategies that may have unfavourable implications for current employment in established firms undertaking these strategic changes. New firms that adopt integrated strategies from the start do not need to restructure their existing assets.

Table IV.3. World foreign-direct-investment stock and estimated employment in transnational corporations, 1975, 1985, 1990 and 1992

(Millions of dollars and millions of employees)

Item	*1975*	*1985*	*1990*	*1992*
Outward FDI stock	282	674	1 649	1 932
Estimated employment in TNCs	40	65	70	73 [a]
Employment in parent companies at home	..	43	44	44 [a]
Employment in foreign affiliates	..	22	26	29 [a]
Developed countries	..	15	17	17 [a]
Developing countries	..	7	9	12 [a]
China	-	..	3	6
Memorandum:				
Employment in United States TNCs	26 [b]	25	25	..
Of which: employment in foreign affiliates	7	6	7	..

Source: UNCTAD, Division on Transnational Corporations and Investment, based on UNCTC, 1988a, p. 24; and Parisotto, 1993, p. 34.

a Preliminary estimate.

b 1977.

As regards the influence of the considerable expansion of FDI activities on the amount of employment accounted for by TNCs, although a certain number of firms became transnational over the period — thereby adding to the total number of employees in TNCs — the most prominent effect was an increase in the share of employment in foreign affiliates.

In host developed countries, that increase was less the result of direct job creation than that of a process of exchange or reshuffling of ownership of already existing employees. A significant part of FDI flows to developed countries during the second half of the 1980s took the form of mergers and acquisitions by TNCs, as opposed to greenfield investments, thus resulting in employment-acquisition, in many instances accompanied by restructuring and rationalization of employment, rather than employment creation. A growing shift in the sectoral composition of FDI towards services, such as trading, finance and real estate, that are less labour-intensive than manufacturing also contributed to the relatively slow increase in employment in foreign affiliates compared with the growth of FDI. In short, while there has been a certain amount of net direct employment creation, the quantitative picture with respect to total employment in TNCs in the developed countries — where most FDI is located — has not changed significantly despite the dramatic expansion of FDI. The employment generating effects of FDI have been more visible in host developing countries, partly as a result of the preponderance of greenfield investments that added to net production capacity and the labour-intensive nature of the operations established by TNCs in many of these countries (figure IV.1).

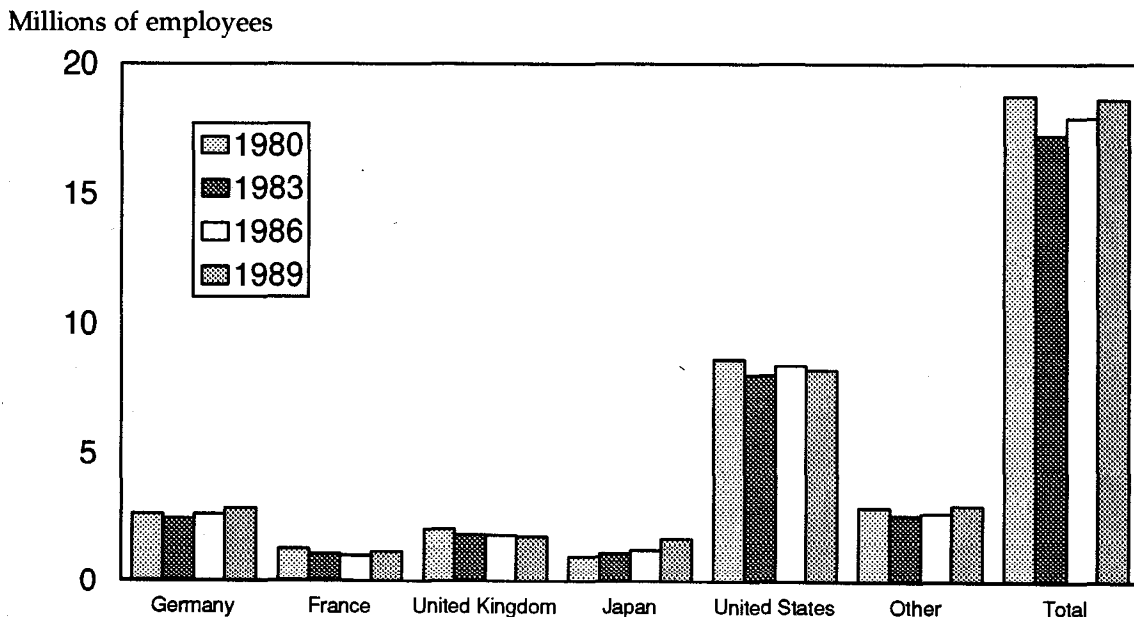
Box IV.4. Employment in the largest transnational corporations

The largest TNCs account for a significant proportion of the activities of TNCs worldwide. It has been estimated, for example, that the top 100 TNCs accounted for about one-third of the combined outward stock of FDI of their countries. As far as employment is concerned, these companies accounted for about 12 million people in 1992, of whom about 40 per cent worked in affiliates abroad (chapter I).

The evolution of total employment over the 1980s for a sample of over 300 leading industrial TNCs is shown in the accompanying figure. Direct employment fluctuated with the business cycle, registering a decline in the recessionary climate of the early 1980s and renewed growth in the latter half of the decade, only to decline once again by the early 1990s. While the companies for which this pattern is recorded account for a tiny fraction of the total population of TNCs, they are by far the largest in employment terms. Cyclical fluctuation in employment in the largest firms thus highlights the cyclical character of employment in TNCs taken as a whole.

In the first half of the 1980s, these largest well-established TNCs undertook a massive reduction in employment. It was in the second half of the 1980s that these leading companies increasingly resorted to major national and cross-border mergers and acquisitions. This produced an intricate reshuffling of transnational and national ownership patterns, which was mainly "internal" to TNCs in highly transnationalized industries. Overall, global TNC networks of production and distribution expanded, as indicated by a general increase in employment in affiliates abroad; but total direct employment at the end of the 1980s – at least in a large sample of leading industrial TNCs – was actually lower than in 1980, particularly for TNCs from Europe and the United States.

Figure 1. Employment in 343 leading transnational corporations, by country of origin, 1980-1989



Source: Parisotto, 1993, p. 47.

(b) Developed countries

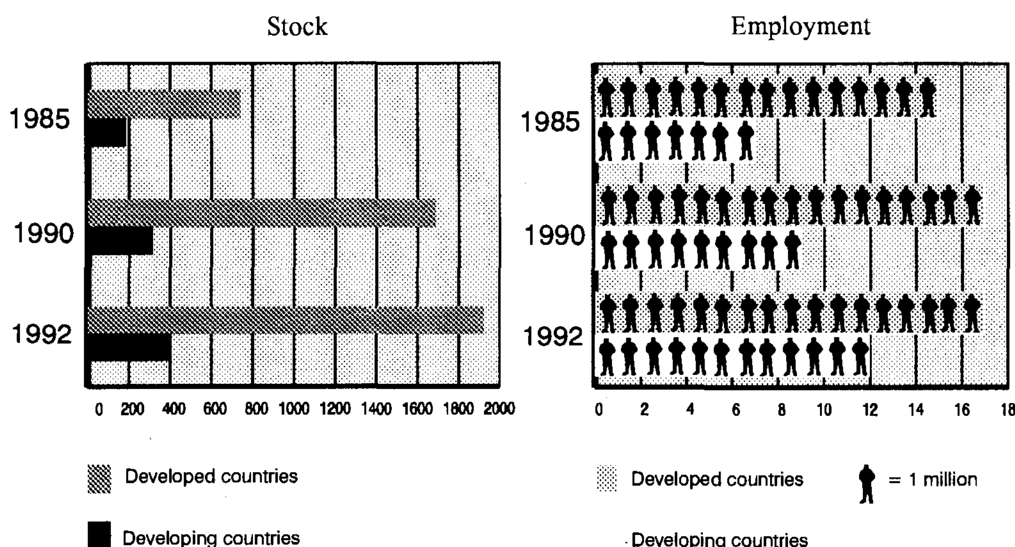
Almost two-thirds of employment in TNCs is accounted for by parent companies' operations at home, primarily in developed countries, and, of the remainder, two-thirds is in their foreign affiliates in developed host countries. It is important to underline that, except for the United States, there are no comprehensive data on the total number of employees in TNCs.

Estimates suggest that the amount of total direct employment generated by TNCs from the major developed countries broadly parallels the significance of their home countries as outward investors, with TNCs from the United States accounting for the largest number of employees, followed by those based in the United Kingdom, Germany, Japan and France (table IV.4). During the 1980s, particularly in the second half of that decade, employment in foreign affiliates of TNCs based in major developed home countries rose (table IV.5). For instance, employment in foreign affiliates of Japanese TNCs more than doubled from 716,000 in 1980 to 1.6 million in 1991.

Increases of employment were also registered in the foreign affiliates of TNCs based in other major developed countries. In the case of the United States, however, there was virtually no growth in employment in foreign affiliates during the period 1982-1991. Employment increased in foreign affiliates in services, but that hardly compensated for the decline in manufacturing employment. A large and growing portion of outward FDI from the United States during the past decade took place in services, particularly financial (non-banking) activities, resulting in a shift of FDI stock towards services in general and financial activities in particular. These services accounted, however, for a much smaller share of total employment in foreign affiliates of United States TNCs, reflecting their lower employment-generating capacity as compared with manufacturing. A similar development took place in the case of Germany and Japan. In all the three countries, manufacturing accounts for a relatively higher share of employment in foreign affiliates than its share of total outward FDI stocks (table IV.6): manufacturing accounted for between 70 and 80 per cent of employment in foreign affiliates at the beginning of the 1990s, while its share

Figure IV.1. Inward foreign-direct-investment stock and estimated employment in foreign affiliates, 1985, 1990 and 1992

(Millions of dollars and millions of employees)



Source: UNCTAD, Division on Transnational Corporations and Investment.

in total FDI was between 30 and 50 per cent. This relationship holds true also for nearly every industry. Differences are minor for the chemical industry, but they are more evident in the textiles, leather and clothing, electrical equipment, motor vehicle and other manufacturing industries, in particular for Japan. Correspondingly, the opposite pattern in the relative distribution of employment versus FDI stock characterizes both the primary and tertiary sectors.

A main change in the 1980s was the decline in the share of outward FDI stock in the primary sector, coupled with a corresponding decline in the employment associated with this investment. The share of the tertiary sector in outward FDI stock increased by over 10 percentage points in Germany and the United States and about 18 percentage points in Japan. The corresponding increase in the share of employment in foreign affiliates associated with this shift was more modest, ranging around 4 percentage points in Germany and the United States and an even smaller increase in Japan (table IV.6).

Therefore, the shift of outward investment towards the tertiary sector lowers the rate at which foreign affiliate employment grows. That sector is, of course, very diverse, ranging from labour-intensive activities, such as hotels, restaurants and retail trade, to industries such as public utilities and finance. Public utilities are capital intensive and provide relatively little employment. They have recently reappeared as a destination for developed countries' outward FDI, and seem likely to grow further in importance as developing countries attempt to improve their communications systems. A large part of the increase in FDI in the tertiary sector in the 1980s, however, was accounted for by FDI in financial services, insurance and real estate. While these industries are not very intensive in their use of physical capital, they provide little increase in employment because they are typically intensive in the use of financial capital and technology, rather than labour. To some extent, the likelihood of gains in employment from FDI in finance has been reduced by policies of the host countries. In many countries, foreign banks are barred or discouraged from retail banking, a relatively labour-intensive part of banking, and are confined to international or TNC lending, with less need for host-country labour.

With the notable exception of United States TNCs, the growth rate of employment in foreign affiliates of developed country TNCs was generally higher than that of total national employment in developed home countries (table IV.7). Moreover, it appears that, during the 1980s, TNCs themselves probably generated less additional employment in their operations at home than in their affiliates abroad, which partly attests to the increasing importance of production abroad for TNCs. For example, employees in foreign affiliates abroad as a proportion of total employees in Swedish industrial TNCs rose from 41 per cent in 1986 to 61 per cent in 1990. At the same time, employees in operations at home declined sharply, both in absolute terms and as a share of total industrial employment in Sweden (box IV.5).[1] In the case of United States TNCs, the ratio of employment in foreign affiliates to total TNC employment rose slightly from 21 per cent in 1982 to 23 per cent in 1991 (Mataloni, 1993).

The geographical distribution of employment in foreign affiliates varies across developed home countries. A quarter to one-third of employment abroad of TNCs based in France, Germany, Italy and the United States is in developing countries, mainly Latin America and South, East and South-East Asia and the Pacific (table IV.8). Japan is a major exception in this respect, with over half of employment in foreign affiliates of Japanese TNCs being located in developing countries, primarily in the Asian-Pacific region (table IV.8). Smaller countries, such as Finland, Sweden and Switzerland, tend to have a much higher concentration of TNC employment in developed countries, mainly in the European Union. It is worth noting that developing countries generally account for considerably lower shares of the outward FDI stocks than their shares of employment in foreign affiliates of TNCs based in the major developed countries.[2]

The growth of employment in foreign affiliates during the 1980s has been strong in host developed countries (table IV.7), particularly in North America and the European Union,

Table IV.4. Outward and inward stock of foreign direct investment and related employment, selected developed countries, 1990

(Millions of dollars and thousands of employees)

Country	Year	Outward FDI stock	Employees in TNCs originating in country: Total worldwide	Employees in TNCs originating in country: In foreign affiliates	Year	Inward FDI stock	Employees in foreign affiliates in country
Australia	1989	29 569	846 [a]	..	1987	39 689	200 [b]
Belgium and Luxembourg	1989	22 651	266 [c]	..	1980	7 306	349 [d]
Canada	1984	35 888	1 174	..	1986	66 934	1 329
France	1990	110 126	3 680 [e]	2 100	1989	60 588	773 [b]
Germany	1990	151 551	4 459 [fg]	2 337	1990	119 619	1 789
Italy	1991	12 702	1 110 [h]	511	1990	57 985	506 [b]
Japan	1990	202 450	4 064 [g]	1 550	1990	34 630	182
Netherlands	1981	40 311	1 454 [i]	1 071 [i]	1989	54 979	196 [b]
Sweden	1990	49 842	1 110 [i]	590	1990	11 759	206
Switzerland	1990	65 731	1 095 [j]	779	1988	25 299	130 [i]
United Kingdom	1981	88 222	5 484	1 390	1990	203 905	775 [b]
United States	1991	466 870	24 909	6 833	1991	414 358	4 809

Source: UNCTAD, Division on Transnational Corporations and Investment, based on Parisotto, 1993, and national official sources.

a Sample of 34 companies.
b Manufacturing only.
c Sample of 15 companies.
d 1978.
e Sample of 100 companies.
f Sample of 87 companies.
g 1989.
h 1987.
i Estimate for 1981.
j 1988.

although employment has diminished slightly in the affiliates of United States TNCs in the latter region. The share of employment in foreign affiliates relative to total national employment is, nevertheless, low for the major host developed countries and regions, amounting, for instance, to just 4 per cent in the case of the United States in 1990 and 3 per cent in the European Community taken as a whole in 1988.[3] In Japan, it is barely visible. But the share of foreign affiliates in manufacturing employment is generally higher. Attaining between 10 and 20 per cent or more of total manufacturing employment in most developed host countries (table IV.9), manufacturing

Table IV.5. Selected home and host countries: employment in foreign affiliates, total and manufacturing, selected years

(Thousands of employees and percentage)

Country	*Employment in inward affiliates (Thousands)*				*Employment in outward affiliates (Thousands)*			
	Year	*Total*	*Manufac-turing*	*Share of manufacturing in total (Percentage)*	*Year*	*Total*	*Manufac-turing*	*Share of manufac-turing in total (Percentage)*
France	1980	..	812	..	..	..	..	..
	1986	..	718	..	..	..	..	..
	1990	..	773	..	1992	2266	1359	60
Germany	1980	1636	1240	76	1980	1743	1312	75
	1986	1500	1071	71	1986	1788	1276	71
	1991	1830	1224	67	1991	2370	1660	70
Italy	1986	..	476	..	1986	..	322	..
	1991	..	508	..	1991	..	511	..
Japan [a]	1980	215	178	83	1980	716	611	85
	1990	182	145	79	1986	921	726	79
					1991	1621	1261	78
Sweden [b]	1980	114	56	49	1980	326	..	..
	1988	195	117	60	1987	488	458	94
	1990	224	128	57	1990	590	523	89
Switzerland	1985	..	..	..	1985	644	539	84
	1992	..	..	..	1992	1079	837	78
United States [c]	1981	2417	1300	54	1982	6640	4429	67
	1986	2938	1412	48	1986	6250	4120	66
	1991	4809	2215	46	1991	6898	4270	62

Source: UNCTAD, Division on Transnational Corporations and Investment, based on national official sources.

a Excluding banking, finance and insurance.

b Manufacturing includes mining.

c Non-bank affiliates.

Table IV.6. Distribution of outward foreign direct investment stock and employment in foreign affiliates of transnational corporations based in Germany, Japan and the United States by industry/sector, selected years

(Percentage)

Sector and industry	Germany				Japan [a]				United States [b]			
	1991		1983		1990		1982		1991		1982	
	Stock	Employment	Stock	Employment	Stock	Employment	Stock	Employment	Stock	Employment	Stock	Employment
Primary	1	1	4	1	8	2	24	5	8	1	21	8
Agriculture	-	-	-	-	1	1	2	2	-	-	-	2
Mining	1	-	1	-	7	1	22	3	1	-	2	2
Petroleum	1	-	2	-	-	-	-	-	7	-	18	4
Secondary	52	70	61	74	34	80	36	79	44	70	42	67
Food, beverages and tobacco	1	2	1	2	2	2	2	2	5	10	4	8
Textiles, leather and clothing	1	4	1	4	2	6	4	11	-	1	1	1
Paper	1	2	1	2	1	1	2	3	3	4	2	3
Chemicals	17	15	20	20	5	5	7	6	9	11	9	9
Coal and petroleum products	2	1	1	1	-	-	-	-	5	4	4	2
Rubber products	1	2	-	1	-	-	-	-	1	1	1	2
Non-metallic mineral products	2	3	2	2	-	-	-	-	2	3	1	3
Metals	2	4	4	4	4	4	8	9	2	1	2	4
Mechanical equipment	6	7	6	7	0	0	-	0	7	10	5	8
Electrical equipment	9	15	10	13	12	33	8	29	4	7	3	10
Motor vehicles	9	14	10	13	0	0	-	-	5	12	5	13
Other transport equipment	0	0	1	0	5	15	4	11	0	3	0	1
Other manufacturing	1	1	3	4	4	14	3	9	2	5	3	4
Tertiary	46	30	36	25	58	18	40	16	47	29	34	25
Construction	1	2	2	2	1	1	1	1	0	1	-	1
Distributive trade	4	19	4	16	13	12	18	13	14	3	16	14
Transport and communications	1	2	1	2	-	-	-	-	2	4	1	1
Finance and insurance	18	3	11	2	-	-	-	-	11	7	4	4
Real estate	17	0	11	-	-	-	-	-	17	0	9	-
Other services	5	4	7	3	44	5	21	2	3	14	2	5
Total	100	100	100	100	100	100	100	100	100	100	100	100
Total (billions of dollars and thousands of employees)	259	2375	123	1617	240	1550	47	881	467	6898	215	6816

Source: UNCTAD, Division on Transnational Corporations and Investment, based on United States, Department of Commerce, 1985, 1993c, 1993e; Ministry of International Trade and Industry of Japan, 1984, 1992; Deutsche Bundesbank, 1991, 1993.

a Data for Japan exclude banking and finance; other services include real estate, transport and communication; motor vehicles include other transport equipment.

b Data for the United States exclude banking.

Table IV.7. Annual average rate of change of employment in foreign affiliates of transnational corporations, by home country and host region, and of total domestic employment, selected developed countries

(Percentage)

Host region	*Germany (1982-1991)*	*Italy* [a] *(1985-1991)*	*Japan* [b] *(1982-1990)*	*Sweden* [a] *(1982-1990)*	*Switzerland (1985-1990)*	*United States* [c] *(1982-1991)*
All areas	3.5	8.0	9.7	7.1	7.2	0.3
Developed countries	4.1	10.1	16.1	7.3	6.9	0.6
North America	3.2	16.9	18.9	9.5	10.0	-0.0
European Union	4.3	6.2	17.6 [d]	9.3	6.2	0.5
Other Europe	6.7	14.7	..	-0.6 [e]	10.5	3.8
Other developed countries	0.8	..	..	-6.3	-5.9	1.1
Developing countries	1.8	8.0	4.3	-6.2	8.4	-0.1
Latin America	1.6	6.1	1.7	..	1.6	-0.1
Africa	-0.6	4.7	-1.4	..	21.5	-3.3
Western Asia	-3.0	45.2	-5.3	..	..	-10.7
South, East and South-East Asia and the Pacific	3.7	8.3	8.0	8.0	15.4	2.3
Memorandum: Rate of change in total domestic employment						
All sectors [f]	1.0	0.4	1.1	0.7	1.6	1.6
Manufacturing	-3.4	-0.0	1.0	0.1	-1.3	0.1

Source: UNCTAD, Division on Transnational Corporations and Investment, based on national official sources.

a Manufacturing only.
b Excluding banking, finance and insurance.
c Excluding banks.
d All Europe.
e Nordic area only.
f Including banks.

continues to account for the bulk of TNC employment, although the transnationalization of the services sector has increased rapidly in terms of FDI shares in recent years. The manufacturing industries in which foreign affiliate employment has been highest in developed host countries have been the chemical, electronic and automotive industries.[4] In these industries, employment generated by foreign affiliates in the past three years has either stabilized or continued to grow. On the other hand, employment has declined in metals and metal manufactures and, in some cases, in the oil industry.

With a few major exceptions (Canada, Germany and Japan), the employment shares of foreign affiliates in total manufacturing employment in host developed countries increased during the 1980s. This trend reflected large FDI inflows that either created new jobs or shifted the ownership of production activities to foreign TNCs, as well as better employment performances

Table IV.8. Distribution of employment in foreign affiliates, by host region, selected developed home countries (Percentage and thousands of employees)

Host region	*France (1992)*	*Germany (1991)*	*Italy* [a] *(1991)*	*Japan* [b] *(1990)*	*Sweden* [a] *(1990)*	*Switzerland (1990)*	*United States* [c] *(1991)*
Developed countries	72.1	74.7	63.0	49.5	86.4	79.5	69.0
North America	..	21.5	11.5	30.1	22.9	20.0	13.3
European Union	45.5	35.1	49.1	13.5	55.9	46.0	40.1
Other Europe	1.1[d]	13.9	8.0	0.6	4.9[e]	11.1	3.1
Other developed countries	-	4.2	-	3.3[f]	2.8	2.4	12.5
Developing countries	27.9	25.3	32.9	52.5	13.6	20.5	31.0
Latin America and the Caribbean	8.6	15.2	19.0		9.9	9.0	19.5
South America	..	12.6	..	7.4	..	..	9.3
Central America	..	2.7	..	..	..	..	9.6
Caribbean	..	0.0	..	..	..	..	0.7
Africa	13.4	2.2	5.2	1.0	0.1	3.0	1.2
Western Asia	..	0.6	..	0.5	..	0.9	0.7
South, East and South-East Asia and the Pacific	5.9[g]	7.3	5.1	43.6	3.6	7.5	9.6
Total	100	100	100[h]	100	100	100	100
Total (Thousands of employees)	**2 266**	**2 375**	**511**	**1 550**	**308**	**1 048**	**6 898**

Source: UNCTAD, Division on Transnational Corporations and Investment, based on national sources.

a Manufacturing only.
b Excluding banking, finance and insurance.
c Excluding banks.
d Eastern Europe only.
e Nordic countries.
f Including developing countries in Oceania.
g Including Western Asia.
h Including unallocated.

of foreign affiliates relative to domestic firms (OECD, 1993b). The latter result can be partly explained by the concentration of TNCs in science-based and scale-intensive industries that experienced a higher rate of growth of output (or a lower decline) relative to labour-or resource-intensive industries in developed countries during the 1980s (Papaconstantinou, 1993).

Box IV.5. International production and employment: the case of Swedish transnational corporations

The internationalization of the Swedish economy, traditionally high, experienced a remarkable acceleration in the second half of the 1980s. Outward FDI was primarily directed towards developed countries, particularly in Europe, motivated mainly by the need to consolidate access to the forthcoming European single market. Although small Swedish TNCs were dynamic foreign investors, the 13 largest TNCs played the primary role in the growth of FDI. Takeovers were the main mode of entry (accounting for 80 per cent of Swedish FDI in the European Community), suggesting that little new employment was directly generated. The employment implications for host countries were, however, far from neutral: employment was cut in some affiliates, e.g., in Italy and France, or shifted among affiliates in different countries.

Sweden is a particularly interesting case because the Swedish economy is highly internationalized in comparison with the size of its domestic market. The strategic choices of Swedish TNCs concerning investment abroad are likely to have a considerable impact on industrial performance, and hence employment, particularly at home. In the late 1980s, there were signs of a shift from complementarity to substitution of investment abroad in relation to investment at home, as attested by the weak export performance of TNC production in Sweden, a change in the nature of intra-firm trade and the declining share of TNC employment at home coupled with the strong growth of employment in affiliates abroad (table 1). This pattern -- growth of employment abroad and decline in employment at home -- was more strongly pronounced in Swedish TNCs in modern industries such as chemicals, electronics and transportation.

Table 1. Employment in Swedish industrial transnational corporations, selected years
(Percentage of total industrial employment in Sweden)

Item	*1974*	*1978*	*1986*	*1990*
Parent companies in Sweden	46	48	48	67
Affiliates abroad	31	35	46	42
Total	77	83	95	109
Total industrial employment in Sweden (thousands of employees)	922	930	777	728

Source: based on data obtained from the Industrial Institute for Economic and Social Research, Stockholm.

Restructuring and expansion of Swedish TNCs abroad seems also to have been associated with an upgrading of the role of foreign affiliates as a result of deeper integration strategies. There was a stronger growth of exports, productivity and research and development in the affiliates abroad relative to TNCs' operations at home. Although these changes were also associated with various other factors, e.g., differential growth rates and exchange rate fluctuations, they were largely influenced, particularly in the European Union, by the reorganization of corporate organizational structures, a new division of labour across networks of TNCs' affiliates and a shifting of functional responsibilities.

Outward FDI from Sweden to developing countries has been primarily greenfield and thus employment-generating in nature. Taken as a whole, however, the foreign affiliates of Swedish TNCs in developing countries registered a decline in employment during 1986-1990, because the reduction in employment due to disinvestments was larger than employment created in newly established affiliates. This reduced the share of developing countries in Swedish foreign-affiliate employment from 18 per cent in 1986 to 14 per cent in 1990. Affiliates in the Association of South-East Asian Nations countries, particularly in electronics and transport, were the main exception. Low labour-cost sites in developing countries have therefore benefited only to a limited extent from the internationalization and integration strategies of Swedish TNCs, although recent information suggests that FDI by Swedish TNCs in developing countries and countries of Eastern Europe has begun to rise.

Source: based on data obtained from the Industrial Institute for Economic and Social Research, Stockholm.

(c) Developing countries

Because developing countries are overwhelmingly host rather than home countries for TNCs, it is the employment in foreign affiliates located in their economies that is of greater relevance for them. Indeed, less than 10 million workers out of the total of more than 70 million directly employed in TNCs were employed in foreign affiliates in developing countries in 1990; the number increased to an estimated 12 million in 1992 (table IV.3). In general, such employment has comprised less than two per cent of the economically active population of most of the developing countries for which data are available (table IV.10). In most developing countries, the employment directly provided by TNCs is thus virtually inconsequential at the aggregate level; in other words, few, if any, of the large numbers of poor in the developing world that are often rural and either unemployed or underemployed have any prospect of working in a foreign affiliate. However, the overall share mentioned above conceals disparities between and, more importantly, within countries reflecting the pattern of FDI. Over the 1980s and early 1990s, for example, a

Table IV.9. Selected home and host countries: share of employment by foreign affiliates in total manufacturing employment, various years

(Percentage)

Country	*Year*	*Home country* [a]	*Year*	*Host country* [b]
Australia	..	..	1987	23.8
Austria	1982	34.1	1985	36.5
Denmark	..	..	1986	12.4
Finland	1988	36.7	1988	8.4
France	1992	30.1	1990	16.4
Germany [c]	1992	24.0	1992	17.0
Greece	..	..	1977	21.3
Ireland	..	..	1987	42.8
Italy	1991	10.8	1991	10.7
Japan	1991	8.1	1990	1.0
Netherlands	1987	60.5 [d]	1987	14.0
New Zealand	..	..	1990	23.7
Norway	1981	2.5	1989	6.4
Portugal	..	..	1984	12.9
Sweden [e]	1990	47.0	1990	11.5
Switzerland	1992	95.5	...	..
Turkey	..	..	1990	3.2 [d]
United Kingdom	1981	22.9	1990	14.9 [d]
United States	1991	20.8	1991	10.8

Source: UN-TCMD, 1993b, except where indicated otherwise.

a Ratio of total employment in affiliates abroad of TNCs originating in country to total manufacturing employment in country.

b Ratio of total employment in foreign affiliates in country to total manufacturing employment in country.

c Data obtained from R. Jungnickel, 1994.

d Data obtained from OECD, 1993b.

e Manufacturing includes mining.

number of Asian countries with dynamic economies, as well as a few other countries such as Mexico have attracted considerable FDI and have become more fully integrated into the international division of labour, with significant benefits in terms of the direct and indirect generation of new jobs. Generally, however, countries with higher shares of employment in foreign affiliates to total employment have tended to be economies that have small populations, such as Botswana, Jamaica or Singapore (table IV.10). Among the larger developing economies, Malaysia is the only country with the share of foreign affiliates in total employment exceeding two per cent. In contrast to its limited significance relative to aggregate employment, however, the role of TNC employment in the modern manufacturing sector of developing countries is often substantial (table IV.10). Indeed, TNCs account for one-fifth or more of total manufacturing paid employment in a number of countries, both large and small, e.g., Argentina, Barbados, Botswana, Indonesia, Malaysia, Mauritius, Mexico, the Philippines, Singapore and Sri Lanka.

Judging from data on employment in foreign affiliates of TNCs from the major home countries, employment in foreign affiliates in host developing countries expanded during the 1980s. However, while some developing countries saw a growth in direct employment in foreign affiliates, others, including several countries in Africa, West Asia and Latin America, experienced a decline (table IV.7). Employment also increased rapidly in export processing zones of developing countries growing at an annual rate of 9 per cent during 1975-1986 and 14 per cent during 1986-1990 (Parisotto, 1993, p. 61).

Since 1991, FDI inflows into developing countries and economies in Central and Eastern Europe have been rising considerably faster in relation to those into developed countries (chapter II). Major opportunities for foreign investors have been provided by large privatization programmes in many developing countries, including Argentina, Chile, Indonesia, Hungary, Mexico, Peru, Singapore and Venezuela. The employment impact of the participation of TNCs in privatization programmes may be uncertain, at least in the short-term, as streamlining of employment by the new owners is likely to occur. Most of the increase of foreign affiliate employment in recent years has been concentrated in China, where joint ventures and greenfield investments of a largely labour-intensive orientation expanded at a rapid rate. Employment in foreign affiliates in China increased from 0.9 million in 1987 to 3.2 million in 1990 and further to 6 million in 1992.[5] If the current trend towards the expansion of FDI into developing countries continues, the pace of employment generation by TNCs can be expected to grow rapidly in the future.

A question of some interest to developed home countries is the extent to which affiliate employment in developing host countries represents a relocation of jobs formerly situated in their economies (box IV.6). As discussed earlier, the effects of outward FDI on home country employment are not easy to assess. Among other things, they are influenced by the pattern and motivation of FDI, for instance, whether it is resource-seeking or market-seeking investment. In the case of developing countries, available data suggest that about half of the FDI they receive is in the primary and tertiary sectors (UNCTAD-DTCI, 1993a, p. 62). These investments are typically location-bound and involve little, if any, relocation of production and, hence, employment from home countries. As far as FDI in manufacturing is concerned, it is often meant to serve domestic markets (i.e., it is market-seeking); and, for a number of reasons, such markets cannot be served by exports, e.g., in the case of high tariff barriers or low-cost domestic competition. In fact, such investment rather maintains or creates employment in home countries, to the extent that foreign affiliates are dependent on home country firms for intermediate products or services. The remainder of manufacturing FDI represents, therefore, the maximum potential for relocation effects. Although data limitations make it difficult to arrive at an estimate of these latter effects, the magnitude is likely to be low, especially also in relation to the size of labour markets in developed countries. This is not to say, however, that employment in a few specific industries (e.g., electronics and textiles) may not have been considerably affected. Larger displacement

Table IV.10. Employees in foreign affiliates, by host developing country/area, all sectors and manufacturing, latest available year

(Thousands of employees and percentage)

	All sectors			Manufacturing			
Economy/area	*Number of employees in foreign firms (Thousands)*	*Share of economically-active population (Percentage)*	*Share of paid employment (Percentage)*	*Number of employees in foreign affiliates (Thousands)*	*Share of economically-active population (Percentage)*	*Share of paid employment (Percentage)*	*Year*
Africa							
Botswana	35	8	..	6	..	36 [a]	1989
Cameroon	35	1	10 [a]	34	..	..	1984
Côte d'Ivoire	61	1	14 [a]	34	..	..	1984
Mauritius	..	..	..	35	26	33	1990
Rwanda	6	..	..	2	14	..	1989
Senegal	41	1	..	26	..	..	1984
Tunisia	..			47	..	..	1990
Zaire	67	1	30	44	..	..	1984
Asia							
China	4831	..	..	..	..	..	1991
Hong Kong	..	..	..	81	12	..	1991
Indonesia	..	1	..	400	7	24 [b]	1985
Korea, Republic of	315	2	..	288	9	15 [c]	1978
Malaysia	215 [d]	4	..	188 [e]	..	..	1984
Philippines	184 [d]		..	124	5	20 [f]	1988
Singapore	270	21	26	193	5	58 [g]	1988
Sri Lanka	..	..	..	71 [h]	8	40	1989
Taiwan Province of China	250	..	..	160	..	..	1989
Thailand	205 [d]	..	..	183	9	15	1986
Latin America and the Caribbean							
Argentina	..	..	..	185	..	32 [i]	1984
Barbados	..	..	..	3	19	31	1989
Brazil	..	..	..	909	14	..	1977
Colombia	..	..	..	81	..	16 [f]	1981
Jamaica	87	10	12	36	26	..	1988
Mexico	756 [j]	2	12	516 [k]	8	21	1988
Panama	24	..	3	4	6	..	1988
Uruguay	24	2	..	15	7 [k]	..	1988

Source: UNCTAD, Division on Transnational Corporations and Investment, based on Parisotto, 1993, p. 56; and International Labour Office, *Yearbook of Labour Statistics*, various years and national official sources.

a Modern sector.

b Firms with 20 or more workers.

c Firms with five or more workers.

d Data for 1990. e Majority-owned foreign limited companies.

f Firms with ten or more workers.

g Private sector firms with ten or more workers.

h Foreign firms in Greater Colombo area 1986, paid employment in firms with five or more workers.

i Firms with 300 or more workers.

j Instituto Mexicano del Seguro Social.

k 1987 Censo Economico Nacional.

effects may actually have taken place through trade, reflecting the emergence of independent producers in developing economies, as well as intra-firm trade or reliance by TNCs on subcontracting arrangements with suppliers in developing countries. Recent empirical work by the Organisation for Economic Co-operation and Development (OECD) suggests that even the impact of trade between OECD and developing countries on unemployment in developed countries has not been large. Estimates on the employment content of net imports from developing to developed countries, i.e., employment displaced through trade, range from 1 to 9 million person-years.[6]

For many developing countries, one of the most discussed aspects of employment-creation is the establishment or expansion of export processing and other special economic zones. These zones are a significant avenue in terms of the number of jobs created through FDI (table IV.11).

Box IV.6. The délocalisation debate

A debate over the shifting of manufacturing production to other countries, especially those with lower wages and labour standards, and its significance for rising unemployment at home has surfaced in Europe. The debate has been particularly vigorous in France, which is currently experiencing one of its most severe post-war recessions: In 1993, GNP growth was negative, and 3.5 million people, constituting 12 per cent of the economically active population, were unemployed. *Délocalisation* became a popular word, in referring to cases such as the closing of the Hoover plant in Dijon to relocate production to Scotland.

A number of reports prepared by special committees of the Parliament of France, including, among others, a much-publicized report presented by Senator Jean Arthuis, have argued the existence of a link between relocation and unemployment (Arthuis, 1993a). That report presents an account of the "alarming situation" regarding the increasing number of jobs lost due to the relocation of production, and estimates that over one million jobs are threatened in France as a result of *délocalisation*. Three factors are identified as elements of a chain reaction leading to a potential loss of jobs in France.

- Technological progress is allowing companies in some industries (for example, textiles, electronics and toys) to transfer downstream and upstream segments of production to lower-cost countries.
- Countries such as China, Madagascar, Mauritius and Taiwan Province of China, as well as countries in Central and Eastern Europe, that have opened or are opening to international trade are becoming additional potential sites for relocation. In particular, according to the report, Central and Eastern Europe could become a preferred site as a result of its substantial industrial potential and the absence of significant cultural or infrastructure constraints.
- The recession itself forces companies to reduce production costs, including through relocation of production segments to low-cost countries. The report identifies three successive generations of relocations, namely, traditional consumer products, services and intangibles. The last of these could, potentially, affect all sectors (Arthuis, 1993b).

The report presents evidence of the existence of a link between relocation and unemployment, showing, for example, that firms in three industries affected by relocations (electronics, textiles-clothing and footwear) have reduced by half their number of employees in France during the past decade. The report suggests that the "rules of the game" are not respected by some Asian economies: it claims that currencies of the newly industrializing economies are undervalued, their exports are sold at "dumping" prices, while their domestic markets are closed to French exports. The report proposes a number of measures to address the problem, including tax measures, other protective measures at the national and European levels and more stringent rules governing international trade. "Within the framework of international trade negotiations, the Community should obtain a selective increase of custom duties in the sectors most affected by job relocations.... Like the United States, the EEC must have its Chapter 301, i.e., an external trade protection instrument, serving as a deterrent..." (Arthuis, 1993a, p. 8).

The report drew the attention of the Government of France and academia to the need for examining more rigorously the problem of *délocalisation* as regards its definition and quantitative dimension.

At present, nearly 200 zones in approximately 60 developing countries directly provide about four million jobs; additional export processing zones are planned for at least 20 more countries. In China alone, more than two million persons were employed in such zones in 1990 (Starnberg Institute, 1991).[7] There are several other countries that are success stories in terms of job-creation through export processing zones, but others have been less successful (table IV.11). It is important to note that TNCs are not the only investors in these zones, although they have a crucial role in the initial stages. The participation of local employers varies considerably across the various zones, but it generally increases over time as the zones' activities get rooted and attract the attention of local entrepreneurs.

The process of evolution of export processing zones partly reflects the changing labour cost advantages of developing countries for TNCs. A distinction can be made between the first

Critics of the report have pointed out that the FDI-employment linkage is complex and that unemployment created by technological changes or recession should not be attributed to FDI (Madeuf, 1994, p. 22). Academic research and government institutions (e.g., Sorbonne, OFCE and Ministère de l'Economie) questioned the magnitude of relocations presented by the Arthuis report (Borotra et al., 1993). A group of experts estimated that, currently, less than 5 per cent of the FDI stock held by French TNCs abroad represents *délocalisation* in the strict sense of the term, i.e, the transfer of production units abroad coupled with the closure of a domestic production unit (Madeuf, 1994, p. 3). The Arthuis report claims that production is being shifted to South-East Asia and Central and Eastern Europe. Affiliates in South-East Asia, however, employ only a small fraction of the employees abroad of French TNCs (5 per cent), and their relative share of total FDI outflows is negligible (less than 2 per cent). Furthermore, a large part of this investment seems to target the growing Asian markets rather than seeking to reduce production costs for export purposes. An analysis of trends in international trade also produced contrasting findings: in 1992, France's trade deficit with the rapidly growing South-East Asian countries was 4 billion French francs; with the newly industrializing economies, France had a surplus of 6 billion French francs in 1993 (Hatem, 1994). According to a recent study carried out by the Direction des Rélations Economiques Extérieures (DREE, 1993) an estimated 70 per cent of imports from South-East Asia may be the result of *délocalisation* in its broad sense, that is, including imports resulting from trade and subcontracted manufacturing. On the other side, there has also been a marked improvement in French exports to South-East Asian countries, especially in exports of capital goods. In examining all these elements, a recent study (Mathieu and Steerdyniak 1994) estimated the loss of employment in France due to the growth of the relative economic importance of South-East Asian countries to be 190,000 to 230,000 since 1980. At the same time, it has been noted that French commercial relationships have increased with countries such as the Republic of Korea and Singapore in which wages and social protection are the highest, as well as with countries that were, or progressively became, open to trade and investment.

Policy options regarding *délocalisation* have been widely debated and the employment issue has become a test of the effectiveness of government policies. One of the measures proposed to encourage employment creation has examined ways of reducing the cost of unskilled labour. One proposal, made by Senator Arthuis, suggested the introduction of a social value-added tax "...in order to prevent the consumer of imported goods from being exempted from his participation in the financing of national solidarity" (Arthuis, 1993a, p. 7). This has been rejected on the basis of the argument that it would not alleviate costs borne by the enterprises (Borotra and Chavanne 1993; Mathieu and Steerdyniak 1994). Other initiatives have instead suggested the introduction of selective wage reductions (mainly for unskilled labour), by partially exempting firms from the payment of certain social charges. Finally, as far as trade policies are concerned, protectionism is only a limited option, since France, the world's fourth largest exporter, would be the first loser in a more restricted trade environment (DREE, 1993 and Hatem, 1994). The Ministry of Trade is increasing efforts to encourage the development of economic relationships with the dynamic economies of Asia and Latin America. At the multilateral level, there are proposals for the inclusion of a new clause in the multilateral trade framework, implemented under the new World Trade Organization, addressing the question of union rights, child and prison labour and related social matters. Other measures advocated have included the strengthening of trade policies

Table IV.11. Employment in export processing zones and other special zones in developing countries, 1990 (or latest available year)

(Number of employees)

Economy or area	*Number of economic processing zones in operation*	*Number of employees*
Africa	**31**	**230 648**
Botswana	1	13 000
Egypt	7	25 000
Ghana	1	2 600
Lesotho	1	..
Liberia	1	..
Mauritius	7	90 000
Morocco	1	1 500
Senegal	1	1 200
Swaziland	1	..
Togo	1	3 971
Tunisia [a]	9	93 377 [b]
Asia and the Pacific	**57**	**2 666 349**
Bahrain	2	4 600
Bangladesh	1	10 000
China	7	2 200 000
Fiji [a]	-	..
India	6	30 000
Jordan	1	..
Korea, Republic of	2	21 910 [b]
Macao	4	60 000
Malaysia	10	98 900
Pakistan	3	2 000
Philippines	5	43 211 [b]
Sri Lanka	2	71 358
Syrian Arab Republic	6	..
Taiwan Province of China	3	70 700
Thailand	1	27 990
Tonga	1	..
United Arab Emirates	2	5 500
Yemen	1	..
Latin America and the Caribbean	**85**	**1 087 449**
Antigua and Barbuda	1	..
Argentina	1	..
Aruba	2	800
Bahamas	2	8 000
Barbados	-	20 000
Belize	1	600
Brazil	1	137 000
Chile	1	8 500
Colombia	8	7 000
Costa Rica	4	6 000
Dominica	1	..
Dominican Republic	18	150 000
El Salvador	1	5 890
Grenada	1	..
Guatemala	1	55 000
Haiti	2	43 000
Honduras	3	3 000
Jamaica	4	18 000
Mexico	23	460 000
Netherlands Antilles	1	300
Nicaragua	1	..
Panama	1	6 476
Puerto Rico	2	155 000
St. Kitts and Nevis	1	583
St. Lucia	2	1 500
St. Vincent	1	400
Trinidad and Tobago	1	400
Total	**173**	**3 953 107**

Source: ILO-MULTI database, based on Starnberg Institute, 1991 and other sources.

a There are no geographically demarcated export processing zones, but industrial areas in which a number of exporting enterprises enjoy conditions similar to those generally granted in the zones.

b 1991.

generation of zones (i.e., those in the 1970s or early 1980s) that are now reaching maturity, and the second generation, including export processing zones that have experienced considerable expansion throughout the late 1980s and early 1990s.

- The former category includes "mature" zones in countries or areas like Mauritius, the Philippines, the Republic of Korea and Taiwan Province of China. These zones have gone through the full life cycle of a typical export processing zone. Initially, employment in the zones expanded rapidly thanks to sustained FDI in labour-intensive operations. As wages and working conditions improved and restrictions on union activities became less severe, capital-intensive production gradually replaced labour-intensive activities, and there was a decline in FDI inflows that triggered a fall in employment as labour-intensive production was relocated to more convenient locations.
- The second category includes zones in countries like China, the Dominican Republic, Guatemala, Mexico, Sri Lanka and Tunisia. These registered a considerable expansion in the late 1980s, partly as a result of the relocation of investment in simple, labour-intensive manufacturing production from the newly industrializing economies of Asia.

The experience of both categories of zones suggests that the establishment of export processing zones can be a useful strategy for the generation of employment through FDI. However, it has definite limitations, both in terms of the kinds of jobs generated (see the discussion on quality of employment below) and the long-term sustainability of those jobs. Production in the majority of the export-processing zones has been concentrated either in textiles and garments or in electrical and electronic products, suggesting that the attraction of low-cost labour, even when reinforced by other incentives, is confined to FDI in a limited group of industries. Furthermore, over time, as labour costs increase, such FDI is likely to relocate and countries can maintain the level and growth of FDI and related employment only by investing in education and skill enhancement and encouraging TNCs to invest in more technology-intensive processes and products. Such a strategy has been pursued successfully, for example, by some of the newly industrializing economies of Asia.

Large, well-established TNCs have been the primary targets of promotion efforts by export processing zone authorities. However, with the exception of large TNCs in electronics, the majority of foreign investors in these zones are small and medium-sized firms. The latter, in fact, are more attracted by the incentives offered by the zones and the low costs of production than are their larger counterparts, since their locational decisions are often more influenced by short-term cost considerations. From the viewpoint of employment, this is useful for developing countries because affiliates of small and medium-sized TNCs tend to be relatively efficient generators of employment, with higher labour-capital ratios than affiliates of large TNCs or indigenous firms in developing countries (UNCTAD-DTCI, 1993c, pp. 115-116).

Some developing economies — particularly in the Asian region — are also emerging as home bases for TNCs. During 1986-1990, partly in response to rising labour costs at home, outward investment by companies from these economies increased rapidly — twice as fast as that from the developed countries — and now accounts for some one-third of inward FDI in a number of Asian countries. Indeed, TNCs from these economies are largely responsible for the rapid growth of inward FDI (chapter II) and related employment in China. Although their share in FDI inflows worldwide remains small, their significance as employers for home as well as host countries has increased and is likely to grow further. This is of relevance for host developing countries, where the greater proportion of FDI from developing economies is located.

2. Indirect employment effects and spill-overs

In addition to the numbers of those directly employed, TNCs, like other enterprises, generate employment opportunities through various linkages with enterprises in home and host countries and multiplier effects (table IV.12). As a general rule, for each job directly generated by a TNC, one to two may result indirectly from backward and forward linkages (see below). *Backward linkages*, e.g., through the purchasing of raw materials, parts, components and services from subcontractors and external suppliers, are among the principal channels through which TNCs can indirectly contribute to employment generation. The importance of these effects has grown in recent years, following the trend towards a deeper division of labour and the declining degree of vertical integration that is occurring within the largest firms. These firms progressively focused on a smaller part of the value-added chain, relying increasingly, for technological or flexibility reasons, on national and international outsourcing. Employment, as a consequence, is being gradually externalized (box IV.7). *Forward linkages*, such as ties between TNCs and the distributors of their products, can also create jobs, although not to the same extent as backward linkages.

Table IV.12. Indirect employment-generating effects of transnational corporations in host countries

Type of effect	Illustration
Vertical	
Upstream (backward) linkages	Employment indirectly generated by foreign affiliates in their local suppliers of raw materials, parts, components, services etc.
Downstream (forward) linkages	Employment indirectly generated by foreign affiliates in their local customers (e.g., distributors, service agents etc.).
Horizontal	
Narrow	Employment indirectly generated (or displaced) in local enterprises competing in the same industry as foreign affiliates.
Broad	Employment indirectly generated in local enterprises active in industries other than those of foreign affiliates.
Macroeconomic	Employment indirectly generated throughout the host economy as a result of spending by foreign affiliate workers or shareholders, or displaced as a result of the increased import content of production.

Source: adapted from ILO, 1984a.

Based on the results of various empirical investigations with respect to the relative significance of the indirect employment effects of the activities of TNCs in host countries, a number of observations can be made: [8]

- Indirect effects are on the whole positive and substantial; under certain conditions, they generate roughly the same or more number of jobs than TNCs create directly. Indeed,

Box IV.7. Working for manufacturers without factories

A growing number of TNCs in manufacturing are separating the physical production of goods from the research-and-development and marketing stages of the production process (UNCTAD-DTCI, 1993a), relying for the former on a dense network of independent (but often closely monitored) suppliers and for the latter on their own efforts. As the tasks directly performed by these TNCs have shifted to higher-value added activities, the number of jobs in subcontractors located in both developed and developing countries has increased rapidly. Such subcontracting is popular in the garment and footwear industries but is also spreading to other manufacturing activities as well as services. Prominent examples are Nike (United States), Ikea (Sweden) and Benetton (Italy).

Nike (United States), a footwear company with annual sales of nearly $4 billion in 1993,[a] subcontracts 100 per cent of its goods production. Nike itself currently employs 9,000 people, while nearly 75,000 people are employed by its independent subcontractors located in different countries. These figures reflect the division of labour in value added: Nike's own team of highly skilled workers focuses on the services part of the production process, including design, product development, marketing, distribution, data processing, sales and administraive tasks. Labour-intensive manufacturing tasks are performed by the workforce at the subcontractors' facilities in developing countries. Apart from a powerful media-driven image, a key source of the company's profitability is its performance-oriented inventory-control system, *Futures*.[b] Nike manages to get orders from retailers in advance in return for guaranteed delivery times and discounts making it possible for it to organize timely production from its different producers located abroad.

The location of Nike's subcontractors and the associated employment has shifted over time. From its inception, the company sourced almost all its shoes from independent producers. But the original suppliers in Japan, the United States and the United Kingdom have been partly replaced by producers in developing countries, including China (which now supplies about 25 per cent of Nike's shoes) and the Republic of Korea, Malaysia, Taiwan Province of China and Thailand. In an attempt to achieve both flexibility and stability, Nike has created a set of clearly differentiated supply relationships that have implications or the quality of employment provided by subcontractors (Donaghu and Barff, 1990). There are three groups of suppliers in Nike's network:

- The most important are what the company calls the *developed partners*, mainly located in the Republic of Korea and Taiwan Province of China, who participate in joint product development and concentrate on the production of newest product designs. Given the rising labour costs in these locations, labour intensive activities previously performed by suppliers in these countries were relocated to other countries. However, the relationship with Nike of these old suppliers was, if anything, strengthened as they started to manufacture higher value-added products, working exclusively for Nike on the basis of a minimum monthly order.
- The second group of Nike's suppliers, called *developing sources* offer low labour costs and the opportunity for Nike to diversify assembly sites. Currently, they are located in China, Indonesia and Thailand. Nearly all are exclusive suppliers to Nike and as such receive considerable assistance from the company with a view to upgrading their production to form the next generation of *developed partners*.
- The third group, called *volume producers*, are large scale factories serving a number of other independent buyers. They generally manufacture a specific product for Nike, but they are not involved in any new product because of fears of leakage of information to competitors. Orders from Nike for suppliers from this group fluctuate, with variations of 50 per cent between monthly orders.

Backward linkages with further employment generation are generated by all of Nike's suppliers, but only for non-proprietary components and material inputs.

Another well-known TNC that relies heavily on subcontracting is Ikea (Sweden). This company manages from its headquarters and through its main affiliates an entire value-added chain covering market analysis, product design and development, material testing, production and construction design, stock management, transport and sales to consumers. It has its own department stores worldwide and issues a yearly catalogue. Ikea itself currently employs 25,000 people. Like Nike, the only thing it does not do is the actual manufacture of the goods it sells; that generally takes place in independent companies (approximately 2,300 firms of various size), located in 70 countries, developed as well as developing, generating employment especially in activities requiring skilled or semi-skilled

labour. However, in certain countries, such as in Central and Eastern Europe, Ikea has recently helped in financing new investments and the modernization of production facilities. The company has strict procedures for selecting its suppliers, which have to meet its quality requirements and delivery deadlines. It also constantly tries to improve and rationalize production, introducing new technology and quality upgrading among its suppliers, encouraging them to improve production methods and work organization and invest in new machinery. Ikea has also encouraged its suppliers to engage in new planning routines and diffuse the use of computers because its suppliers may be linked to its computer network to receive orders (ILO, 1991b).

Like Ikea, Benetton (Italy) relies on its computer network to receive orders and monitor sales. However, the company, which defines itself a "clothing service company" rather than a simple manufacturer or retailer, subcontracts not only some parts of its goods production but also a large part of its trading outlets. The firm has built a system of flexible franchising (no royalties and no stock return) and its worldwide shops are mostly owned by unrelated enterprises. In manufacturing its goods, the company undertakes in-house only the parts of production that it considers crucial, including design, cutting, dyeing and packing. These activities rely on the creativity of the firm's 200 hundred young designers and its high-technology cutting and packaging plants. This organization of activities has resulted in Benetton itself employing a total of 3,500 persons, as compared with an estimated 45,000 to 50,000 persons employed in its subcontracting facilities. However, in order to maintain close linkages with its own factories and the flexibility of last-minute dyeing of garments to respond to sales trends, Benetton's suppliers are located mainly in Europe where 80 per cent of the firm's clothes are manufactured. Unlike many of its competitors, Benetton locates only a small fraction of its clothes' production in developing countries.[c]

These and many other examples suggest that subcontracting has contributed towards building up competitive advantage and domestic specialization in the industry concerned in countries where subcontractors are located, providing opportunities for employment and improved quality of employment. The clothing and textile industries in Hong Kong and Taiwan Province of China have successfully moved up in the international market, at least partly on the basis of subcontracting: many firms were able, after a long experience in subcontracting, to start production under licensing, and even to develop local brand-name products (OECD, 1993c). Similarly, in electronics, subcontracting represents the fastest growing aspect of the industry, involving TNCs from both sides of the Atlantic and East Asia (Boswell, 1993). Growing subcontracting linkages between electronics TNCs and local firms have been established in Malaysia, Singapore, Taiwan Province of China and Thailand. For example, some United States TNC affiliates in Malaysia subcontract up to 20 per cent of their production to local firms located in other Asian countries in order to handle periodic fluctuations in market demand (Lim and Fong, 1991). Lately, Asian firms, based mainly in Hong Kong, the Republic of Korea, Singapore and Taiwan Province of China, pushed by rising costs and labour shortages, have also started to establish their own networks of subcontractors, mainly in low technology, labour-intensive products.

Subcontracting has sometimes been criticized because of the heavy pressures it places on subcontractors to cut prices and labour costs, especially in the case of long subcontracting chains; possible fluctuations and instability of employment in supplier firms; and the subcontractors' lack of control of the market. However, the outsourcing of production, as these examples well show, also requires close co-operation between different participants in the value-added chain, particularly in view of the relatively short product-development schedules, customer-oriented production and high standards of quality that are demanded by TNCs relying on subcontracting. This makes it possible for large as well as small and medium-sized firms, including ones located in developing countries, to access international markets and new production opportunities without bearing the risks attached to exports and independent marketing. In many cases, subcontracting provides opportunities not only for employment creation through production for the world market but also for skills upgrading, quality control, access to new technology and major advances in manufacturing production.

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a *Forbes*, 3 January 1994.
b "Can Nike just do it", *Business Week*, 18 April 1994, pp. 86-93.
c "Benetton: the next era", *The Economist*, 23 April 1994.

estimates for the early 1980s based on input-output analyses suggest that one to two jobs were generated indirectly for each job directly created by foreign affiliates in the case of Thailand, the Philippines and Association of South-East Asian Nations countries taken as a whole (Miranda, 1994, p. 19 and Watanabe, 1993, p. 136). A much lower coefficient (one indirect job for every four direct jobs) has been estimated, however, in a similar exercise for the Mexican *maquiladoras* in 1989, largely as a result of the prevalence of off-shore assembly production (Fuentes *et al.*, 1993, p. 176). In general, the direct creation of jobs in export processing zones has been considerable in many countries, but the indirect employment effects of these zones are rather weak owing to few backward and forward linkages. Based on a series of eight recent case studies of foreign affiliates in developed and developing countries, it has been estimated that the average coefficient of indirect employment generation is 1.6; in other words, 1.6 jobs are generated indirectly as a result of one job directly created by the affiliates (Dupuy and Savary, 1993). This result takes into account only the employment generated indirectly through backward linkages (average coefficient equal to 0.9) and forward linkages (average coefficient equal to 0.7).

- Indirect effects vary to a great extent in accordance with the modalities of FDI projects, the industry of the investment, the sourcing strategy of the foreign investor and the conditions in the host country. The nature of each affiliate and the degree of its integration within the global network organized by the parent company were major factors in explaining large differences across the various affiliates (Dupuy and Savary, 1993). Affiliates that were strongly rooted in a host country and mainly oriented to the domestic market accounted for significant local procurement (e.g., Capral-Nestlé in Côte d'Ivoire). Assemblers of final products, highly integrated in the global sourcing strategy of the parent company, had negligible indirect employment effects (e.g., the affiliates of NEC in Thailand). The most interesting case was that of highly integrated affiliates characterized by a variety of tasks, including intermediate and final assembly for the national and international market, which accounted for strong backward linkages with the host economy (e.g., IBM-Montpellier in France and Fasa-Renault in Spain).

- Linkages with local enterprises are likely to increase over time as foreign affiliates get rooted in the host economy, as illustrated by the case of Nissan Motor Manufacturing (United Kingdom) Ltd. (box IV.8). As far as foreign affiliates of Japanese TNCs are concerned, the local procurement ratio in 1989 was 63 per cent among manufacturing affiliates established before 1970 and 45 per cent among those established in the first half of the 1980s (Watanabe, 1993, p. 139). In some cases, and sometimes also in response to local-content rules, major foreign investors have induced their traditional supplier firms at home to follow them to the host countries.

Major narrow and broad horizontal employment effects are likely to result from the role of TNCs as catalysts in bringing about long-term structural transformation in a host economy, for instance by introducing advanced technical standards, providing a stimulus to the endogenous accumulation of technological and organizational capacities and creating links with world markets. In this regard, quantitative effects are considered as closely interwoven with qualitative and other spill-over effects, as long as the latter help to generate sustained economic growth and employment in the host countries. Not much evidence is, however, available on the importance of the qualitative effects and the conditions that are necessary to optimize the advantages of FDI for employment in a host country. The newly industrializing economies of East Asia have been able to gain skilfully in terms of industrial restructuring and employment from the presence of foreign investors, particularly when the development of local capacity in some industries, e.g., electronics, has been supported by sectoral programmes and competent guidance by the host government (Henderson, 1993, p. 40). The experience of Mexico is similar (UNCTC, 1992c, p. 86). On the other hand, in many other developing countries, a similar virtuous circle of industrial restructuring leading to employment upgrading has not yet emerged.

Box IV.8. The indirect employment effects of Nissan in the United Kingdom

In addition to the direct employment created in the overseas affiliates of TNCs, jobs may be generated through local linkages with supplier companies. The extent of local linkages has been a particular area of controversy in the case of Japanese companies who have been accused of establishing "screwdriver" plants abroad that rely heavily on parts and components imported from Japan. Such plants, it is argued have been set up to circumvent real or threatened import restrictions on Japanese exports. Such accusations were probably true in the initial phase of Japanese direct investment abroad. As the case of Nissan shows, however, there has been an evolution in plant status overtime associated with a strategy of localization. This is illustrated clearly in the case of Nissan Motor Manufacturing (United Kingdom) Ltd..

The origins of Nissan (U.K.) date back to 1984 when Nissan (Japan) signed an agreement with the Government of the United Kingdom to build a car plant in the United Kingdom. Initially, the plant at Sunderland, in the North East of the country, was a simple assembly operation supplying mainly the domestic market and relying heavily on imported parts and components from Nissan's factories in Japan and elsewhere. In line with Nissan's overall strategy of localization, however, there has been a rapid evolution in plant status in a fairly short period of time. This evolution has involved the introduction of new product ranges, a substantial increase in local content (which is now 80 per cent) and of exports. Nissan now exports over 80 per cent of its annual output of 246,281 vehicles mainly to Germany, Italy, France and Spain, but to over 30 countries in total (including exports back to Japan). The plant is now United Kingdom's largest car exporter, with 182,207 Primeras and Micras exported to 36 countries in 1993. As a consequence of the rapid evolution of plant status in a short time period, total employment at the plant has increased from 470 initially (1986) to 4,250 currently.

Detailed information on the multiplier/indirect employment effects of Nissan's Sunderland plant are not available. It is possible, however, to trace the plant's increasing integration with local suppliers (since the United Kingdom is a member of the European Union, local in this context implies European suppliers).

Nissan's initial intention in 1986 was to have a 60 per cent local (European Union) content at the Sunderland plant by 1990. At the official opening ceremony in September of that year the President of Nissan Motor Company announced an acceleration of its United Kingdom manufacturing programme, which would see local content rising to 60 per cent by 1988; and this was successfully achieved. This has subsequently risen to 80 per cent for the Micra range; although transmission systems, cylinder blocks and diesel engines continue to be imported from Japan. The plant now uses 197 European suppliers accounting for an average annual expenditure of £850 million. Two thirds of suppliers are located in the United Kingdom, with other major component suppliers based in Germany, France and

C. International production and the quality of employment

The quality of the employment generated by TNCs is an area of principal concern for policy makers in both host and home countries, as governments compete vigorously to attract or retain investments by TNCs in activities that provide high-wage, high-skill jobs. As with the question of employment quantity, the range of direct and indirect effects is quite broad, and each individual effect may be positive or negative (table IV.1). There is a general agreement, however, that TNCs provide employment on conditions that, on the whole, compare favourably with those prevailing among domestic firms in host countries. This conclusion is supported by a relatively large amount of empirical and anecdotal evidence. Indeed, TNCs tend to be concentrated in high skills-and marketing-intensive industries and use more capital-intensive technologies and superior managerial and organizational techniques. These features — together with the increasing importance of skills and quality of work in generating competitive advantages — account for more favourable conditions and opportunities for workers in TNCs. Thus, in general, TNCs have a large and increasing potential to exert a positive qualitative influence on labour markets and working

Spain. Thirty suppliers are located in the area immediately surrounding the plant in the north east of the United Kingdom.

The importance of such high local content can be emphasized by examining the cost structure of Nissan's product range, with 70 per cent of final product value being accounted for by parts and components, (table 1).

Table 1. The cost structure of Nissan (UK) product range

(Percentage)

Item	*Share of total costs (Percentage)*
Parts/components	70
Labour costs	10
Energy	10
Other costs	10
Total	100

Nissan estimates that the total permanent employment generated in the north east of the United Kingdom from its Sunderland plant is 8,029 (i.e., a multiplier of 1.7) comprising the following:

Direct employment at Nissan (UK) (1992)	4,600
Subcontractors, e.g., catering etc.	247
Other Nissan companies	162
Component suppliers - on site	1,020
Total permanent employment on site	6,029
Other north east region component suppliers (approx.)	2,000
Total permanent employment generated in the North East region of the United Kingdom	8,029 (approx.)

Source: based on information obtained from Nissan Motor Manufacturing (United Kingdom) Ltd.

conditions in home and host countries. This section reviews main issues related to the impact of TNCs on the quality of employment, broadly defined, and discusses some potential implications of integrated international production for employment quality. (The importance of TNCs as a source of training and human resource development in the countries in which they operate will be discussed more fully in chapter V.)

1. Quality of employment in transnational corporations

Generally speaking, at the aggregate and industry levels, the workforce directly employed by foreign affiliates enjoys superior wages, conditions of work and social security benefits relative to the conditions prevailing in domestic firms. In developed countries, for instance, the average level of wages and salaries in foreign affiliates has been found without exception to be above that in domestic firms, and the gap between affiliates and domestic companies continued to grow during the 1980s (OECD, 1993b). The increase in wage differentials in favour of foreign affiliates ranged from over 10 per cent in France, Ireland, Sweden and the United Kingdom to a peak of 134

per cent in Turkey (OECD, 1993b). In the United States, affiliates of foreign TNCs pay, on average, wages almost 30 per cent above those paid by locally owned firms; even within manufacturing, foreign affiliates' wages are more than 12 per cent higher.[9] In Indonesia, Malaysia, Peru and Thailand, on average, TNCs pay generally higher wages than local companies (Hill, 1993a, Yong, 1988, Vasquez, Aparicio-Valdez and Benedo, 1989, Sibunruang and Brimble, 1989).

A number of closely-related factors explain why remuneration generally tends to be better in foreign affiliates than in local firms:

- Productivity in foreign affiliates tends to be higher on average than that in domestic firms. Foreign affiliates tend to be concentrated in high skill, marketing and capital-intensive industries in which the occupational mix of employment often differs from that in national firms.[10] Thus, for instance, while foreign affiliates in the United Kingdom have approximately a 20 per cent productivity advantage over similar domestic producers and, therefore, pay more than domestic firms (Davies and Lyons, 1991), correcting for the difference in the distribution of firms across industries brings the average wage gap to

Box IV.9. Labour compensation in transnational corporations in developing countries

It has been observed in many countries, particularly developing countries, that foreign affiliates pay higher wages, or total labour compensation, than locally owned firms. That fact, by itself, does not imply that foreign-owned firms have any impact on the host country's labour market. It could be that TNCs are in industries that require higher skills than the average domestic firm. Or the functions that TNCs place in a host-country market may be of a type, such as sales or purchasing, requiring relatively high skill. Or TNCs may locate in higher-wage geographical locations, such as the largest cities in host countries.

On the other hand, it might be that TNCs drive up the price of high-skill labour for all employers by increasing the demand for it. They might drive up the price of city labour for all employers, relative to that of rural labour, by locating their operations in large cities.

Still a third alternative might be that TNCs pay more than local employers for labour of the same quality. That could occur, for example, if the Government encouraged the unionization of firms owned by foreigners, or if other pressures, including those from the home country, are imposed on TNCs to pay higher than usual wage levels. It is also conceivable that workers would consider foreign firms less desirable as employers than local firms and therefore require some additional compensation to work for them (although the opposite may be more frequently the case, at least in developing countries). In these cases, the impact of the TNC presence would be felt by their own employees, but might not spread to employees of local firms.

A comparison of foreign manufacturing affiliates with locally owned firms in Côte d'Ivoire, Morocco and Venezuela shows that, in every industry in which the difference was statistically significant, foreign affiliates paid higher wages (Harrison, forthcoming). The unweighted averages of the ratios of TNC wages to local firm wage levels in industries in which they differed significantly were: Morocco: 1.9; Côte d'Ivoire: 1.5; and Venezuela: 1.5. The ratios for all manufacturing industries together were similar, except in the case of Côte d'Ivoire, where TNCs were reported to pay 20 per cent less than local firms, on average. It is difficult to explain that figure since TNC/local firm wage ratios were below 0.8 in only one of the 12 industries, rubber manufacturing, for which it is also reported that the output per worker in foreign affiliates was only half that in local firms, while the growth of total factor productivity in foreign affiliates outpaced that in local firms by more than in any other industry. On the whole, therefore, most of the evidence for these three countries points to higher average compensation in foreign affiliates in manufacturing than in local firms, whatever the reason. Compensation was higher in foreign affiliates in general and within individual manufacturing industries, quite consistently in two of the three countries.

about 6 per cent (Driffield, 1991). In the United States, on the other hand, foreign ownership *per se* did not account for differences in wage levels, as these were entirely explained by industry mix and size of establishments (Howenstine and Zeile, 1994). Disparities between foreign and domestic firms in size, technology and organization of production are especially pronounced in developing countries and explain the prevalence of large wage differentials, even when comparisons are made at the firm level (Jenkins, 1991 and box IV.9).

- World-market oriented strategies require well-disciplined workers who can be counted upon to meet quality-control standards and production schedules decided upon on the basis of the position that a foreign firm occupies in a production network. An option for reducing the risk of production errors and delays is to offer attractive inducements to workers to join and remain with foreign affiliates rather than national firms. These inducements are likely to be especially costly in countries where local skilled labour and managers are scarce.

Similar findings are reported for a number of economies in Asia in the manufacturing sector (Ramstetter, 1994). The percentage differences between foreign affiliates and local firms in manufacturing over various periods of time, beginning with 1972 and ending in 1991, were as follows for four Asian economies:

Economy	*Wage differential*
Hong Kong	21.4 [a]
Malaysia	-16.9 [a]
Singapore	37.7 [bc]
Taiwan Province of China	1.1 [b]

a Nominal values.
b Real values.
c Non-oil manufacturing.

Additional data on a large sample of domestic firms and foreign affiliates in Thailand for 1990 suggest that wages, average labour productivity (value-added per employee) and capital intensity (total assets per employee) were, on average, higher in foreign affiliates of TNCs from developed countries than in local firms. They also show that affiliates of developing country TNCs tend to be characterized by lower average labour productivity and capital intensity than local firms.[a] However, a closer examination reveals a large variation across industries that renders any differences observed among different groups of firms statistically insignificant. In other words, variations of wages, capital intensity and average labour productivity are much more pronounced across industries than across firm groups. To investigate the statistical significance of the differences further it is thus necessary to perform an analysis at the firm level. After controlling for a number of industry- and firm-level characteristics, wages remain higher in developed country affiliates than local and other foreign firms in Thailand. However, there are few significant differences observed in terms of labour productivity, the relatively high labour productivity of developed country affiliates apparently being accounted for by relatively high capital intensity and other industry- and firm-level differences.

a Based on an analysis of 1990 data on promoted firms obtained from the Board of Investment, Thailand.

- The likelihood that TNCs offer favourable wages, training and working conditions to prospective employees is most pronounced in circumstances in which the host-country culture is biased in favour of domestic companies.
- Because of their high-visibility profile, TNCs are in part motivated to offer good pay, benefits and working conditions in order to fend off any possible national or international criticism concerning the standards of employment that they provide.
- The large size of many foreign affiliates[11] could make them more prone than smaller domestic firms to unionization and the pressures that come from organized labour to comply with national legislation and practices intended to protect worker rights.

Even if industry mix and size of establishment account for all of the differences between foreign affiliates and local firms, this does not necessarily mean that TNCs do not affect wage levels. If TNCs enlarge the high-wage sector in a country or the large-plant share of an industry, they may raise the wage level even if they are identical to local firms in their operations. That is likely to be the case even aside from "indirect" effects on labour markets. The higher average wage levels in foreign affiliates, even if they are associated with industry mix and establishment size, are most likely an influence raising wage levels in general.

While TNCs may pay a premium for attracting quality labour in developing countries, there is, predictably, a sizeable gap between their levels of remuneration in developing and developed countries. For instance, the average compensation in United States TNCs foreign affiliates in developing countries is about one-half of the average compensation of parent companies in services, and one-quarter in manufacturing (UNCTAD-DTCI, 1993a, p. 64). This suggests that — while wages and salaries differ in both manufacturing and services as between TNC operations at home and in host countries — the gap is much smaller in services. The reason is that, since the free standing nature of most service affiliates results in the replication of the technology and capital intensity of operations by the parent firm to a significant extent, labour productivity at home and in foreign affiliates are likely to be similar.

When it comes to other aspects of employment policies — such as conditions of work, working hours and holidays, fringe benefit policies, recruitment policies and practices, standards of safety and health, employment security and training — TNCs need to adapt these to the legislation of their host countries, although foreign affiliates generally have a great deal of autonomy in the determination of wages and working conditions beyond minimum national requirements.[12] In general, it appears that the standards adopted by foreign affiliates are not less favourable than those of comparable national employers, although often they are above the national average. Fringe benefits, training, safety and health are the areas where this is usually the case, although there may be significant differences between developed and developing countries.

More detailed information on the labour and social practices of TNCs is available for a few industries, such as food and beverages as well as banking:

- In food and beverages, it appears that the level of wages, working conditions and welfare benefits offered by TNCs are often better than those of local companies. As part of their company policy, a number of parent firms in this industry have applied concepts such as company-sponsored housing, social activities or profit-sharing for workers in their home countries, and these benefits are now frequently offered to affiliate employees as well. The assessment by trade unions of the employment conditions that prevail among foreign affiliates in that industry is generally positive, although the situation may be quite different in some developing countries and concern is sometimes expressed with respect to the conditions of seasonal and part-time workers (ILO, 1989b, pp. 156-157).

- Intensified competition, technological change and diversification of activities are influencing employment in international banks, as labour-intensive activities in retail banking are being replaced by new capital-and technology-intensive activities; the increased tradability of banking services is likely to add to this as well (UNCTAD-DTCI and the World Bank, 1994). On the whole, employees in foreign affiliates are in a more advantageous position than those in domestic banks. Transnational banks "have proven particularly imaginative and generous as regards fringe benefits — mainly, it is true, for career professionals and expatriate staff at overseas locations" (ILO, 1991a, p. 147). However, training seems to be mainly concentrated at headquarters, and limited attention, compared with domestic banks, is being given to training of local staff in foreign affiliates.

While generally progressive in terms of pay and conditions of work offered to host-country employees (compared with domestic companies), the record of a number of foreign affiliates with respect to their workers leaves room for improvement. An important area of concern relates to the quality of employment in small, formally independent producers based in developing countries who participate as subcontractors in the dense network of international inter-firm arrangements that are ultimately organized and driven by producers, buyers or distributors from developed countries. Such arrangements are quite common in a broad range of export-oriented, light manufacturing industries, such as textiles, garments, toys, footwear and sporting goods. These have been of increasing importance in the rapidly growing economies of the East and South-East Asian region. With TNCs at the top of such subcontracting chains and, therefore, more or less involuntarily involved, some corporations, such as Levi Strauss (United States), have adopted strict guidelines governing the choice of foreign subcontractors in which they insist on subcontractors' respect of workers' rights, for example, not utilizing child labour or physically abusing workers (chapter VIII).

The international division of labour in the electronics industry is characterized by two distinct patterns. One is organized and driven by TNCs; with foreign affiliates tending to have a better record than their locally-owned counterparts. The other is driven by major buyers in developed countries and organized in commodity chains via a dense network of subcontracting firms. The latter pattern consists in original equipment manufacturer arrangements whereby the purchaser supplies the designs, some of the components, monitors production quality and ultimately markets the product under its own brand name, while the original equipment manufacturer merely assembles the final product. Locally-owned firms integrated in commodity chains, however, may often have more problematic working conditions, especially when they are linked to TNCs based in East-Asian economies (Henderson, 1993, p. 34).

Concern regarding substandard conditions of work in subcontractors to TNCs is, however, in many instances at least partly misplaced. Though the quality of the jobs provided through outsourcing arrangements in developing countries has usually not been up to the standard of formal-sector employment (and, at the lower levels of the subcontracting chains, job quality is often dismal), such jobs by and large are vital for creating income-earning and on-the-job training opportunities that enable otherwise underemployed workers to escape poverty. Inasmuch as it upgrades their human capital, managers and workers alike in subcontracted firms stand to benefit from the concern and training given them by foreign affiliates with regard to quality control and on-time delivery of their output. This symbiotic working arrangement between TNCs and their suppliers particularly characterizes the efforts of Japanese affiliates to replicate abroad their home-country subcontracting arrangements (Watanabe, 1993, p. 169).

A second area of widespread concern regarding employment conditions in the operations of TNCs has to do with export-processing zones. Given the predominance of assembly-type operations in the textiles and garments and electronics industries, the type of employment that has been created consists primarily of unskilled and semi-skilled jobs. Young women on average make up around 70 per cent or more of these zones' employees (box IV.10), although their

Box IV.10. Women's employment in transnational corporations

In the past two decades, the proportion of women that entered the workforce has increased dramatically. In some developed countries, such as the United States and the United Kingdom, women now account for nearly 50 per cent of the labour force.[a] A larger proportion of women than men usually works in services and, since in most developed countries new jobs created are mainly in services, women's jobs have been less under threat than men's jobs during the recent recession. Nevertheless, even in countries where the proportion of working women is high, there are still substantial asymmetries in the division of labour by gender. Women in general are still paid considerably less than men in comparable jobs, and still occupy a restricted range of jobs. This is slowly changing in some developed countries, but the patterns vary extensively from one country to another (Coré,1994).

This is also reflected in the positions occupied by women employed in TNCs. Women have provided TNCs in some industries with the flexibility they seek: cost-cutting initiatives, undertaken by TNCs, such as part-time work or adaptable working hours, have evoked favourable responses among female workers.[b] For example, the introduction of part-time jobs at Philips Electronics (the Netherlands), favoured because of its positive effect on labour costs, has dramatically increased the number of women employed. However, the proportion of women in the five highest layers of that company's management remained very low. An investigation by the company suggested that the reasons for women's lower position have much to do with their family responsibilities (that are typically higher than those of men) and the need to combine family with a career. Besides, "old boy's networks" favour men for higher positions; women have reportedly to be qualitatively twice as good as their male colleagues to move up.[c]

Corporate responses to facilitate women's careers during the initial years of child rearing have been limited. Only a few large TNCs, in some countries (e.g., Germany and Denmark), offer part-time professional jobs to mothers and both parents. Moreover, women are denied career opportunities on various other grounds as well, as shown by a survey of sixty managers of United States TNCs, who expressed hesitation in selecting women for assignments abroad on grounds of concern for women's physical safety, hazards of travelling and, especially for single women, isolation and loneliness (Adler, 1987).

In developing countries, the employment of women by TNCs has added to employment opportunities for women in organized industry. Many foreign affiliates in labour-intensive assembly industries employ women, mainly those in young age groups. This has benefited an otherwise discriminated-against segment of the labour force and has opened up job opportunities that pay higher wages than most traditional occupations for women. Furthermore, it has improved women's access to education and has given them a higher measure of independence. For example, the majority of women workers surveyed in affiliates of TNC electronics firms in Malaysia considered their lives to have significantly improved since they started working in those factories (Lim and Fong, 1991). But there is also widespread criticism due to foreign firms' preference for, and manner of, employing young women. Young female workers employed by TNCs face particular problems. For example, in TNC data-processing activities in Brazil, Jamaica and Malaysia, women frequently suffer from exhaustion,

proportion has begun to fall in a number of export processing zones. The zones' employment record is mixed, reflecting as it does the limited and unequal opportunities that exist in many developing countries in terms of access to good quality jobs. Working conditions in these zones tend to involve long hours, including overtime and night shifts, and labour turn-over is often higher than in national companies. Moreover, unionization rates are low, job-security is limited, opportunities for training and skills-enhancement are poor, and there are few if any backward linkages to the host-country economy. On the other hand, evidence also shows that wages — when allowance is made for the difference in gender composition (suggesting that TNCs do not contribute significantly to bridging wage inequalities by gender) — tend to compare favourably with the levels prevailing in the host country for comparable work (Reyes-Castro and Domínguez, 1993; Hein, 1988; Ho, 1993; Sivalingam, forthcoming). Facilities also tend to be better than in local

migraine anxiety and stress because of the intensive nature of their tasks and the long hours for which they are immobilized in front of computers. A high rate of abnormalities in respect of pregnancies and childbirth has also been observed (Pearson and Mitter, 1993).

In export-processing zones, in which around 80 per cent of the labour force comprises women from the age of sixteen, working conditions are often poor and hazardous to health. Workers in these zones, especially in electronics, are often exposed to radiation, toxic substances and chemicals without warning or safety equipment. In addition, production is often speeded up, working hours are 25 per cent longer than elsewhere and wages are lower (between 20 to 50 per cent lower) than those of men working in the same zones. These conditions contribute to an early burn-out, with the women leaving the company by the time they are 25 years old (Kamel, 1990). Sexual harassment by male supervisors and job insecurity can be other problems faced by these women workers (Kamel, 1990).

The reasons for employing young women in export processing zones include, among others, that they are typically unmarried and without family responsibilities and, as one employer in the *maquiladoras* in Mexico put it, because they do not have too much experience and can be shaped to the employers' needs by appealing to their "feminine sensibilities" (Kamel, 1990 p. 40). Many employers view women as more pliant and less prone to claim their rights or to participate in union actions. For instance, only 10 per cent of female workers in the *Maquiladoras* are unionized, although women also start organizing when they get some work experience (Kamel, 1990).

Women are often employed in the informal sector of developing countries. In Latin America, for example, they account for 39 per cent of the total informal sector workforce.[d] Women in the informal sector are often at the very end of the subcontracting network of TNCs, paid on the basis of pieces produced, rather than working days and unprotected by labour legislation.

It is important to note that negative experiences of female workers in TNCs as well as other enterprises are often related to broader phenomena, such as rural-urban migration, gender subordination in society and other traditional cultural factors. At the same time, it should be underlined that for many women in developing countries or backward regions, factory work in TNCs is a step upwards towards economic well-being and independence: the alternative is often even lower paid jobs, for example, as domestic servants. For women who do not wish to return to traditional roles, but to work, for fair wages and with fair working conditions and prospects of career development, TNCs may some times offer the first opportunity for change.

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a The term "working women" refers here only to women who work in the paid labour force, and does not include unpaid work.

b "The war between the sexes", *The Economist*, 5-11 March 1994, pp. 79-80.

c "Survey shows up shortage", *Philips News*, 15 April 1994.

d "Seccion Latinoamericana", *Commercio Extérior*, April 1991, pp. 367-371.

firms outside the zones, which suggests that standards of health and protection from industrial accidents can be more readily safeguarded. Finally, it should be kept in mind that export processing zones represent job opportunities, however meagre, for persons with no better options.

2. Indirect qualitative effects

Indirect qualitative effects on the labour market can be considered as one component of the positive externalities that can be generated by the activities of foreign investors that ultimately should lead to improved overall technical and social progress and allocative efficiency. In principle, when superior production systems of TNCs are transferred abroad, superior techniques

filter out to the host economy as workers in foreign affiliates and local suppliers are trained in new skills and local employers are confronted with new management methods and organizational patterns.

The migration of managers and skilled staff from foreign affiliates to local firms is the principal example of indirect qualitative effects that can benefit a host economy. Albeit limited, the mobility of skilled labour has an important qualitative impact and represents an effective avenue for spreading technical knowledge and fostering a host country's managerial and technological capabilities. Evidence for some developing countries, however, shows that the importance of labour mobility as a channel for transferring skills and technological competence is limited, partly because of the better wages and conditions enjoyed by skilled employees in TNCs. In a sample of foreign affiliates in Malaysia, a high turnover occurred mainly among sales and production workers (Yong, 1988, p. 69). The mobility of professional and technical employees in foreign affiliates was minimal, given, among others, the lack of enticements to move to employment in the domestic sector. In Kenya, the mobility of the managers trained in foreign firms was lower than in other kinds of firms (Gershenberg, 1987b).

Technical assistance to local suppliers is another avenue for transferring advanced knowledge and encouraging training and skill formation. The main examples can be found in the affiliates of Japanese TNCs in Asia and in developed countries. Deep and stable relationships with a network of external suppliers are an important element in the functioning of Japanese-style organization of production. For various reasons, Japanese affiliates have made attempts to replicate overseas their subcontracting system by means of technical assistance and incentives to local suppliers to improve quality and reliability. Progress in raising local procurement has been slow so far, but in ASEAN countries, a limited number of indigenous component manufacturers have emerged, such as Thai Engineering Products Company, which, equipped with numerous computer-numerically controlled machine tools, cater to many transnational companies operating in the region (Watanabe, 1993, p. 140).

Finally, TNCs play a major role in the international diffusion of organizational and technological innovations that have an impact on working conditions, labour productivity and human resource management (chapter V and VI). Significant effects derive from the introduction of "best practices" in host countries. The automobile industry in the United States and the United Kingdom is an important example of how Japanese firms train more and give their workers slightly higher benefits, such as additional insurance, profit sharing, discounts and attendance bonuses, than other firms. The most significant new features introduced by Japanese firms in the United States, however, derived from the new patterns of work organization (teams, quality circles etc.). This has produced conscious emulation efforts by United States automakers, with positive effects on the industry (box IV.3).

3. Integrated international production and the quality of jobs

The tendency of TNCs to shift to more complex corporate strategies in recent years and the emergence of an integrated international production system (chapter III) have significant potential implications for the quality of the jobs generated by these corporations. It should be noted that the transition to complex strategies appears to apply most thoroughly at present to major established firms which, however, account for a large share of total employment in foreign affiliates.

The integration of production across affiliates and the creation of a variety of inter-firm relations can have several impacts on the quality of employment. Four observations in particular can be made regarding the possible implications of complex strategies for employment quality:

- Greater integration means a greater interdependence across formerly discrete or relatively autonomous segments of a firm's labour force attached to different production units. A certain interdependence in aspects of the employment package among geographically dispersed affiliates may result, for example in ways in which work is organized and production is scheduled to meet corporate-wide demand and requirements. In this sense, an essential element of integrated international production is that outputs from each affiliate are inputs elsewhere in the system. The scheduling of production across borders is a much more internally driven process than production of stand-alone operations catering to the demands of any given national market. This is particularly clear in the case of vertical inter-firm networks in just-in-time production. But the same integration of production schedules would presumably apply to intra-firm global production networks. It is possible to conceive of a certain loss of autonomy of local affiliates with respect to the pace of work and production. One electronics affiliate in the Philippines, for example, is the sole global source for a component used internally in the firm's worldwide production network. Its production schedules are updated frequently in the course of the workday, according to requirements set centrally by company's management.
- Another consequence of a higher level of integration is the possibility that certain aspects of employment quality tend to converge across national labour markets (Papaconstantinou, 1993; Frenkel, 1991). The quality of inputs depends not on physical factors alone but, increasingly, on the training and organization of human resources. If firms rely not only on the timing, but also on the quality of particular inputs in their integrated production systems within and between firms, the wider diffusion of "best-practice" strategies with favourable consequences for employment quality could be one outcome.
- In integrated production strategies, the role of the affiliate is moving away from the traditional patterns of parent-affiliate relations (Hamill, 1993b). One important question related to employment quality is the position in which a particular affiliate is located in a firm's value-added chain. As noted earlier, some affiliates may acquire global responsibility for a particular product line or function for the firm as a whole. Because of their enhanced role and status, those affiliates (or product/functional specialists) are likely to be characterized by higher quality employment and job security. A second and related point is that integrated production may be associated with a decentralization of value-adding activities traditionally located at the parent firm or headquarters, such as research and development (OECD, 1993b). One implication is that the highly integrated international producers may allocate critical functions (and associated high-quality jobs) wherever they appear to be most profitable, thus surrendering parent firm home country operations to affiliates in other countries (Cantwell, 1992).
- Finally, in their search for the appropriate location of their various business functions integrated TNCs are increasingly attracted by created assets such as labour quality, critical skills and a good social, as well as physical, infrastructure. To the extent that such assets can be generated by government policies, opportunities for interventions aimed at enhancing locational advantages may increase.

The patterns discussed here are still emerging; systematic empirical evidence therefore is limited. It is not clear, for example, to what extent a broad-based convergence in the terms and conditions of employment is taking place across borders and for what groups of employees. Of course, contradicting forces and frictions embedded in national environments will influence the process. But the logic of the emergence of an integrated international production system suggests that development will move in this direction. The management of integrated TNCs tends to pursue policies that, over the long term, lead to a more highly skilled and presumably better remunerated workforce. In doing so, it increasingly endeavours to take full advantage, for the

corporate system as a whole, of critical skills and innovatory solutions that are available in any part of the system.

The positive implications for labour quality, of course, are not only the result of the adoption of new corporate strategies and structures. They have their roots in the corresponding trends towards innovation and quality production as main tools to compete, the diffusion of best-management practices and the pervasive introduction of technology that requires workers with higher skills and problem-solving capacities. The combined effects of complex corporate strategies and these latter trends on human resources development will be examined, among other things, in chapter V, while chapter VI will highlight some implications for the conduct of industrial relations.

D. The growing interdependence of labour markets

Several issues deserve attention in connection with the implications of the growing degree of transnationalization in general and the emerging tendency towards integrated international production in particular for world labour markets. The first is the question of the geographical dispersion of global production systems. The second is the tendency for patterns of integration to produce greater specialization of dispersed labour markets. The third is the question of what these tendencies mean for the autonomy of national labour markets and the influence of cross-border integration on their structures.

Foreign direct investment is not evenly distributed across countries, although its pattern does tend to be more dispersed than that of international trade (UNCTAD, DTCI, 1993a, p. 173). As has been noted earlier, the locational pattern of much FDI is determined for the most part by access to markets. The new complex strategies, however, involve a greater geographical separation of production from consumption and, in so doing, they imply a greater dispersion in the global production system than if the latter were governed by market-seeking FDI or arm's-length international trade alone.

The greater dispersal of TNC operations is what most distinguishes integrated international production from other forms of TNC strategy. A growing number of operations and functions may be located wherever the needed labour, assets and infrastructural requirements are present, thus widening the range of potential jobs in foreign affiliates. Even service activities, once characterized as being relatively non-tradable, now participate in an electronic division of labour in which physical proximity to users no longer matters (Reich, 1991a; Arthuis, 1993b, UNCTAD-DTCI and the World Bank, 1994). Thus, as human resources as created assets gradually gain precedence in global competition over such considerations as proximity to main production facilities and consumer markets, a fuller separation of production from consumption is likely to result, and individual value-adding activities are likely to become more dispersed transnationally.

It is important to underline, particularly for developing countries, that low wages in themselves may not be sufficient to attract sustained FDI unless they are coupled with conditions, such as a suitable infrastructure and labour force quality, capable of granting reasonably high productivity and the efficient organization of production in the affiliates. Vast differences in nominal labour costs across developed and developing countries are to a large measure offset by parallel differences in labour productivity. Unit labour costs are thus much more similar across locations than nominal wages (table IV.13).

Indeed, an important factor encouraging the relocation of many TNC jobs from developed to developing countries has been the rapidly rising quality of the workforce in many of the latter countries, together with their continuing generally low wage and benefit structures. For instance, in terms of university graduates, China and Brazil rank third and fifth in the world in numbers of

Table IV.13. Hourly wages and index of unit costs in the international clothing industry, 1987 and 1992

(Deutschmarks and percentage)

Economy	*Average hourly wage including social costs, 1992*		*Unit costs*[a]			*Produc-tivity assumed,*[b] *1992*
	Deutsch-marks	*Index*[b] *(Percen-tage)*	*1992 Index*[b] *(Percen-tage)*	*1987 Index*[b] *(Percen-tage)*	*Change, 1987-1992 (Percen-tage)*	
Developed economies						
Austria	18.14	66	75	82	15	100
Denmark	28.71	105	110	115	20	100
France	15.81	58	75	80	17	95
Germany[c]	27.30	100	100	100	26	100
Italy (North)	27.77	102	101	108	18	100
Italy (South)	18.53	68	81	..	..	90
Portugal	6.00	22	43	33	61	85
Spain	10.44	38	60	54	38	90
Switzerland	25.06	92	97	97	25	100
Turkey	5.50	20	45	40	41	80
United Kingdom	13.77	50	63	56	44	100
United States	11.92	44	85	74	44	90
Developing economies						
Dominican Republic	0.94	3	32	..	..	70
Hong Kong	5.25	19	39	44	11	90
India	0.52	2	32	..	..	40
Jamaica	1.27	5	30	..	..	72
Malaysia	1.44	5	29	..	..	65
Mexico (United States-border)	2.53	9	37	..	..	70
Morocco	1.81	7	34	41	3	70
Sri Lanka	1.54	6	39	42	16	65
Taiwan Province of China	5.74	21	43	..	..	85
Tunisia	2.66	10	35	40	9	75
Viet Nam	0.42	2	28	..	..	50
Central and Eastern Europe						
Former Czechoslovakia	1.72	6	26	..	..	80
Estonia	0.96	4	29	..	..	80
Poland	1.87	7	30	..	..	70
Slovenia	3.33	12	36	..	..	80

Source: Jungnickel, 1994.

a Total of overhead and variable production costs (including transportation) per processed standard minute. A medium-sized model factory producing with medium-level technology on a subcontracting basis was assumed for all countries, with differences in productivity resulting from national circumstances.

b Germany = 100.

c Including only the western states of the Federal Republic of Germany.

science graduates, while Brazil, China, Mexico, the Republic of Korea and the Philippines all place ahead of, for instance, France and the United Kingdom in the number of engineering graduates (Johnston, 1991). Under such circumstances, TNCs bring to developing countries a technology and managerial package which, when combined with the available high-quality local labour force, can generate increased productivity and a significant competitive advantage at a fraction of the labour costs of developed-country settings.

Based on current apparent trends, however, it appears that the redistribution of jobs through integrated international production has mainly a regional focus. Specific business functions can be conveniently centralized in sites that serve as global sources of specialized inputs or services for a TNCs global production system, but the relocation of jobs so far has been most apparent in the intra-regional distribution of value-added activities across developed and regionally proximate developing or former centrally-planned economies. To date, these regional linkages appear more pronounced than interregional modalities of investment and employment, which suggests that proximity to consumer markets is still important for many kinds of operations by these TNCs. Cross-regional linkages through a TNC may be motivated by traditional market-seeking factors; within a given regional market, however, a firm may attain its greatest degree of cross-affiliate integration (Morrison and Kendall, 1992).

Greater labour market specialization also seems to be occurring to the extent that integrated affiliates participate in only some of the activities in a firm's global value chain and that the strategic assets now sought by integrated producers have a greater human-capital component, that is, consist of created assets. Both of these factors have a potentially significant influence on patterns of locational advantage within a firm and its network of affiliated and non-affiliated units, as well as across countries. Since human-capital-based advantages are not merely sought by major firms, but are also partly transferred by them in the form of organizational and managerial innovations, it is at least plausible that internationally integrated production could accentuate patterns of employment segmentation within national labour markets, while contributing to a cross-border convergence of wages and other conditions in some occupations or industries. The emerging pattern of integrated international production may indeed be accentuating disparities between certain core activities and jobs that are dispersed throughout a firm's international production system, and — particularly with the rise of vertical inter-firm production linkages — a growing periphery of jobs, many of which are less stable and less highly remunerated than those at the core (Sengenberger and Campbell, 1993).

Finally, it may be that the autonomy of national labour-market regulations or welfare systems could be eroded to some extent by the process of cross-border corporate integration through FDI. The reason is that TNCs have greater leeway nowadays to locate their activities in those locations with the right mix of quality and costs. For integrated international producers, geographically distant labour markets compete directly for the same jobs. An automobile maker wishing to restructure its network of affiliates may want to refurbish the capital equipment in one of its affiliates, maximize the weekly operating time and perhaps add a third daily production shift. In choosing among different affiliates in different countries, the firm may discover that regulations concerning operating time vary substantially across these settings. The extent to which countries accommodate in adjusting to proposed changes in the organization of work and production, i.e., the extent to which national labour-market regimes are flexible, can play an important role in the decision-making process. Wide disparities may exist in this respect between labour markets among countries. Even among developed countries, there are considerable differences between social welfare and security systems affecting labour. Not surprisingly, differences between developed and developing countries are significantly greater. Local labour-market policies and regulations may influence positively or negatively the attractiveness or advantages of a particular location.

The declining autonomy of national social and labour policies should be considered in the broader context of globalization. Overall, national institutions have become more open to the influence of international economic trends. For example, the concern expressed by some with respect to the North American Free Trade Agreement is not only that the agreement may result in a loss of jobs in the United States, but also that the inclusion of a low-wage, unorganized workforce of rising quality within the North American market will apply further downward pressure on United States working conditions and living standards (Appelbaum, 1993). Similar concerns apply in Western Europe relative to Central and Eastern Europe.[13]

Given the disparities that exist between labour-market conditions, as well as local policies and regulations relating to labour, the question is whether integrated international production, with its increased scope for locational choice, might result in a further downward adjustment of social and labour standards, as local policy environments compete for a share of international production. The policy issue that is raised by this process is whether social policy regulation at the international level should and could minimize such social policy competition and its attendant social costs, an issue that is briefly addressed in chapter IX.

Conclusions

The recent increase in unemployment in the context of the growing globalization of the world's economic activity has focused attention of policy makers on the role of TNCs in the generation, relocation and distribution of jobs. Although the fundamental factors underlying current unemployment problems relate to macroeconomic and structural imbalances in developed countries and resource constraints in developing countries, TNCs, as a major force in the transnationalization of the world's economies, influence in many ways the quantity and quality of jobs available worldwide and their locational distribution.

The international activities of TNCs experienced a remarkable growth during the late 1980s, directly reflected in the doubling of the value of world FDI stock over the 1985-1990 period. The expansion of outward FDI flows was accompanied by an increase in the number of persons employed in the foreign affiliates of TNCs from the major developed countries. Nevertheless, the global quantitative picture with respect to total employment in TNCs did not change significantly during the period owing to a number of factors, including slow growth of employment in TNCs in their home countries, reshuffling of ownership rather than greenfield investments abroad and a shift of FDI towards services. More recently, with the increase in FDI inflows to developing countries, it is likely that employment generation by TNCs in these countries will increase further.

The role of TNCs in locating or relocating production and jobs in different countries is receiving growing attention. A few spectacular cases of relocation involving plants that close one day in one location to open soon thereafter at a different location have aroused particular concern, especially from the perspective of employees. Moreover, in some industries, a large-scale relocation of production activity has taken place over time due to changing patterns of comparative cost, resulting in widespread closures of plants in traditional locations. In general, greater mobility of capital and technology under the governance of TNCs may bring about dramatic shifts in production and employment at the local, national and regional levels, generating considerable albeit temporary strain on workers in certain industries and/or labour markets. The low occupational and, at least in the short-term, geographical mobility of labour relative to capital may also contribute to making adjustment more difficult and socially painful. Although it is increasing for some groups of workers, labour mobility does not match capital mobility.

A distinction can be made between relocation through FDI within developed countries and from developed to developing countries. The former may have, as a whole, a neutral employment

impact (as the effects of cross-border movements may cancel each other out) or a generally positive effect as a result of higher allocative efficiency, increased national industrial specialization and economic growth. Nevertheless, the disparities in national patterns of industrial specialization, rates of economic growth and employment creation across developed countries or locations within countries can be exacerbated by cumulative movements of foreign capital, particularly in the context of regional integration.

The location of TNC production, or parts of it, in developing countries has been linked by some to the growth of unemployment in developed countries. Such a concern finds its ground in some features of the employment situation in developed countries, particularly the long-term shift in the composition of manufacturing employment from labour-intensive to high-technology and capital-intensive industries, as well as the decline of demand for, and the fall in the wages of, unskilled workers. These developments are probably the result of a long-term adjustment process activated, among others, by the relatively large supplies of low-cost unskilled labour in developing countries. However, increased internationalization reflecting a greater ease of relocation of production may bring unskilled labour in developed countries more rapidly into direct competition with comparable labour in an increasing number of low-wage countries. From this point of view, while providing considerable benefits in terms of lower costs of production, lower prices for consumers, higher flexibility and enhanced competitiveness, TNCs may have a globally positive effect on employment in developing countries while exacerbating the pressure on labour markets in developed countries to adjust rapidly and move to higher value-adding activities. However, the quantitative impact, in terms of jobs transferred to developing countries through FDI, does not have major implications for the spread of unemployment in developed countries, mainly because of the modest size of outward FDI that has relocation implications.

Overall, international production contributes to employment opportunities, not so much by directly increasing demand and employment in the short-run, as through higher allocative efficiency, the strengthening of competitiveness and increased opportunities for output growth in both home and host countries. As emphasized particularly by industrial organization explanations of FDI, TNCs generally enjoy specific competitive advantages based on their superior proprietary technological and organizational capacities. These can ultimately filter out to local producers in home and host countries by means of various spill-overs and linkages and assist in reviving or enhancing prospects for growth through increased competition and efficiency and technological gains. The ultimate employment impact of the process of industrial change engendered by TNCs depends, among other things, on the capacity of local firms to adapt and take advantage of the presence of TNCs. In developing host countries, where this capacity can be weak, TNCs could still have a major catalytic or tutorial role in stimulating learning processes and fostering economic development, and thus contributing to increased employment. It is these long-term effects, based on the package of resources that TNCs provide for development, rather than the direct employment effects *per se*, that should be of primary interest to host developing countries. Furthermore, the long-term employment effects of international production by TNCs should not be considered as a zero-sum game. However, the distribution of gains between countries or locations, as well as groups of workers, may be uneven, and government policies have an important role to play in facilitating change, ensuring an equitable distribution of benefits and minimizing hardship for those most seriously affected through job losses or wage reductions.

Turning to the quality of the employment, available evidence suggests that, at the aggregate and industry levels, the workforce directly employed by TNCs generally enjoys superior wages, conditions of work and welfare services relative to the conditions prevailing in domestic firms. Transnational corporations tend to be concentrated in high skill, marketing and capital-intensive industries and, within industries, to use relatively more capital intensive techniques and superior managerial and organizational structures. These structural features — together with the increasing importance of skills and quality of work in generating competitive advantage — account for

more favourable conditions. Transnational corporations, therefore, have a large and increasing potential to exert a positive qualitative influence on labour markets and working conditions in home and host countries.

While stand-alone and simple integration strategies have traditionally dominated TNC behaviour and still characterize a large portion of their operations, the shift to more complex corporate strategies in recent years and the emergence of a system of integrated international production has significant potential implications for the quantity, quality and location of the jobs generated by TNCs. These include a greater geographical dispersion of TNC activities, a greater scope for placing abroad individual value-adding activities, increasing coordination and specialization of the activities of individual affiliates, and greater importance being attached to created assets in decisions as to where to locate. The employment implications that follow from this tendency are still at an embryonic stage and have not yet been taken into account in national policy formulation, either for their many potential advantages or for their potential costs.

Given the unemployment problems facing many countries, retaining or attracting TNC operations with a view to maintaining or adding to jobs available is a frequent objective of governments, both national and local, in developed as well as developing countries. In fact, competition for FDI may tempt governments to offer visible or invisible concessions, including in the social and labour fields as an incentive to attract TNCs and create badly needed jobs. This reflects a genuine policy dilemma faced in particular by developing countries, between the need to create jobs and that of raising labour standards. Policy formulation in this respect should recognize the complex factors determining employment and go beyond simple measures for attracting additional inflows of investment *per se* or, in the case of home countries, discouraging outward investment. In the current context of growing global competition and integrated international production, the key policy issue is how to attract or retain value-adding activities in a way that maximizes the long-term contribution by TNCs to national production capacities as well as local employment levels.

For those countries that are home to TNCs, integrated international production implies that efforts at preserving current employment levels and keeping good jobs at home by restricting outward investment may generate only temporary benefits, which have to be balanced against the possibility of substantial employment losses in the long-term if national firms become internationally less competitive in the process. In other words, it may be better for TNC home countries to ensure the survival of their firms by encouraging them to focus on higher value-added activities than to protect them in order to preserve employment, at the cost of becoming less efficient producers. As suggested at various points in this *Report*, the capacity to organize activities in an integrated way across different geographical sites is a critical element in ensuring the efficiency and competitiveness of home-based firms and, hence, their capacity to generate output growth and employment in the long-term. The choice of policy and the extent to which a country may try to influence its firms to choose efficiency and competitiveness leading to long-term growth will depend upon the overall policy context. The cross-border redistribution of jobs that is implied by international production overall and integrated strategies in particular, can be associated with an increasing need for rapid labour-market adjustments, particularly painful under conditions of widespread unemployment in which each single job counts. That burden could be minimized if, first, all countries play by the same rules, that is, pursue similar, open policies with respect to FDI and, secondly, an overall mix of macroeconomic, industrial and social policies exists in each country to ensure satisfactory employment levels and adequate living standards.

A lesson for large countries that wish to retain or attract TNC operations could come from small countries. Small countries have generally been prompt in recognizing the need to let their national firms develop their international production networks as a way to increase the opportunities for a significant generation of jobs, especially high-quality jobs at home. In competing for

FDI without the advantage of having a large local market, they have, in some cases, focused on attracting investment, both domestic and foreign, in selected areas in which they have a potential to specialize. The challenge for large countries, particularly developed countries with large domestic labour markets, is to develop a wide range of skills to enable their labour forces to compete successfully in the international economy.

The widening of the scope of value-added activities that might be located abroad and the growing reliance of integrated strategies on created assets, such as a well-educated and trained workforce, also implies that relocation creates more opportunities overall, as well as opportunities for the creation of higher-skilled jobs for host countries that are well-equipped for the international division of labour that is being shaped by TNCs. In this respect, enhancing the quality of the labour force is likely to be a main avenue for policy interventions for developing and developed host countries oriented at attracting FDI, with high potential effects on employment. Created assets are, indeed, at least to an extent, within the scope of local or national policy control. It should be recalled, however, that this may be a necessary, but not a sufficient factor, since the supply of high-quality human resources would appear to be growing across locations. Moreover, except for very specific needs, TNCs are most likely to be attracted by the combination of an educated labour force with a social and physical infrastructure capable of generating high productivity and efficient organization of production.

Participation in integrated international production need not occur only through attracting FDI, given the rise in importance of a variety of non-equity forms and inter-firm channels of participation. Specific policies could be enacted with a view towards encouraging maximum employment benefits not only from TNCs that establish affiliates locally, but also from those located outside the national borders and linked to local enterprises through non equity arrangements. Policies that focus on the upgrading of local capacities to provide efficient and specialized inputs to TNCs through such arrangements could have a significant employment impact on the host country and help to increase the local embeddedness of TNCs.

Finally, as national and local authorities in developed and developing countries struggle to present themselves favourably as candidates for the location of production by TNCs, concern is mounting that this competition may lead to some decline of the autonomy of national social and labour-market policies and exert a downward pressure on social and labour standards in countries that are home or host to TNCs. National and international policy makers may need to consider ways and means of minimizing such social policy competition for attracting investment as well as avoiding a wasteful incentive war, while taking positive steps to strengthen their attractiveness, including, among others, through the development of their human resources.

Notes

1 The latter share rose from 46 per cent in 1974 to 48 per cent in 1978 and 1986 and then declined to 42 per cent in 1990.

2 For Japan, the developing countries' share of outward FDI stock was 30 per cent in 1990. For France, Germany and the United States it was 12, 15 and 25 per cent respectively. See UNCTAD-DTCI (1993a).

3 The share for the European Community refers only to inward FDI from non-European Community countries; see Parisotto (1993), p. 54.

4 However, in the United States (which became the largest host to FDI flows during the 1980s), the largest increase in affiliates' share was registered in services (trade, insurance and other services).

5 China State Statistical Bureau (1992) and, for 1992, statement of the Minister of Foreign Trade and Economic Cooperation at the International Conference on Transnational Corporations and China, Beijing, September 1993.

6 These estimates do not take into account the labour-saving technical progress stimulated in developed countries in reaction to competition from developing countries (Papaconstantinou, 1993, p. 21).
7 It should be noted that many export processing zones never lived up to the expectations of their creators in terms of attracting FDI and creating employment. A number of factors explain these failures, including poor planning; inconvenient location; insufficient attention to the basic infrastructure such as roads, airports, telecommunications or electricity supply; and lack of effective promotion and mismanagement (UNCTC, 1990b, chapter I).
8 For a full review of the literature on the issue see Jécquier, 1989.
9 Based on data from the Census-BEA link project (Howenstine and Zeile, 1994).
10 In Canada, in 1985, for example, each manufacturing foreign affiliates provided a higher share of non-production jobs compared with Canadian enterprises (Bradley and Kumar, 1990).
11 For instance, in 1990, the average foreign affiliate in manufacturing was from 4 to 17 times larger than the average domestic enterprise in Germany, Japan, Ireland, Sweden and the United Kingdom; see OECD (1993b), p. 48.
12 This (and the following) information is based on the views expressed by government's, employers' and workers' organizations in periodic surveys in individual countries carried out by the ILO in the context of the Tripartite Declaration on Multinational Enterprises and Social Policy (chapter IX); these are conducted every three years; the last one covered the period 1989-1991.
13 For example, "East Europe threatens even deeper erosion of the west's job base," *The Wall Street Journal Europe*, 9 December 1993, p. 1.

Chapter V

Transnational corporations and human resource development

Introduction

Human resource development is central to economic growth and development. Although its precise contribution is difficult to measure, human capital created through investments in education and the development of skills emerges as one of the most significant determinants in studies of economic growth (Schultz, 1980; Barro, 1991), High levels of education, the most important element in human resource development, lead to high productivity through improvements in the ability to adopt sophisticated technology and efficient organization structures. Education also shapes values, attitudes and behavioural patterns which are instrumental in influencing the pace and form of social and economic development. Not surprisingly, the most rapidly growing economies have made considerable investments in education. For example, between the 1950s and the 1980s, the share of education in government expenditure in the Republic of Korea rose from 2.5 per cent to 22 per cent; in fact, the latter represented only one-third

of total educational expenditure when private spending was included. Between 1945 and 1986, enrolment in tertiary education in the Republic of Korea rose by 150 times (Tan, 1992, p. 52).

Human resource development is a principal determinant not only of economic development, but also of international competitiveness (Porter, 1990). Investment in human capital represents a major form of created assets — assets created from natural resources, particular climatic conditions and the stock of (untrained) labour — as well as a means to create other assets. Such assets, tangible (e.g., plant and equipment) or intangible (e.g., technological and organizational know-how) offer a more sustainable basis for competing because they are more difficult for competitors to imitate. The very creation of such assets contributes positive externalities in the form of a growing pool of ideas, information and creative personnel, offering the potential for ongoing innovation and upgrading.

Building up a stock of human capital generating development and increasing competitiveness may require more than simply public investment in education. National education systems focus on the provision of general training that has applicability in more than one activity or industry. Industry-specific or specialist training has more limited applications, but is fundamental to the creation of a sustainable competitive advantage. The development of such skills is also riskier and may require funding from the private sector. Private sector organizations have closer links to the market and are in a better position to judge priorities in skill formation. This suggests that private enterprises, including TNCs, have an important complementary role to play in the provision of education and training.

The relationships between TNCs, globalization and the growing significance of created assets are important. The present trend in technological innovation is towards increasing the international mobility of created assets that are the basis of competitive advantage. This shows itself as generic advances in communications and transportation and in the continuing miniaturization of intermediate and final goods. These trends increase the potential for the globalization of business. At the same time, TNCs provide a major vehicle for the international exchange of created assets, many of which are intangible. Their proprietary investments in technology and skill development create a large pool of such assets. The difficulties of trading knowledge-based assets at arm's length mean that, in many cases, internal transactions within a corporate network may be achieved at a relatively lower cost. On the other hand, the rising cost of creating and upgrading resources is reflected in a variety of new TNC operating forms, a shift towards greater functional integration within TNCs, the growing regional integration of markets and the shift by government towards market-oriented policies. In sum, these developments highlight the role of created assets in determining both corporate competitive advantage and, increasingly, locational advantage.

The management of production activities within TNC networks implies the possibility of a mutually beneficial relationship between globalization, upgrading of competitive advantage and human resource development. This potential interaction is explored in this chapter. The discussion focuses on two principal issues. The first is the contribution that TNCs can make to human resource development, particularly within developing nations. The second issue is the role that the level of human resource development plays in the location decisions of TNCs. Increasingly, it is the quality — rather than simply the cost of labour resources — that influences location decisions. The interaction between these two considerations has major implications for the design of policy and for the encouragement of cooperative relationships between TNCs and national governments in fostering human resource development.

A. The role of transnational corporations in human resource development

In the course of their production activities and the formation of sophisticated assets necessary for maintaining and exploiting their competitive advantages, TNCs have a significant direct effect on human resource development through the provision of employment opportunities for skilled labour, the provision of additional training opportunities and the creation of incentives for employees to augment their skills. They also provide opportunities for informal learning through contacts with experts and through the creation of a business culture conducive to economic growth and development. Industries in which TNCs are active, both in manufacturing and services, are characterized by a marked reliance upon highly skilled labour. In addition, TNCs may be involved in the provision of formal or general education, directly as transnational educational service providers or indirectly through support of and collaboration with national educational institutions. Transnational corporations also have important indirect effects on human resource development, through their impact on educational investments by potential employees, impact on government programmes and educational institutions and on technical assistance to enterprises linked to them through backward and forward linkages.

While a broad conception of human resource development includes the contribution of health and nutrition as well as education and training, and TNCs play an indirect role in the former two areas through their research and development, production and trade activities in certain industries, it is mainly in the latter two areas that TNCs have a role to play (UN-TCMD, 1992a, chapter VII). The discussion below focuses, first, on formal education and then on training and considers to what extent and how TNCs play a role in human resource development by directly or indirectly affecting each of these areas.

1. Formal education

Formal education takes place at three principal levels: the primary level (formative schooling years, typically from age 5 to 11); the secondary level (typically schooling from age 11); and the tertiary level (post-school education). In most countries, TNCs play a limited role in primary and secondary education, but may be significant for the tertiary level. Foreign affiliates do provide opportunities for basic education if local circumstances make it necessary (UN-TCMD, 1992a), as when their production facilities are located in remote or isolated areas and access to public schooling is limited. This may occur, for example, in the case of some transnational agricultural or mineral operations. In such cases, TNCs are typically responsible for a range of services, including, among others, education and health provision.

Transnational corporations may also influence pre-tertiary education in two more general ways. The first is through the provision of financial support or specialists to schools. The donation or subsidization of capital equipment, such as computers, is widespread, even within developed countries. The second influence is where TNCs offer remedial education opportunities, typically to those who have been denied or poorly served by the public education system. Poorly qualified employees may have access to remedial reading, writing and mathematics education at the workplace. Such education is typically provided through classes organized before or after work hours. As well as benefiting the individuals concerned, such education may lead to more effective internal communication, reduced labour turnover and lower accident rates as employees better understand instructions and warnings.

However, it is within the tertiary, or post-compulsory schooling stage, that TNCs exercise their principal influence on formal education. Their most obvious direct impact is in the provision of employment opportunities to highly skilled science, engineering and commerce graduates. While there are no precise estimates of the employment of such graduates within TNCs, their

clustering within technology-intensive industries as well as the higher skill-intensity observed in foreign affiliates than in comparable domestic firms, (within both developed and developing economies),[1] are indicative of their importance in employing graduates. Transnational corporations also play a direct role in the provision of scholarships and the sponsoring of employees for higher education. This assistance encompasses both formal education and work experience which may form part of the study programme.

Apart from assisting actual and potential employees, TNCs — partly because they are among the largest and best endowed firms, partly because they have a special interest — provide, in a variety of ways, assistance to institutions of higher education. Their demand for highly trained graduates manifests itself in the form of financial support, particularly to business schools and science facilities, the provision of assistance and advice through membership of advisory boards, curriculum review committees, councils and senates. The senior management of many TNCs play a similar role in training organizations and certification agencies. In a number of countries, as public funding to higher education has been restricted in recent years, the links between large businesses and educational establishments have increased significantly. In the United Kingdom, for example, TNCs have provided considerable funding for the establishment of professional chairs and the creation of business schools in a number of universities. This has long been true in the United States. It is increasingly the case that senior appointments made by universities and polytechnics draw upon a pool including international business leaders.

The links between international business and business school education are particularly close. Indeed, the *Institute pour l'Enseignement des Methodes de Direction de l'Enterprise* (IMEDE) and the International Management Institute (IMI), two of the most prestigious business schools in Europe, were originally founded as company training centres (of Nestlé and Alcan, respectively). In large part, they were established to meet specific needs of international business or were a response to the then limitations of training provided by publicly-funded universities and business schools.

Mirroring the internationalization of production, an acceleration in the expansion of transnational educational institutions has also been seen in recent years. A considerable number of universities have internationalized their operations through the establishment of overseas facilities, international strategic alliances and by a range of agreements for the exchange of knowledge. Most of this internationalization has occurred in the field of management education. An international survey of business schools engaged in teaching international business programmes reported that 33 per cent of respondents were involved in at least one consortium, of which 38 per cent were abroad. Twenty-three per cent of respondent schools offered their programmes in another country (Arpan, et al., 1993). The Belgian-based European University operates affiliates in sixteen European cities. The Netherlands International Institute for Management operates joint ventures with local institutions in a number of European and Asian countries.

Management education has long been exported in the form of distance learning. The British Henley Management Centre is one of the longest established institutions in this field and offers its programmes in a number of European, Asian and Pacific rim centres. Business schools are developing cross-regional alliances; a good example is provided by the Macau-based Asia-Pacific International University which links students, faculty and employment experiences between Asia, Western Canada, Australia and the Pacific. United States-European, United States-Japanese and European-Japanese links are now being forged by a number of schools. Leading United States schools, such as Harvard, play an important role in management education in Latin America; MIT is now linked with a Hong Kong university; and Canadian business schools are active in China (UN-TCMD, 1992a, p. 174). Eastern Europe represents an important emerging market for Western management schools.

These initiatives with respect to formal tertiary education have significance for TNCs as well as for other firms in that they provide a source of managerial skills and also influence business culture. The global spread of international business training contributes to local pools of management talent and facilitates the localization of management, which is important for TNCs as well as host countries. Among others, the high costs and failure rates of expatriate managers encourage TNCs to localize management where possible.

The internationalization of management education by universities and other institutions and the introduction of "best-practice" management methods complements the educational contributions of TNCs engaged in the production of goods and other services. This is because, in large part, the curricula, faculty experience, and research programmes of transnational schools are determined by the present and future operational needs of TNCs. This may not be without drawbacks. For example, one might question the appropriateness of United States dominated management programmes for Asian managers.[2] Asian management, for example, places a greater emphasis on cooperative approaches; it is, moreover, less concerned with short-term financial performance than United States business education.

Growing local educational capability means that new training paths are likely to be developed in the near future, further strengthening the importance of national differences in the valuation of, and approach towards, education. For example, the United States system places a high value on formal education, with perhaps 85 per cent of top United States managers holding university degrees. This investment in education is seen as largely the responsibility of the individual. Since the return on such investment may be maximized by frequent job moves, external certification is important. In contrast, while education is also highly valued in Japan, the approach to management education is quite different. The Japanese view is that management skills are best acquired through a process of tutelage under the supervision of older, more experienced colleagues. This focus on internal training, coupled with lifetime employment and promotion based on service and seniority, reduces the importance of external credentials. There are probably no more than 3,000 Japanese managers who possess MBAs. In contrast, the United States produces more than 65,000 each year (Warner, 1992, p. 69).

2. Training of employees

(a) Factors influencing training

The provision of training for their employees is perhaps the most important contribution of TNCs to human resource development in the countries in which they operate. The amount and types of training provided by TNCs, as well as their probable impact on local labour markets, depend on a range of factors. Among others, they include the industry, the size of investment, duration of commitment to operate in a country, and the nature of activities undertaken; the last is itself likely to depend upon the size and quality of the existing domestic manpower (including the skills available) of the country.

Also significant for the amount and nature of training is the mode of entry, with greenfield investments likely to require greater initial investments in training, in contrast to firms that are acquired by a TNC. Another factor is the extent to which new technologies are imported and require new skills: unique technologies reduce the opportunities for TNCs to add to pressures on local labour markets by poaching fully trained employees from competitors or by increasing the demand for skilled labour. The location of production facilities (including higher value-added ones) in the home or host country, and the extent to which the investing firm chooses to tap completely new sources of labour, are also important because they may require a company to provide basic training in the early stages of investment. Government policies encouraging the

promotion of training programmes by TNCs, including provision of incentives or other schemes for TNCs and workers, as well as the availability of alternative training programmes (for example, national educational training institutions) also play a role. The type of training provided by TNCs is also influenced by the values and business culture prevalent in the home country. Some TNCs tend to emphasize technical, individual training and monetary rewards, while others stress group training and non-monetary rewards to those undertaking such training. The size of the foreign affiliate is also a relevant factor with respect to the type of training undertaken: large affiliates are more likely to have formal and specialized training programmes for their employees, while small affiliates may rely more on ad hoc training schemes and informal training.

The strategies of TNCs with respect to the functional scope of activities in different locations have implications for the amount and quality of training and the way in which it is distributed across the parent company and its various affiliates worldwide:

- In companies pursuing stand alone strategies, the amount and quality of training is most likely to be determined by the conditions that govern production for the local market. Firm-specific capabilities, such as technological and marketing skills, may be an important factor for the success of a company operating abroad, and distinctive training efforts may be required to consolidate such skills in foreign affiliates. Training packages can be developed on the basis of what has been successfully experienced at home and then exported, sometimes in an adapted form, to foreign affiliates, but the gist of the training is framed nationally, and training programmes and human resource management policies are drawn up primarily at the affiliate level, taking into account local needs and requirements.
- In simple integration strategies, particularly when they are geared towards taking advantage of a local supply of labour at low cost, employment in foreign affiliates is often mainly constituted by unskilled and semi-skilled workers. For these workers, training is likely to be limited to the acquisition of elementary skills. The tasks of the affiliates are circumscribed, and training at the managerial and technical levels is correspondingly narrow.
- Complex integration strategies are likely to require greater commitment and coordination of training because of the greater interdependence they involve between the parent firm and affiliates, and among affiliates. In an integrated structure, the profitability of the entire corporate system depends upon achieving satisfactory performance in each unit of the value chain. Thus, an internationally integrated approach towards human resource management may be an important element for complex integration strategies to be successful. Such an approach is more evident for some corporate functions, such as marketing, accounting, research and development that are more frequently globalized.

  International executive development is particularly important for companies that adopt complex integration strategies. The move to such strategies implies that the human resources function becomes more significant and more centralized as it is more closely linked to the overall corporate strategy. Indeed, attention by corporate boards to the management of key human resources has gradually increased in a number of companies (Evans, Lank and Farquhar, 1990). Many TNCs have developed mixed human resource management policies, in the sense that human resource management is global and centralized for senior executives and those with such potential, while for other employees a decentralized, country-based approach prevails (Evans and Lorange, 1990). The wider distribution and deepening of training efforts at the affiliate level are likely to be greater in those integrated TNCs that adopt new flexible forms of production and best management practices, such as just-in-time or lean production. Within these new forms, labour tends to be seen as an innovatory resource whose potential has to be maximized, rather than as a factor whose cost has to be minimized. Thus, these developments are likely to influence human resource development by TNCs in several ways. First, training is increasingly

directed towards production workers. Such training will have to be more intensive if these workers are to carry out their new tasks. Indeed, the distinction between blue-collar and white-collar workers is already becoming blurred in some industries, as growing emphasis is being placed on knowledge workers; TNCs carry such approaches and practices to their host countries. Second, the recruitment of production workers will have to be more selective, and recruitment standards generally higher, as basic education is a requisite for workers to take full advantage of training. Third, training will also include both technical and motivational or behavioural aspects. Without this, workers' involvement in the new production methods can decline markedly over time and the expected gains in productivity may not be achieved.

Cross-border integration and the interdependence of tasks across affiliates also imply that inputs of production and services increasingly flow across borders within a firm's system. Intra-firm communication at various levels is ceaseless and requires widespread language competence within the firm. People that participate in these intra-firm networks have to be equipped with the capacity to understand and manage interpersonal cultural diversities. A similar capacity is also needed to sustain the galaxy of international inter-firm arrangements that characterize integrated producers, ranging from international outsourcing to joint-ventures and strategic alliances.

One result of integrated international production may be that the training function becomes a more specialized function within the firm. Formal corporate training centres may be established outside the home country in the most convenient locations for the firm from a global or regional perspective. Formal corporate training would not only allow employees, particularly managers, to gain cross-cultural expertise rapidly and share cross-border experience, but also to contribute to shape and disseminate common corporate values. As technical and production workers are increasingly the target of training efforts, training packages can be developed centrally for dissemination to foreign affiliates. Training for specific purposes can also be outsourced to international specialists or business consultants, and links can be developed with local training institutions and universities.

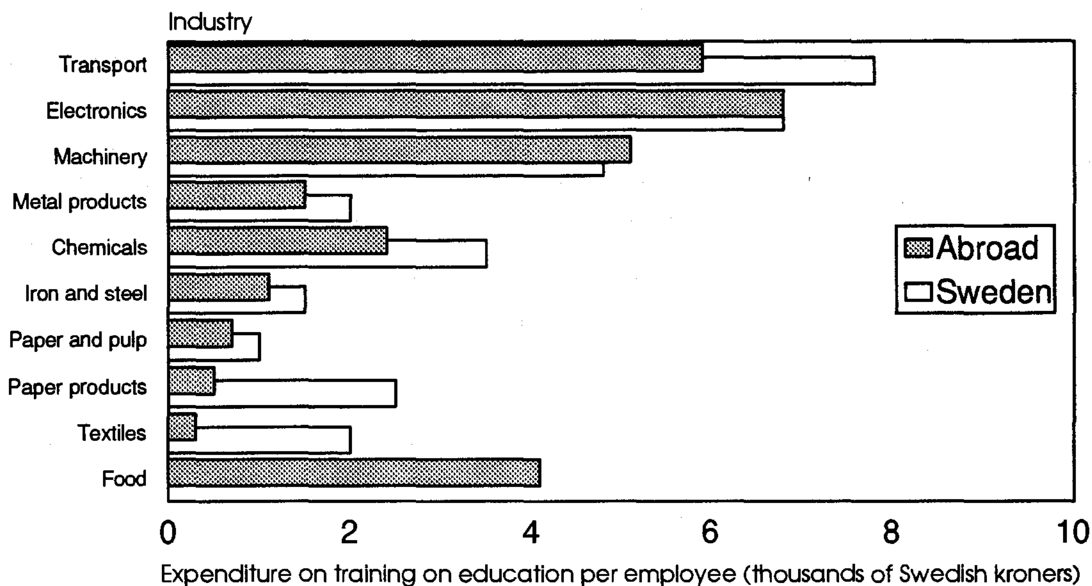
(b) *Extent and pattern of training*

Subject to these factors, most TNCs provide facilities and programmes for training their employees. Often, the extent of training in their foreign affiliates is comparable to that provided at home. For example, in 6 out of 10 industries, expenditure on education and training in the foreign affiliates of the largest Swedish manufacturing TNCs was comparable to that provided by those firms at home (figure V.1). Overall, average training expenditure per worker in Swedish foreign affiliates was three-fourths of that in the parent firms. Transnational corporations from Japan have also been observed to undertake significant expenditure on training and retraining of workers in host countries, comparable to that of their parent firms (Watanabe, 1993).

Transnational corporations often spend more on training in their foreign affiliates than do similar local firms in the host country. For example, Japanese affiliates in the United States spend significantly more on training than their domestic counterparts (Campbell and McElrath, 1990, p. 78). The proportion of workers in Japanese-owned plants who received training (24 per cent) in 1985 was almost twice that in comparable indigenous United States plants. The cost of training per worker was two-and-a-half times as high and the cost of training per newly hired person was over four-and-a-half times as high as that in United States plants (Mincer and Higuchi, 1987, p.22). That included not only training for new employees but also continued training. More was spent on recruitment as well per newly hired person by Japanese-owned plants, although the degree of newness of Japanese plants may have accounted for some of these higher costs. The purpose of the training was apparently the building up of specific, rather than general human capital — that is, the purpose was to develop a workforce with the specific skills and consistent with the affiliates'

management style. Japanese firms were also less interested in training subsidies offered by states or in external tuition grants than other foreign investors (Watanabe, 1993).

Figure V.1. Training expenditure by Swedish transnational manufacturing corporations at home and abroad, by industry, 1990



Source: based on data obtained from the Industrial Institute for Social and Economic Research, Stockholm.

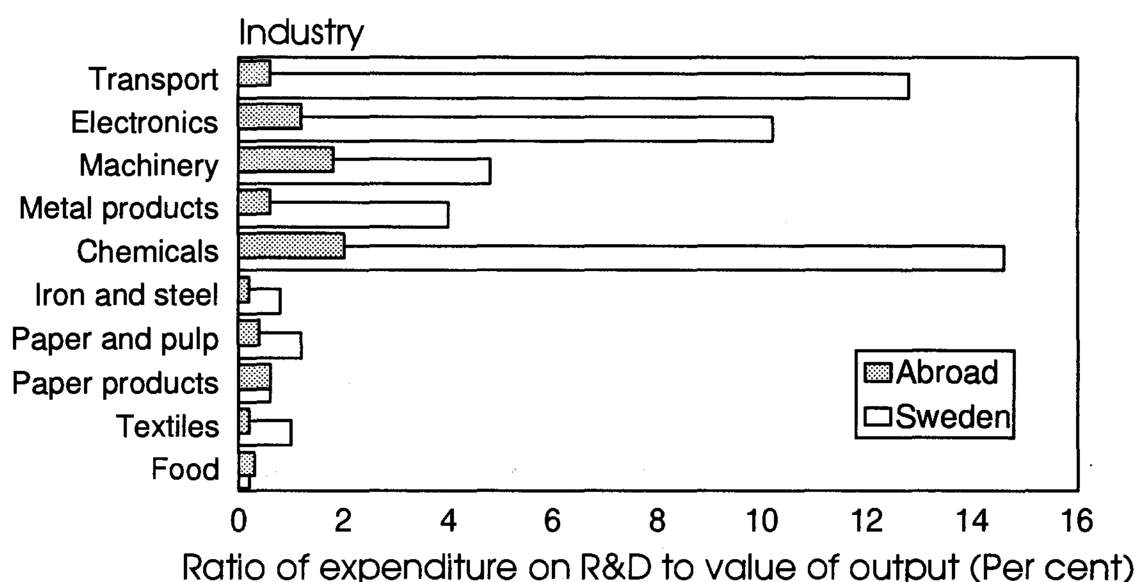
a The data are based on a questionnaire survey of all Swedish TNCs in manufacturing; the response rate exceeded 80 per cent but with a number of large TNCs missing.

Studies on training activities of TNCs in other host areas, such as Scotland (Scottish Development Agency, 1986), Thailand (Sibunruang and Brimble, 1988), Malaysia (Yong, 1988), Nigeria (Iyanda and Bello, 1979) and Turkey (Erden, 1988), also confirm that foreign affiliates often spend more on training than their local counterparts. However, there are variations depending, among others, on firm size and industry. For example, among the relatively large non-oil manufacturing firms promoted by the Board of Investments in Thailand, a higher proportion of employees was trained locally by Thai-owned firms and affiliates of TNC's from developing economies than affiliates of TNCs from developed countries in 1990, but there were wide variations according to size and industry, making it impossible to reject the hypothesis of identical ratios at the industry-level. However, training provided abroad was greater in the case of TNCs from developed countries.[3] In Kenya, although TNCs provided an appreciable quantity of training for Kenyan management, the average number of weeks of training per year provided to managers by joint ventures as well as national public enterprises was greater than that provided by other foreign affiliates, according to a survey of 72 top- and middle-level managers from 41 firms conducted in 1982-1983 (Gershenberg, 1987, p. 935). Where comparable levels of training expenditure are found it is important to note that some of the training provided by TNCs may be undertaken outside the host country, perhaps at headquarters, and may be financed by the parent company (Gonçalves, 1986).

As mentioned earlier, training opportunities in TNCs vary according to the industry, as well as types of workers involved. For example, training by Swedish manufacturing TNCs (figure V.1) tended, by and large, to be positively related to the research-and-development intensity of TNCs by industry (figure V.2). Data for Japanese foreign affiliates also show considerable variation, with affiliates in electrical, machinery and chemical industries providing training to a larger proportion

of workers than those in other manufacturing industries or services (table V.1). In Malaysia, considerable differences were found in the frequency of training among industries and among types of workers in 31 foreign affiliates that responded to a questionnaire survey in 1988 (Yong, 1988). While 18 per cent of employees attended training of one kind or another, training was concentrated in the managerial and professional staff; about 45 per cent of the managerial employees and over 40 per cent of professional and technical employees received training, but only 16 per cent of sales employees, and less than 2 per cent of others, including clerical, production and service workers (table V.2). Clearly, the investment in training was directed mainly to higher-level staff. However, while training was heavily concentrated in the managerial and professional/technical categories, it was not concentrated in the higher-technology industries, according to the survey mentioned above. The proportion of employees given training was highest in non-metallic minerals and beverages, where almost all the managerial and professional/technical employees benefited from it (table V.2). More technologically-oriented industries, such as chemicals and electrical machinery, were about average in the extent of training, and the chemicals industry was below average in the proportion of managerial and professional and technical workers trained. This is related, of course, to the kind of employment placed in the host country. In the case of electrical machinery, 90 per cent of the employment placed in Malaysia at the time was clerical and production work that apparently required little in the way of training of the labour force (Yong, 1988).

Figure V.2. Research-and-development intensity in Swedish manufacturing transnational corporations, at home and abroad by industry



Source: based on data obtained from the Industrial Institute for Economic and Social Research, Stockholm.

The amount of training varies not only according to the category of worker and industry but also according to the entry strategy and the nature of technology or management methods used by an affiliate. For example, when Ford Motor Company established a greenfield plant in Hermosillo, Northern Mexico, it invested heavily in training for the new just-in-time production system. All new workers received nearly 700 intensive classroom hours before starting work, and

the 300 technical and supervisory workers spent between one and three months in training abroad (Shaiken, 1990). A study of the introduction of new production methods within Brazilian manufacturing reported similar levels of investment in training for quality management and just-in-time (Fleury and Humphrey, 1992). In Malaysia, electronics TNCs have more recently introduced new production concepts with implications for the quality of production workers hired as well as training provided to them. According to an empirical study of 12 electronics TNCs in Malaysian export processing zones conducted in 1990, the qualifications for operators entering employment had been upgraded to 12 years of schooling, and training provided had significantly increased (Liebau and Wahnschaffe, 1992, p. 192).

Transnational corporations may also provide training opportunities for certain specific groups, such as rural migrants and women workers, who may find themselves disadvantaged in gaining access to training and promotion. For example, Japanese electronics TNCs have preferred to employ women with limited work experience (Oliver and Wilkinson, 1989). Although the majority of women and migrant workers are likely to be employed in unskilled and semi-skilled jobs in labour-intensive industries, when compared with alternative employment opportunities, such as agriculture or domestic service, TNCs offer above average wages and conditions and the opportunity for acquiring some skills. In some countries, such as Singapore, the entry of foreign firms — by accentuating labour shortages — has increased the employment opportunities of those from non-traditional groups, including women in white-collar occupations (Lim, 1985).

(c) Nature and types of training activities

The training provided by TNCs may be formal or non-formal. Formal training involves classroom instruction, courses of specific duration or structured apprenticeship programmes, and may be provided either in-house or by external experts. Non-formal training takes many forms and is largely within the employing organization and on the job.

Box V.1. Vocational training in foreign affiliates of transnational corporations: some examples from developing countries

Vocational training is an important element in the training programmes of TNCs for the workforce in their foreign affiliates. For example, the Daimler-Benz group has vocational training programmes in virtually all countries where it has production facilities, including Brazil (with 640 apprentices in 1994) and Argentina and India (200 apprentices each). In total, almost 2,500 young people in developing countries and newly industrialized economies are trained for qualified jobs in Daimler-Benz affiliates. The company's apprentice schemes usually offer a two-to-four-year training programme — partly on the job, partly in the classroom and partly in special apprentice workshops affiliated with a factory.

Nestlé runs apprentice schemes all over the world, designed to offer basic training and provide skills for upgrading the company's artisans and crafts persons in the various grades and trades. For example, in Araras, Brazil, a special workshop is integrated into the local production plant. After passing an entrance examination, school-leavers from the country receive three years of practical and theoretical training in mechanical and electrical engineering in the workshop to enable them to install, maintain and repair the machinery. After vocational training in the workshop during the day, they continue their upper secondary school education in the evening. Apprentices are not required to stay with the company after passing the final examination; however, most of them do go on working for Nestlé. In a number of cases, people who had received the training subsequently succeeded in opening and running their own repair workshops.

Source: information provided by the European Round Table of Industrialists (Working Group North-South).

Table V.1. Proportion of employees trained by foreign affiliates of Japanese transnational corporations, by region and industry, 1989

(Percentage)

Region/area	*All industries*	*Total*	*Manufacturing*					*Services*
			Textiles	*Chemicals*	*Metals*	*Machinery*	*Electrical*	
All countries	4.1	4.3	0.9	1.0	6.9	3.4	7.1	3.6
Developed countries								
North America	2.7	2.9	-	0.3	9.1	3.5	3.8	2.1
United States	2.8	3	-	0.3	9.2	3.7	3.9	2.2
Europe	5.9	6.4	1.2	0.2	1.6	0.3	11.1	4.7
European Community	6.1	6.6	1.2	0.4	1.6	0.3	11.1	5.0
Australia, New Zealand and the Pacific Islands[a]	2.7	0.2	-	-	-	-	-	9.7
Developing countries								
Africa	3.2	5.7	-	-	30.9	-	-	0.1
South, East and South-East Asia	4.9	5.0	1.0	1.5	9.6	2.8	6.7	4.6
ASEAN	3.8	3.9	0.9	1.3	9.5	0.9	3.4	4.4
Newly industrializing economies	6.1	6.6	1.0	1.8	6.4	3.1	9.6	3.6
Latin America and the Caribbean	4.2	4.8	1.0	2.5	0.4	8.2	16.0	1.0

Source: Japan, Ministry of International Trade and Industry (1992a).

a Including, also, developing Pacific islamd economies.

Table V.2. Training provided to employees by selected transnational corporations in Malaysia, by industry, 1988

Industry	Number of firms in sample	Percentage of employees provided training				
		Total	Managerial	Professional	Sales	Other[a]
Food	5	16.3	43	11	33	1
Beverages	1	26.3	100	100	0	3
Tobacco	1	17.1	59	61	13	1
Printing and publishing	1	10.4	33	25	..	0
Rubber products	1	12.3	27	20	..	3
Chemicals	5	19.4	23	21	46	8
Non-metallic minerals	5	36.0	100	81	47	3
Basic metals	1	19.4	75	100	0	0
Electrical machinery	9	16.1	40	41	20	1
Transport equipment	2	2.8	3	14	3	0
Total	31	17.7	46	44	16	2

Source: based on Yong (1988), pp. 59 and 63.

[a] Clerical, production and service workers.

Training of production workers is undertaken mainly to satisfy the staffing requirements essential for the functioning of the enterprise. However, an important secondary objective may be for workers to adjust to the culture of the corporation or the type of corporation. The latter factor, in particular, leads to greater emphasis on the use of on-the-job or in-house training, as, for example, in the case of Japanese TNCs (Watanabe, 1993).

Systematic vocational training programmes are implemented by many large TNCs (box V.1), particularly for skilled workers who usually get a significant share of TNCs' training budgets (ILO, 1980b). These may be established at or close to the production facility or local or regional training centres. However, on-the-job training for varying durations is the most common avenue for training production workers. In Malaysia, new production employees in 12 electronics foreign affiliates studied in 1990 were first put on a training programme lasting from three days to a week, which finished with a test that they had to pass in order to be given a permanent job. This was then followed in all of the firms by on-the-job training lasting up to three months. The management systematically aimed at expanding and raising the qualifications of the production workers by offering further both internal and external, training courses, and corresponding opportunities to rise within the company. Multi-tasking with multi-skilled workers was the principal goal of the firms' educational and training policy. Each company had its own educational and training department with a number of full-time teachers. One of the United States affiliates, with 200 employees, had 40 full-time teachers, and an annual expenditure on education and training of $750,000 or one per cent of total wage costs. Another United States firm reported

spending 2.5 per cent of its total wage costs annually on education and training (Liebau and Wahnschaffe, 1992, p. 192).

Training programmes for professional employees in management as well as technical fields are generally the most important part of TNCs' training activities. Here, again, the objective is generally to provide training in job-related skills, as well as (frequently) to imbue staff with the corporate culture that many firms consider essential for effective management. Some TNCs — for example, Citibank, Pepsi Cola and IBM — implement global human resource and training strategies. In others, such as Glaxo, the United Kingdom's largest pharmaceuticals company, personnel and human resource policies and programmes are completely decentralized, with each affiliate having its own human resources director reporting to the local managing director, although these policies and programmes take their general direction from a broad framework of corporate values developed centrally.[4] In still others, such as Nissan, centralized programmes are combined with a significant amount of foreign affiliate autonomy (box V.2).

A distinct advantage enjoyed by TNCs in their training is the ability to utilize international networks of facilities and expertise in employee development (UNCTAD-DTCI, 1994h; ILO, 1991a; Foley et al., 1993). For example, a study of foreign-owned firms in the Republic of Ireland showed that almost 90 per cent of respondent firms had sent employees abroad on training visits to the parent company (Whelan, 1980, p. 39). Another example is that of Japanese affiliates in Germany, which show a high propensity to send qualified staff for training and exchange visits to Japan. Overseas assignments are widely used for key executives and technical staff. In developing countries, too, the most popular mode of training for foreign affiliate employees is to send them to the parent firm for training (UNCTAD-DTCI, 1993c, p. 125). In some developing countries the provision of such training may have increased over time. A study of foreign firms in Indonesia in the early 1980s found that TNCs were more likely to attract managers from local firms than to provide their own training (Okada, 1983). On the other hand, a more recent study concludes that most local managers and technical personnel obtained their expertise mainly through on-the-job training and additional training by working for a certain period at the TNC's plant in the home country or other foreign locations (Thee, 1990, p. 232).

The growing globalization and functional integration within TNCs and the spread of international strategic alliances further broaden both the scope of training opportunities and the diffusion of skills. For instance, Ford (United States) and Mazda (Japan) have sent production workers from their jointly operated factory in Hermosillo, Mexico, to Japan and to Ford factories in Europe for training. The engineering team that set up the production line for Ford's Mondeo in Belgium performs the same function in the United States, and trains local engineers in the process. Motorola (United States), as part of its expansion in China, has sent Chinese engineering recruits to Motorola facilities in Hong Kong, Singapore and the United States for training, and rotates top management trainees for its Chinese affiliate through almost all of its semiconductor manufacturing operations worldwide (UNCTAD-DTCI, 1993a, p. 125). Philips (Netherlands) has operated a systematic management development programme for more than a decade. As the global scope of Philips has expanded, it has attempted to increase both the general and the international experience of its managers. One way in which this has been achieved has been to extend job rotation to involve ventures with other companies. As well as contributing to management development, this programme has extended considerably the diffusion of Philip's training investment (van Houten, 1989). In some cases this ability to arbitrage experience may allow a TNC to introduce genuinely innovatory approaches, including those related to new organizational procedures and "best practice" and provide the training necessary (box V.3). The experience of TNCs in a range of cultures and environments also provides exposure to alternative training approaches and an enhanced sensitivity to the learning process. Their experience of cultural gaps may assist in determining the optimal amount and type of training (box V.4).

Box V.2. Human resource development and training at Nissan

Nissan Motor Co., Ltd., Japan's second largest automobile manufacturer, has three key strategic philosophies: technological innovation, strategic role in the market place and quality of product. These philosophies place a high priority on human resource development, viewing people as the key to their successful delivery. This is reflected in the extensive training programmes throughout the corporation.

The training and development activities of Nissan Motor Manufacturing (U.K.) Ltd. provide an example of the company's approach. This is focused on long term individual continuous development rather than narrowly based occupation job specific training. Underlying this is the view that people need to be continually developed, motivated and challenged to grow as all-round individuals. To achieve this, Nissan has established training and development programmes covering all occupational categories within the company.

The Continuous Development Programme provides a structured systematic appraisal of individual training and development needs. The Programme reflects the change of job scope, responsibility and key tasks for each of the occupation category levels from manufacturing staff to managing director. At each level, training and development needs are identified jointly between the company and the individual staff member, the emphasis being based upon competent performance and the training or development required to do the job effectively. The resulting programme selections are tailored specifically to the needs of each staff member covering all aspects of performance including technical, process and personal effectiveness content. The approach is typically incremental, considering the training and development needs over a forward planning time of two to three years.

Nissan's total expenditure on training in the United Kingdom represented 7.6 per cent of total payroll costs during 1993. The training department budget totalled £5.85 million, including the salaries of staff undertaking training and trainer specialists. Off-the-job training delivery for each employee averaged 7.2 days during 1993, and the young person trainee programme averaged 56.4 days per trainee. On-the-job training, mainly aimed at manufacturing production workers, averaged 4 days per staff member. Training programmes are not limited in duration; rather they reflect the needs of the individual balanced against the operational business needs. Over 50 per cent of off-the-job training is delivered in-house. Nissan has its own college, practical training centre and open learning centre on-site.

The training programme has been developed largely by the United Kingdom affiliate itself, with very little consultation with the parent company in Japan. Indeed, significant differences exist in the training programmes between the parent firm and United Kingdom affiliate. In Japan, 90 per cent of training days are on the job and only 10 per cent off the job. As the above data show, the pattern in the United Kingdom is quite different. For Nissan, decentralization in the development and implementation of training is necessary to respond effectively to local needs. Employees are consulted during the development and design of the training programmes and provide feedback and evaluation data for programme improvement.

Source: information provided by Nissan.

Transnational corporations that are large in size and scope can achieve considerable economies in training through the development of global or regional training centres. One example is Motorola University, which trains in-house personnel and operates a number of cooperative arrangements with both private and public university business schools around the world. The University has established, among others, a branch in Beijing which provides training for Motorola employees, customers, partners and suppliers in management practices and technology.[5] Another prominent example is Nestle's Rive-Reine training centre near its headquarters in Switzerland which, in 1993, held seminars attended by over 1,200 participants drawn from its staff in 60 different countries (Nestlé SA, 1994). Similarly, Nestle's professional training centre

Box V.3. Raising quality standards: the experience of Mitsubishi Belting

The concept of quality control pioneered by Japanese firms has attracted considerable attention in a number of Asian countries. With the support of the Asian Productivity Organisation, many Japanese experts have visited Asian countries. Since 1988, the Union of Japanese Scientists and Engineers has undertaken total quality-control seminars throughout Asia. Quality-control concepts have been adopted by enterprises in India, Indonesia, Malaysia, the Philippines, Singapore and Thailand. The diffusion of quality-control methods in Asian developing countries has been accelerated by the presence of a considerable number of Japanese foreign affiliates.

The experience of the Japanese-owned Mitsubishi Belting Company in Singapore is illustrative. The company began producing automotive and industrial belts for worldwide export in 1978. Its quality-control efforts began in 1979. At that time, Mitsubishi Belting faced a number of problems: many of its employees were new to Singapore; few had experience in the factory work; many were poorly skilled; and labour turnover was high. The company believed that improving education and training, with quality activities as the vehicle, was the answer. Initially, it sent supervisory staff on outside courses to familiarize them with quality-control concepts. This was followed by the provision of English and mathematics classes for production workers. The third stage was to standardize and simplify operations manuals to facilitate on-the-job training.

In 1980, the company commenced small group activities. The focus on solving specific shop-floor problems raised awareness of the importance of quality. The formation of a quality-control circle committee saw members of three pilot quality-control circles sent to head office in Japan to study developments in quality control. Since then, quality-control circles have expanded across all company functions. Apart from participating in Singapore's national quality-control circles conventions, Mitsubishi Belting was awarded the "JIS" mark by MITI in 1990.

Mitsubishi Belting Singapore's quality levels are now comparable to those of the Japanese parent firms and this know-how is now being transferred to group companies in other countries. Throughout this period, labour turnover has been high with the implication that some of the benefits of quality training have spilled over to other companies.

Source: based on Tradescope (JETRO International Communication Department, Tokyo), 20 January 1994.

INDEC, located in Mexico, provides training for employees within the entire Latin American region. McDonald's Hamburger Universities are global training centres for management trainees in the final phase of their training operations. Many transnational banks have also established training centres, some in host countries. One of the few consulting firms to have a training centre is Andersen Consulting which has its own college at St. Charles, Illinois, intended to ensure a consistent approach and methodology to problem-solving (UNCTAD-DTCI, 1993, p. 16). In a number of Asian economies, TNCs, sometimes as the result of government request or with government collaboration, have established technical training schools serving not only their needs, but also those of other firms (Watanabe, 1993; p. 142; chapter X).

While TNCs that are large in size and scope are best-placed to provide training and other activities contributing to human resource development, small and medium-sized enterprises also undertake similar activities (table V.3). There are, however, some differences in the extent and nature of their training programmes, in comparison with large TNCs. According to survey data, formal technical training (other than on-the-job training) was undertaken in 44 per cent of developing-country affiliates of small and medium-sized TNCs, compared to 73 per cent of those of large TNCs (table V.3). Affiliates of large TNCs were also more involved in other forms of technical training. For example, in-plant or in-office training by technical personnel from parent firms was undertaken in more than one-half of affiliates of small- and medium-sized TNCs, but at a higher rate of about four-fifths of large TNCs (UNCTAD-DTCI, 1993c, p. 125). Training of

Box V.4. Suzuki and skills development in India

The Japanese automobile manufacturer Suzuki produces both automobiles and motor cycles in a number of developing countries. In 1983, Suzuki entered a minority partnership with the Government of India, forming Maruti Udyog, Ltd. to produce a range of small vehicles for the Indian market. The selection of a Japanese partner reflected the desire of the Government to foster the acceptance of Japanese production and personnel methods. Before the introduction of a range of Japanese-style practices, Indian managers visited Suzuki plants in Japan and worked alongside Japanese managers. They gained first hand experience of the importance of total quality-control methods, worker participation and open communication for the success of Japanese production systems.

On-the-job training played a central role in the venture. A large-scale employee-exchange programme was initiated. In the early stages, Suzuki personnel provided advice within Maruti. As problems were identified, key Indian operating staff were sent to Japan to learn how these could be solved. This process was repeated. By 1993, Maruti employees had made more than 750 trips to Japan; Suzuki staff have made 500 visits to the Indian plant.

Indian trainees in Japan enter initial training programmes to learn basic work skills. To facilitate communication, they also take Japanese language lessons. Completion is followed by some ten days classroom instruction within a Suzuki factory. They then spend two-to-three months on the shop-floor, working alongside experienced Japanese employees. Workplace training, which even includes office workers, is supplemented by ongoing classroom instruction in such areas as total quality management, the use of suggestion schemes and supervisory skills.

Output at the Maruti plant was ahead of target in early 1993 and a significant expansion was planned. Some vehicles have been exported. A constraint facing the plant was the need to upgrade local suppliers. By 1993, local content was 94 per cent. Under a vendor-development programme, Maruti is helping suppliers to develop their capability. Suzuki is also facilitating exchange relations between Japanese and Indian suppliers.

Source: *based on Tradescope* (JETRO International Communication Department, Tokyo), February 1993.

affiliate employees in parent firms of TNCs was carried out in 80 per cent and 93 per cent of affiliates of small- and medium-sized TNCs and large TNCs, respectively. However, for affiliates of small- and medium-sized TNCs, this form of training is by far the most popular method. Inviting foreign affiliates' employees to parent firms is a channel likely to be chosen if the technical experts are based at the parent firms and involved in another job, there are no training facilities in host countries, or parent firms wish local employees to feel directly the rigour of management and establish relations with home-country employees. However, the national origin of small and medium-sized TNCs as well as the type of affiliates has a bearing in this respect. For example, most Japanese small- and medium-sized TNCs tend to provide training at their headquarters (more than four-fifths of the affiliates) rather than on site (51 per cent), but affiliates of United States small and medium-sized TNCs use on-site training to a greater degree (85 per cent of affiliates, as opposed to 90 per cent for training at headquarters) (UNCTAD-DTCI, 1993c, p. 125).

Formal and non-formal training and professional development, as well as the informal transmission of values, attitudes and behavioural patterns through contacts with expatriates are particularly important in the economies that are in the process of transition to a market-oriented system. In Central and Eastern Europe, entrepreneurial, technological and managerial capabilities required for a market-oriented economic system were largely unavailable, due to the centrally-planned production and the administrative nature of management under the previous economic system. Furthermore, the earlier isolation of the region had greatly reduced the access

Table V.3. Training of employees in foreign affiliates in developing countries, by region
(Percentage of affiliates that provide training)

Type of training and host region	*Affiliates of small- and medium-sized TNCs*	*Affiliates of large TNCs*
On-the-job training		
South, East and South-East Asia	61	75
Latin America	60	69
All developing countries	61	73
Technical training (other than on-the-job training)		
South, East and South-East Asia	46	71
Latin America	35	74
All developing countries	44	73

Source: UNCTAD-DTCI (1993c), p. 110, based on a survey conducted in 1991-1992.

to modern product and process technologies. After their opening up to FDI, to a large extent, therefore, the operations of foreign affiliates in the countries of the region required an adjustment of the workforce to the requirements of the world market through training and education. This situation was characterized as follows in a statement of a director of ABB in Poland: "From the beginning, our approach was to transfer the software first, the hardware second. We began with a lot of training, for instance in marketing and sales. Then we started the technological transfer".[6]

Human resource development has thus become a main feature of all major FDI projects in the region. A great number of major foreign investors in both manufacturing and services sectors establish some kind of employee training scheme. Fiat Auto (Poland), for example, trained all of its 19,000 employees in schools in one or more of its various operations in courses of six weeks duration, during which employees were placed on a so-called "training line", cutting by half their normal workload. This enabled the introduction of technology that resulted in productivity as measured by cars per employee per year rising from 5 in 1991 to 19 by the end of 1993.[7] Similar training efforts have contributed to ABB Zamech achieving rapid productivity increases and winning export orders of some $150 million. It expects that with the injection of new management skills and technology, the Polish operations will generate 4 to 5 per cent of ABB's global revenues by 1996.[8]

Similarly, local managers and business leaders in the economies in transition — who had been trained under a centrally-planned system — were largely unable to conduct managerial functions required for a competitive market environment. Marketing, price-based procurement, "hard" budgeting etc., were largely unknown, since these were unnecessary functions under the centrally-planned system. Apart from training in these new principles of business conduct, adherence to old management practices had to be overcome throughout management and factory levels. To deal with these problems, ABB Zamech, for example, created a "mini MBA programme" in Warsaw in order to introduce the top management to basic business concepts and to enable them to transfer these concepts to the staff. The courses covered five key modules — business

strategy, marketing, finance, manufacturing, human resources — and were taught by faculty members of INSEAD (Taylor, 1991, p. 103).

Training efforts often go beyond the transmission of technological skills needed in the modern world. In general, basic "market" concepts and production philosophies (and, most importantly, language skills needed for basic communication between Western management and the local labour force and management) usually form part of the educational process. Apart from basic technological skills, Fiat (Italy), for example, also tried to instill in its Polish workers concepts of competition and quality as well as cooperation and team-work.[9] These training and professional development activities and the informal transmission of values, attitudes and behavioural patterns are important features of TNC affiliates' activities in Central and Eastern Europe, with direct consequences for efficiency and productivity.

The upgrading of the workforce through training is an important aspect of foreign affiliates in China as well. Despite the fact that the educational system in China provides substantial and diversified vocational training and technical education, the demand for skilled technicians and, in particular, managers exceeds the supply, given the country's rapid growth and market-oriented economic reform. Most foreign affiliates have organized their own training programmes. Some, particularly those in tourism, electronics and chemical industries, have established their own staff training centres. Motorola, for example, has set up two centres in China for its Chinese employees. On-the-job training for Chinese managers and employees is also widely practised (Zhan, 1993).

3. Training and the transfer of soft technology in services

Training in TNCs is closely related to the transfer of technology. Training of production staff in manufacturing is generally intended to provide know-how on how to use the machinery and equipment in which technology is embodied. In manufacturing as well as services, however, the principal channel for the transfer of soft technology, such as management systems, marketing know-how and quality control is training itself, supplemented by knowledge embodied in manuals, blueprints and the like. In service industries, which are generally customer-specific and involve the application of knowledge and know-how by each service provider, most technology is of this latter kind.

Because of their intangible and customer-specific nature, many services are not tradable at arm's length across borders. Transnational service corporations cannot, therefore split up their production process to take advantage of differences in labour and skill availability that may exist between developed and developed countries. Thus, they tend to reproduce in host countries the technologies used by their parent companies. To some extent, this is reflected in the smaller differentials between home and host country compensation levels in service TNCs as compared with those in manufacturing TNCs (chapter IV); this suggests that average skill levels in service affiliates are closer to those of their parent companies than is the case with skill levels in manufacturing affiliates relative to those in their parent firms. In other words, unlike in the case of manufacturing TNCs, the skills required for the production of services do not tend to be centralized in parent companies; rather, they are spread to host-country operations, primarily through training.

Indeed, training practices in transnational banks and financial institutions, for instance, suggest that training, particularly of management personnel, is given considerable importance (ILO, 1991a). Such training is intended to provide managers with both the technical skills and the wider knowledge required to direct an enterprise. As opposed to the earlier approach of focusing on particular jobs, the emphasis of management and supervisory programmes is increasingly placed on modern management skills, such as setting goals, defining tasks and building teams. Such training is provided either through internal courses, which most banks run at residential or

non-residential training establishments, or through external courses, whereby the management-development department selects managers to attend courses at a business school or management department of a university. Another focus for training is that of senior managers, who, as occupants of leading positions, have to be able to articulate the long-term goals of the corporation, based on a global market perspective, to manage large-scale changes in strategy, organizational structure and management practices, while at the same time being responsible for building and maintaining public credibility. While the extent and variety of training is largest in home countries and developed host countries, transnational banks also make a useful contribution by training their management staff in host developing countries. The most common form is on-the-job training, provided in the bank itself (ILO, 1991a). Some banks, however, establish special training

Box V.5. Human resource development and training in Citicorp/Citibank

Citicorp, one of the world's largest financial firms, is a holding company for a group of affiliates involved in the provision of financial services, the principal subsidiary company being Citibank. Citicorp's foreign subsidiaries seek to achieve maximum responsiveness to customer needs, local regulations and competitive conditions. There exists, however, a high level of global coordination and integration in some areas in order to exploit competitive advantages from the company's global scale. One of these areas is the worldwide diffusion of knowledge. Human resource development and training are, therefore, managed on a corporation-wide basis.

The overall human resource policy of the company is to recruit, develop and retain the best people. Citicorp's policy is to employ local staff whenever possible. Where there is an inadequate pool of local personnel of the required quality, the company brings in staff from abroad until local staff is adequately developed. The use of expatriates is also intended to transfer the corporate culture, develop skills in local personnel, create a pool of internationally experienced managers and fully exploit market potential in major growth areas.

Training and development of personnel are considered necessary by the company to meet the ever changing demands of the financial services industry and to improve the quality of local personnel. They are also considered important for reducing labour turnover, which can be quite high in tight labour markets. Training programmes are available in the form of formal courses as well as on-the-job training, in three broad areas: skills-based training, customer-related training and personal self-development. As a result of increasing concentration on higher value-added activities, greater emphasis is being placed on training in customer-related personnel development and people management. The employee groups receiving training are divided into executives (the top 100 senior staff worldwide), managers, professional and technical personnel and others. On average, each Citicorp employee spends five days per annum on training. Most training is done in-house, but external training is provided when required.

Training is organized on a regional basis. The company has established regional training centres in London (covering Europe), New York (covering North and South America) and Singapore (covering Asia and the Pacific). The Asia-Pacific region is Citibank's fastest growing region in terms of total revenue. Nominations for training in the Singapore Centre are made on the basis of a number of criteria, including "must-know" and "should-know" considerations, business needs and priorities, suitability of the participant, distribution of participants by business and class size. Courses at the Singapore Centre include basic skills training, product-specific training and management training, including strategic leadership training. Although most courses are designed for senior and middle management, short (one- and two-day) programmes are available for lower level personnel. Most of the training at the Centre is provided by in-house personnel, but external consultants are used when appropriate. Individual needs for training are identified on the basis of extensive discussions between staff members and their supervisors. Issues in these discussions include staff responsibilities, performance gaps and possible improvements, the selection of the appropriate courses and agreement over objectives and goals of training.

Source: information obtained from Citicorp.

Table V.4. Training activities and related aspects of foreign affiliates in selected service industries in Latin America

Item	*Advertising*	*Banking*	*Consulting* [a]	*Hotels*	*Software*
Number of firms	14	16	17	10	16
Average number of employees	142	172	245	658	138
Ratio of officers to staff (percentage)	91	83	25	6	20
Officers training (days per year)	15	11	23	10 [b]	19
Staff training (days per year)	11	7	20	22 [b]	16
Principal sources of training: officers	in-house, mainly local	local, on the job & univer-sity	in-house, home and local	in-house mainly local	in-house, local and home home
Principal sources of training: staff	local, in-house, on-the-job	local, in-house & univer-sity	local, in-house	local, in-house, on-the-job	local, in-house, on-the-job
Visits per year by home office experts	10	10	18	21	18
Number of expatriates in local affiliate	2	2	2	15	2
Annual turnover of officers (number) [c]	4	5	1	2	1
Annual turnover of staff (number) [c]	9	5	12	126	3

Source: United Nations-DTCI, 1994h, based on information obtained through interviews affiliates of selected transnational service firms in seven Latin American countries, 1991.

a Almost half of the consulting firms operated as partnerships.

b This figure ignores two hotels that provided much more training than the others.

c Turnover averages are modes, not means.

courses for their foreign-affiliate staff, as illustrated by Citibank's training programme for its affiliates in Asia and the Pacific (box V.5).

In Latin America, according to a study of technology transfer by transnational corporations in five service industries, training activities were common in foreign affiliates in all five industries, (table V.4). The firms studied included a majority of fully-owned affiliates but other forms of association as well, such as partnership or association agreements in the case of consulting, locally-owned franchises in the case of hotel chains, and joint ventures in the case of advertising. In all cases, training occupied each employee for an average of at least 9 days per year, ranging upward to an average of 22 days per year for hotel workers and 23 days per year for consulting firm officers. Most training was done in-house in the host country, although a good deal of training was provided at the home office to officers in all of the industries. Visits by home-office experts for

training purposes were common across all services, though most frequent in the software and consulting firms (United Nations-DTCI, 1994h).

The soft technologies required by service industries are by no means static, but rather undergo continuous change, owing to forces such as increased competition and the growing use of data technologies. For example, the skill structure of banks and insurance companies is changing rapidly towards more sophisticated and flexible tasks than used to be the case a decade or so ago (Bertrand and Noyelle, 1988, p. 8). The quality of human resources of service firms has become a major factor determining the rate at which new technology can be introduced and productivity increases can be achieved. This not only creates increased demand for better educational preparation by institutions of formal education, but has also led to the development of in-house training systems for employees by many service companies. This is particularly the case where firms, including foreign affiliates, must compensate for deficiencies in national educational systems (UNCTC, 1989a). This has particular relevance for developing countries and economies in transition to a market-oriented system. For example, Citibank's affiliate operations in Poland, providing foreign trade and cash-management services and electronic banking services for large foreign investors, such as International Paper or McDonald's, are conducted with a workforce comprising 120 locally recruited staff and several expatriates. Training young Polish staff (for one in three it is their first job) in electronic banking has become a priority for the company, which claims to spend $400,000 per year on training.[10]

Box V.6. Human resource development in a non-equity arrangement: management development in Pepsi-Cola International

Pepsi-Cola International, the international beverages division of PepsiCo Inc., operates mainly through franchise agreements negotiated with local bottlers worldwide. Given the limited technology involved in the production process, training requirements for the general workforce are quite limited, and the responsibility for workforce training is assumed by the bottlers themselves. However, the company has developed a comprehensive management development and training programme. Its purpose is to address the shortage of qualified and competent managers in some countries as well as to improve business knowledge and skills and meet specific needs of its franchisees or field managers.

The management development and training programme established by the company is directed by three guiding principles: to achieve high levels of individual and organizational performance; to ensure the worldwide coordination of activities; and to respect the decentralized nature of the organization. In an attempt to combine global coordination with national responsiveness in human resource development, Pepsi-Cola International has established a set of globally applicable human resource practices which are modified to meet country-specific needs in a rapidly changing international business environment. In order to ensure that its managers are able to work effectively with franchisees and have the personal flexibility and creativity to deal with environmental complexity, Pepsi-Cola International has developed human resource programmes and processes focussing on six broad issues: shared values; leadership; personal performance; career/skill development; and balancing teamwork and individual achievement.

A particularly important part of the programme is the Pepsi-Cola International Management Institute (PCIMI). The Institute is an umbrella delivery system that is the primary vehicle for delivering training programmes around the world — to both Pepsi-Cola employees and franchise bottlers. A typical programme for the former would concern sales-force management; for the latter, production and manufacturing techniques for Pepsi brands. For all programmes, broad standards are established on a global basis; but individual programmes are adapted to local market needs and cultural differences.

Programmes offered by PCIMI fall within three broad categories:

Individual programmes, designed to improve skills, such as writing or presentation skills. Such programmes are unique to particular individuals who need to improve some aspects of their

In addition to equity investment, arrangements such as licensing and franchising offer scope for the transfer of soft technology and skills (box V.6). In recent years there has been a rapid growth in international franchising, particularly business-format franchising (Welch, 1992). Business-format franchising is of particular importance in contributing to human resource development, because it requires the establishment of an ongoing relationship between the franchiser and franchisee as the total business system is transferred. In addition to the rights to relevant products, patents or trademarks, this type of franchising provides training in business management. The use of a standard package ensures comparability and adherence to high quality standards. This is achieved through a careful selection of franchisees, a detailed operations manual, thorough training and continuous supervision. Franchisers are prepared to make considerable investments to maintain standards. Other kinds of non-equity arrangements with TNCs also provide scope for training and human resource development. For example, management contracts with hotel chains incorporate training (and localization) as a contractual obligation. Transnational hotels are in a position to perform the training function very well, as they have established procedures, manuals and training programmes that have been revised over the years in accordance with their experience (UNCTC, 1990d, p. 20). Such training can benefit not only employees of affiliates with equity participation (table V.4 above) but also those of non-equity associates, especially if the training requirement is incorporated into the agreement. Management, licensing and technical assistance contracts with TNCs in other industries offer similar opportunities for training and human resource development.

performance, skills or knowledge. Programmes are normally offered by outside vendors or training in-house. Generally, such programmes are locally driven and initiated, with local operating units being free to establish programmes on an as-needed basis. Pepsi-Cola International's head office may assess quality or provide assistance on the inclusion of a particular subject matter.

Managerial/organizational programmes, designed to pursue cultural themes or initiatives. Generally, such programmes are designed by headquarters staff in response to locally identified needs; examples include executive leadership programmes, performance management workshops and excellence-in-management programmes. The aim of such programmes is to deliver specific skill training (e.g., in leadership) and to establish shared values across diverse cultures. The programmes are generally run by outside consultants.

Business programmes, designed to improve specific business knowledge or skills, such as quality control, sales-force management and merchandising. Programmes are developed jointly by Pepsi-Cola International staff and external consultants. The programmes are developed to meet a specific business need identified by franchise bottlers or Pepsi-Cola International field managers.

A second important component of the management development and training programme is the Pepsi-Cola International Designate Programme, which brings non-United States managers to the United States for a period of specialized training (up to 3 years) in Pepsi's system there. It is aimed at providing in-depth experiential training and developing skills which can be transferred back to host country markets. So far, 28 countires have participated in the programme. Individuals are selected by their local units for the programme, covering both newly hired and existing staff. The key criteria for selection are English language ability and potential for significant future growth. Participants must agree to return home or to another mutually agreed upon location on completion of the assignment, since the aim of the programme is to transfer skills to overseas markets. Complementing this programme, young United States managers with potential are sent abroad to gain international experience and knowledge.

Source: information obtained from Pepsi-Cola International and from J. Fulkerson and R. S. Schuler (1992).

4. Research and development

Research-and-development (R&D) activities are both an indicator of human resource development in a country and a channel by which TNCs may upgrade human resource capabilities. Before any meaningful R&D can be undertaken, it is necessary to have a minimum, fairly high, level of skills. At the same time, in carrying out R&D, skills are further upgraded. Transnational corporations are key actors in the development of technology and devote significant resources to R&D. Thus, companies with the highest R&D expenditures in Germany, Japan, Sweden, Switzerland and the United States spent 5 to 6 per cent of their total sales revenue on R&D in the late 1980s (UN-TCMD, 1992a, p. 136). Research and development by TNCs provide opportunities for scientific and professional personnel to become involved in activities related to technology innovation, development and adaptation in new areas and on a larger scale and scope than might otherwise be possible, thereby offering opportunities for applying existing skills as well as improving them. These may be particularly important in countries where there is a shortage of such opportunities.

Historically, R&D by TNCs has been concentrated in their home countries. There are signs, however, that the internationalization of R&D activities is increasing. For instance, the share of R&D undertaken by United States TNCs outside their home country increased from 7 per cent in 1966 to 10 per cent in 1989 (UN-TCMD, 1992a, p. 137). Transnational corporations from European countries such as Germany and Sweden have reached a much higher degree of internationalization of their R&D activities. The trend towards increased R&D abroad seems, moreover, to be accelerating (Pearce, 1990). Two-thirds of all R&D facilities established by the world's leading TNCs since 1980 have been located outside the home country, as compared with only one-third prior to that date (Pearce and Singh, 1992).

However, there is large variation by industry in the propensity to internationalize R&D and overseas facilities are concentrated in a few developed countries possessing distinct innovative capability. Differences by industry are evident, for example, in the pattern of R&D intensity at home and abroad by Swedish manufacturing TNCs (figure V.2). As mentioned earlier, a somewhat similar pattern of distribution of training expenditure per employee prevails for Swedish manufacturing TNCs, although the gap between training in foreign affiliates and training at home was much smaller in each industry than the R&D intensity of home and host country operations.

Although the overwhelming proportion of R&D by TNCs is located in developed countries, the R&D activities of TNCs can be quite significant from the perspective of some developing host countries. In countries such as India, the Republic of Korea and Singapore, the share of aggregate R&D expenditure attributable to foreign firms exceeded 15 per cent in the 1970s (UN-TCMD, 1992a, p. 146). According to survey data, a fairly large proportion of foreign affiliates in developing countries — 55 per cent of affiliates of large TNCs and 45 per cent of affiliates of small and medium-sized TNCs — were involved in R&D activities (as compared with 60 per cent of indigenous firms) (UNCTAD-DTCI, 1993c, pp. 125-126). Judging by data on foreign affiliates of United States TNCs, moreover, it seems that the proportion of R&D scientists and engineers in total employment in foreign affiliates overall, and in particular, in developed and some developing countries, including countries in the Asian region, is increasing.[11]

Little is known of the type of research undertaken by foreign affiliates in developing countries. Much of it is likely to be related to the adaptation of technology transferred from the parent firm to local needs (UN-TCMD, 1992a). While such activity is unlikely to form the basis for strengthening capabilities for technology development, it could nevertheless contribute to the development of human resources, not only by providing a broader market for existing skills but also through spillovers resulting from the movement of personnel.

Table V.5. Expatriates as a percentage of skilled workers in a sample of non-oil manufacturing firms in Thailand, by ownership, 1990

Item	*Executives*	*Technicians and engineers*	*All skilled workers* [b]
Local firms	1.5	0.9	0.7
Affiliates of Japanese TNCs	18.5	3.6	5.8
Affiliates of TNCs from other developed countries	8.4	2.1	2.7
Affiliates of TNCs from developing countries	26.1	11.8	9.9

Source: UNCTAD, Division on Transnational Corporations and Investment, based on information for 732 BOI promoted firms obtained from the Board of Investments (BOI), Thailand, and other sources.

a Includes executives, technicians and engineers and clerical workers.

5. Expatriate staff and the localization of management

Transnational corporations rely, to some extent, on expatriates, especially from their home countries for staffing their foreign affiliate operations. In aggregate terms, the number and proportion of expatriates working in foreign affiliates is not large. For TNCs based in Japan and the United States, for which comprehensive figures are available, expatriates from the home country accounted for 3 and 0.4 per cent respectively of total employment in foreign affiliates in 1989 (UN-TCMD, 1992a, p. 178). Furthermore, in the case of United States TNCs, the percentage had declined by half since 1982.

The relatively small proportion of expatriates in TNCs is largely concentrated in senior management positions or in key technical and engineering jobs to execute sophisticated or specialized production tasks. Reliance on expatriate personnel is greater in the case of foreign affiliates in developing countries than in those in developed host countries: for example, according to a sample survey of the largest United States TNCs (Tung, 1988, pp. 6-7), 40 per cent of the positions at the senior management level in the European affiliates of United States TNCs were staffed by home country nationals (33 per cent) or third country nationals (7 per cent), as compared with 53 per cent (44 per cent home country nationals and 9 per cent third country nationals) of such staff in United States TNCs' affiliates in Latin America. In affiliates of the largest Japanese TNCs, the proportion of expatriates in senior management positions was 77 per cent in European affiliates and 83 per cent in Latin American affiliates, comprising, in both cases, only expatriates from the home country (Tung, 1988, pp. 6-7). The global average ratio of Japanese nationals filling directors' posts in foreign affiliates was 45 per cent in the late 1980s, while the proportion of Japanese nationals occupying the post of chief executive officer ranged from 82 per cent in North America to 63 per cent in Asia, broadly corresponding to the proportion of wholly owned affiliates (Watanabe, 1993, p. 150). Data from a survey of firms in the non-oil manufacturing industry in Thailand in 1990 also show that expatriates accounted for a relatively large share of executive staff in foreign affiliates , reaching 18 per cent in local affiliates of Japanese TNCs and 26 per cent in affiliates of TNCs based in other developing countries (table V.5).

A high share of expatriates can be explained, at least partly, by the age of the investment. In general, reliance on expatriate managers and technicians is higher for new investments but tends to decline as affiliates get rooted in the local market and their local workers gain experience

and can make more operating decisions themselves.[12] In addition to their role in organizing enterprises in their early phase, main reasons for employing managers and professionals from the home country include ensuring the availability of technical expertise and developing the international management expertise that TNCs require (Tung, 1988, p. 10). Other factors may also be important; for example, in the case of Japanese TNCs, these are likely to include language barriers, the need for highly experienced and trained managers to implement lean production methods and maintain high company-wide quality control standards, and the particular management style, in which "human networks" based on informal rules and mutual understanding are important elements in establishing connections within the corporate system. In fact, Japanese TNCs tend to entrust to compatriots those units where close and accurate communication and understanding with head office are required (Dunning, 1986a).

Aside from country-specific differences in management style, administering the development and mobility of expatriates and senior executives in particular, as well as replacing them by host country nationals on the basis of cost or other considerations, is a major challenge for most TNCs. Following the evolution in the strategies and structures of international production, the reasons for relying on expatriate managers have changed over time. Originally, the need for international transfers of personnel within TNCs was for specific skills that the local labour markets did not supply, supplemented by the need to ensure control over affiliates (Evans, Lank and Farquhar, 1990, p.122). While these remain important factors, a further objective has developed that the best executives ought to get international experience in different cultures if they are to manage an international organization successfully. The fact that TNCs operate in a growing number of countries under a variety of complex forms, including joint-ventures and strategic alliances, means that international managerial capacities are of growing importance for TNCs. Thus the restricted number of expatriates usually entrusted with high level management positions and hired directly by parent companies has evolved towards the creation of a larger and more mobile pool of regional and international teams. For example, more than 80 per cent of top managers at Xerox (United States) had had international assignments in 1989; in the case of IBM, which operates in over 130 countries, the number of expatriates is on average 3,500 out of a total of some 300,000 employees (Buckley and Brooke, 1992, p. 526).

In building up their international management teams, TNCs can draw upon the variety of human resources that they find in the different labour markets in which they operate. International experience within the corporate system becomes relatively more important than being a national of the parent company, and opens the possibility to nationals from other countries to reach top management positions in TNCs. Selective recruitment policies and management mobility schemes are a main tool utilized by TNCs in building their international management teams, but the development of tailored training facilities is also essential. As integration at various levels across the geographically dispersed affiliates of a TNC increases, the need to provide affiliate managers with a more thorough knowledge of the corporate system is likely to increase.

Aside from these trends towards developing teams of international managers comprising home, host and third country personnel linked to the spread of internationally integrated production systems, a number of factors lead to the localization of staff, including management and key technical employees, in foreign affiliates. These are both internal and external to the TNC:

- The relative cost of expatriate staff is generally high compared to local staff, especially in developing countries.
- The costs of building a pool of internationally qualified staff are also very high, and the process can be lengthy when the company is engaged in a substantial expansion of its overseas activities.
- Aside from the relatively lower salary costs, the employment of host country staff carries advantages in terms of familiarity with host country culture and language.

Box V.7. Management training, expatriates and localization: Sony's operations in the United Kingdom

Within Sony's Bridgend, Wales, television plant, only 2 out of 11 senior managers are Japanese. The company has integrated its technology-transfer and training strategies. The importation of new technologies is accompanied by the assignment of Japanese managers and engineers to the affiliate. Engineers are typically on two-to-three-year project assignments; managers are more likely to be on six-to-eight-year foreign assignments. At this stage, local personnel is recruited or assigned, and skill transfer begins within two-to-three years. Sony rarely recruits local managers at a senior level. The more usual route is for an aspiring manager to be assigned to a senior Japanese executive for three-to-four years and to gradually assume responsibility over this period. Managers with good potential are moved around the company and between functions. Induction into the "Sony way" is achieved through induction courses both locally and in Tokyo. The process of gradual localization is well illustrated by television research-and-development by Sony in the United Kingdom. A local research and development facility was established in 1984 and, within three years, was fully staffed by local staff, with the only Japanese nationals being those on assignment. Since 1988, all television-design work has been undertaken within Europe.

Source: *Management Europe* (Geneva, Business International S.A.), May 1991.

- Pressures are often exerted by host country governments on TNCs to employ and promote local personnel, particularly in developing countries, as a way to nurture the creation of indigenous management and professional expertise.

The interaction of these factors tends to encourage the replacement of expatriates by host country nationals through professional development and advancement within a foreign affiliate. Mention has already been made of the significant reduction in expatriate staff in United States foreign affiliates during the 1980s. A decline in the relative use of home country staff in management positions has also been observed in recent years for Japanese TNCs (Watanabe, 1993, p. 150). Increasingly, TNC policies with respect to training and use of expatriates are oriented towards the gradual localization of management in affiliates (box V.7). This applies to developed and developing economies as well as economies in transition to market-oriented systems. For example, for some large TNCs, such as Toshiba, Pepsi Cola and Hewlett-Packard, one of the basic strategies with respect to their operations in China is to promote localization of the company's management. During its first five years of operation in China, Hewlett-Packard adopted a "reverse development strategy", i.e., all its profits earned were reinvested; a substantial portion was devoted to human resource development. During 1985-1990, Hewlett-Packard (China) spent $2.5 million to train its Chinese employees overseas. As a result, the proportion of foreign employees declined from 20 per cent in 1986 to 4 per cent in 1990, and operating costs have decreased considerably as well.[13] It should be noted that there are situations where the opportunities for skill acquisition and upward mobility for host country nationals within foreign affiliates may be constrained by the personnel strategies or the desire of TNCs to control their technological assets (Salt and Findlay, 1991, p. 171-172). Increasingly, however, the movement of expatriates within the organizational structures of TNCs represents, on the one hand, an opportunity for highly skilled individuals in home as well as host countries to become part of an international management team whose members might be located at any place where the firm has operations and, on the other, a means for upgrading skills and assisting in the process of localization of management.

B. Maximizing and diffusing the contributions of transnational corporations to human resource development

Irrespective of the particular operating mode, the maximization of the contribution of TNCs to human resource development in a given host country requires that a number of conditions be satisfied:

- TNCs must add to the total stock of training by offering opportunities that would not have been forthcoming in their absence. This is most likely to occur where employees would have been unemployed or confined to unskilled tasks in the absence of foreign investment, and/or where TNCs bring with them new or different skills and management methods that enhance productivity in the host economy. Developing countries with abundant supply of educated labour generally fit both aspects of this description, while economies in transition to the market system are likely to be particularly in need of the new and different business skills that TNCs provide.
- Training costs should be borne by TNCs and not by employees in the form of trainee wages or the taxpayer in the form of training subsidies. While trainees in TNCs generally do not appear to receive apprentice wage rates, instances have been observed of employees of TNC affiliates in Brazil and Mexico being encouraged to obtain training in their own time by, for example, practising other jobs (Miller and Zaidi, 1982). Furthermore, evidence from export processing zones suggests that training costs can be held down by the extreme fragmentation of tasks and the widespread employment of women, who may earn one-fifth to one-half of comparable male employees.
- Benefits are not totally lost through the international movement of production or staff. The mobility of TNCs means that, in a situation of rapid technological and environmental change, production facilities may be relocated, or staff reassigned. Where comparative advantage is declining and production is closed, or where facilities are attracted to locations enjoying increasing comparative advantage, this mobility contributes to economic restructuring. Transnational corporations are accelerating the global movement of employees in other ways. These include their use of expatriates as well as a certain tendency to recruit from global labour pools, certainly for managerial, professional and technical staff. Such movement of personnel within TNCs could be detrimental to a country if there is an excessive loss of highly trained employees who are in demand but who are unlikely to return in the foreseeable future.
- For an economy to capture the full benefits of TNC-financed human capital investment there must also be some mechanism for the diffusion of skills, for example through labour turnover or membership in trade associations. Diffusion is likely to be limited where TNC skills are firm-specific, that is, of productive value within only one organization, or where the underdevelopment of indigenous enterprises means that the acquired skills cannot be employed outside the foreign-controlled sector. Concern regarding truncated production and the transfer of highly specific training relates to plants located in developing countries as well as less developed regions within industrialized economies. In the extreme — perhaps where limited training is provided within highly specialized export processing-zone affiliates — the benefits to a host country could be minimal. In general, the training provided by TNCs within developing host countries must be considered in the light of broader skills that may be displaced through the transfer of a technology package and increased dependence on parent or related operations for higher order activities (research and development, marketing etc.).

However, the specific training provided within TNCs can also be a strong and desirable complement to the training provided by a nation's educational system. The most significant and

durable forms of competitive advantage are those built upon the specialized and advanced skills that result from human capital formation within a firm or narrow industry group. Attempts to develop such factor skills through the public education system are less likely to succeed, because governments lack the commercial pressure and proximity to markets that ensure appropriate skill investment. This suggests a complementarity of general education and the more specialized training offered within TNCs.

Employee turnover is essential for the diffusion of skills and knowledge. According to earlier research on labour turnover within TNCs, wage rates are important determinants of turnover. Turnover rates are much lower when TNC wages are particularly attractive (Cohen, 1973;Gershenberg, 1987b) and much higher, approaching 50 per cent or more in export processing zones, where conditions of work are less attractive (Jenkins, 1987, p. 128). However, in many cases the turnover of export processing-zone labour does not assist in the diffusion of skills, among other reasons, because it involves typically low-skilled labour that is in plentiful supply. This suggests that the potential for training externalities from export processing zones and similar arrangements may be quite low. Turnover rates also depend upon factors other than wages, which may, in turn, vary among TNCs from different home countries. For example, in the United States, annual turnover rates were much lower for Japanese-owned plants than for US-owned plants (Mincer and Higuchi, 1987, p. 23).

Evidence for several developing countries suggests that there are positive effects in terms of diffusion of skills and know-how. For example, according to a study of Latin American manufacturing, many managerial personnel in locally-owned firms started their careers in foreign companies, bringing important spillovers to the host countries (Katz, 1987). According to another study, in Mexico, many management positions in locally-owned firms generally were held by persons with earlier experience in foreign firms (Blomström, 1989). Training in foreign affiliates has been identified as an important element in the development of local firms in South-East Asia as well (Yoshihara, 1988; Hill, 1993b, p. 212). Transnational corporations are reported to have played an important role in the dissemination of managerial know-how in Kenya, although turnover rates in TNCs were lower in foreign affiliates than in locally owned firms (Gershenberg, 1987a). The movement of trained employees to other firms was identified as one of the main ways in which insurance-industry technology was transferred from the American Insurance Group. For instance, in the Philippines, that company was known as the training ground for the insurance industry (Shelp, 1984). Thus, the available evidence from developing countries suggests that positive spillovers exist from the training of employees by TNCs. Although TNCs may have smaller training effects in the more developed countries, they may still have an incubator effect (i.e., incubating new spin-off local businesses) (Blomström, 1994).

The training and human resource development activities of TNCs have also had various spillover effects in the economies of Central and Eastern Europe. Western business culture is diffused through the interaction of employees with their colleagues in other local firms and with their families; expatriate employees do not confine their experience and expertise to their company alone; the TNC trainees are hired away to affiliates of other foreign firms or even local companies. GE Tungsram, for example, provided company finance courses in the United States for some of its local managers who, upon their return to Hungary, left the company.

C. Human resource development through linkages with transnational corporations

Some of the most significant channels through which TNCs add to human resource development are the links they develop with suppliers and customers. The sourcing decisions of TNCs, particularly whether to import or procure locally, are critical in determining this impact.

The decision of TNCs to produce their own intermediate products or to source them externally depends, among other things, upon the relative costs of integrating production, the strategy of the TNC, the extent to which technology is proprietary and specialized and the degree to which quality variations can be tolerated. The maturity of a plant is also an important consideration. Local sourcing tends to be much lower in the early years of establishment and may increase over time. For example, Japanese affiliates in Europe imported 37 per cent of their components by value in 1988. This compares with an average foreign procurement ratio of over 50 per cent when operations first commenced (JETRO, 1990). Nationality differences in the organization of production are also important. Japanese TNCs apparently tend to source externally to a greater extent than European or United States TNCs, although this may be a reflection of the relatively late entry of TNCs from Japan into host countries.

Transnational corporations contribute to skill development in their suppliers in a number of ways. They specify quality and performance standards that may exceed suppliers' norms. In many cases, as illustrated by Nissan and Toyota in the United Kingdom, the buying firm will work with suppliers to help raise their standards and assist in lowering costs (Dunning, 1986b). This is also the case with some TNCs that enter into subcontracting arrangements (box IV.7). Transnational corporations forge critical linkages with local suppliers through the provision of information (on markets, investment plans, competitors), technical assistance (product design, production processes, total quality management, staff development), financial assistance (soft loans, pre-financing of investment, prepayment of orders) and managerial assistance. In Mexico, for example, more than 86 per cent of foreign affiliates provided training in quality management to their suppliers. More than two-thirds provided technical assistance (UNCTC, 1992c). In China, TNCs such as Motorola, Siemens and Xerox have provided training not only to their employees, but to their customers, partners and suppliers (as well as industry-related education in general).[14]

There are marked differences between TNCs from different home countries in their management of supplier relationships and the extent to which such relationships represent opportunities for effective knowledge transfer. Traditionally, United States TNCs have tended to deal with a larger number of suppliers, often on short-term contracts, and with a strong expectation of achieving cost savings. Japanese TNCs seem to work with fewer suppliers, judging from Japanese automobile TNCs (Asanuma, 1992). However, the Japanese approach to subcontracting and backward linkages appears to offer greater potential for the transfer of knowledge and skills. Suppliers benefit from an early involvement in product development and carry considerable responsibility for the successful development of components. While suppliers are under pressure to contain costs, this is achieved through close cooperation between the suppliers' and the foreign affiliate. Suppliers have every incentive to cooperate within such a system as they are likely to benefit financially from any cost savings achieved. There are also strong incentives for them to achieve the highest possible quality levels. This is because, in Japan at least, suppliers' responsibility for defective work extends into the market for the final product. This means that they could be liable for recall and replacement costs. While many Japanese TNCs operate multiple sourcing (typically two to three) with their first-tier suppliers, the competitive nature of the relationship is different. Japanese TNCs seek to develop competitive, but cooperative long-term relationships. Supply is assured over the life of the model, but may not be renewed for successive models.

There is, however, one drawback to this system. The tiers of suppliers form a pyramid in terms of preference and importance. Successful suppliers gradually move up the pyramid as they prove their ability and improve their capabilities with assistance from the TNC in upgrading their activities. This makes its difficult for indigenous suppliers to break into this process and helps to explain why so many Japanese TNCs have drawn their suppliers overseas with them. It underscores, moreover, the attractiveness of supply joint ventures between local firms and leading Japanese suppliers or the TNC itself.

D. Human resource development as a factor inducing foreign direct investment

The relationship between human resource development and the production activities of TNCs runs both ways; TNCs tend to be attracted to those locations that offer them access to the created assets that they need. Since such assets are created by highly skilled labour, the presence of such labour is critical in determining location decisions of TNCs, particularly in certain industries. In other words, the skill and education level of a population determines, to a considerable extent, the volume of FDI inflows and activities that TNCs undertake in a country.

Indeed, the dominant direction of influence is likely to be from the level of skills to the composition of TNC investment. Skill and education levels are largely determined by the countries themselves through the amount and type of investment they make in education and training. The training activities of TNCs can strengthen a country's stock of skills, but only to a limited extent. The interaction of the two factors often results in a virtuous circle, where the domestic availability of skills not only contributes to attracting FDI but is also upgraded in turn by the employment and training opportunities that TNCs, especially in sophisticated industries, provide (box V.8).

Box V.8. Human resource development at IBM's Greenock facility

In recent years, IBM has embarked upon a major restructuring of its activities. These changes aimed at reducing costs and developing a more flexible structure able to penetrate the fastest growing segments of the information-technology industry, have important implications for employment and human resource development. In terms of employment, the restructuring has meant that a total of 115,000 jobs have already been lost or are expected to go between 1991 and 1994. Most recently, and in contrast to earlier years, job losses have been concentrated outside the United States (an estimated 60-65 per cent of the job losses expected during 1993-1994).

IBM's European operations are also undergoing restructuring. Different plants, however, have been affected differently. The experience of the plant in Greenock, Scotland, IBM's main production base for personal computers in Europe, stands out in contrast to other production plants in Europe. The plant is located in an area of high unemployment. In addition to its direct contribution to employment, the plant has helped create employment indirectly through the sourcing of components and services, 60 per cent of which are sourced locally. In addition, given its growing importance in the restructuring of IBM's operations worldwide, there was an increasing recognition that the Greenock facility could make a greater contribution to IBM's global personal-computer operations, including product development, manufacturing and the provision of customer relations.

To achieve "world-class" status in the personal-computer industry, a major contribution from human resources at every level was required at the Greenock plant. In terms of education, the management of the Greenock facility identified the requirements of the plant and the desired results from its proposed training and development programme. This was the outcome of an analysis of the plant's current skills compared with those skills regarded necessary to attain "world-class" status. The management acknowledged that it was necessary to upgrade the skills of both plant managers and labour force in order to maximize the competitiveness of the plant.

Retraining and upgrading the skills of the existing workforce required the removal of various obstacles. The management of the Greenock facility negotiated with the local educational institutions an "open-entry" system, whereby employees would be accepted for various training courses even though they might not possess the required prerequisite qualifications. Once accepted for the course, however, the educational institution would be expected to maintain its normal standards of assessment and evaluation. Another difficulty that had to be overcome was arranging the courses to be delivered to the employees in a manner convenient to them. Rather than expecting employees to commute to the

A country seeking to attract equity or non-equity participation must at least meet TNC expectations with regard to a minimal educational and competence level within the labour force. If a country seeks investment in sophisticated activities or higher value-adding functions in international production, its human resources must possess the necessary specialist skills. Some of these factors can be illustrated by the experience of host countries in South-East Asia, which is one of the major host areas for FDI in the developing world. Transnational corporations were drawn to Singapore by the high skill level of the labour force as well as the quality of infrastructure and incentives offered (Natarajan and Miang, 1992). When they expanded operations to Malaysia or Thailand, they tended to allocate relatively low-skill and labour-intensive operations to those countries, retaining higher skill, more technical operations in Singapore and also using Singapore staff and Singapore operations for the training of staff in the other countries. However, over time, foreign affiliates in Malaysia and Thailand tended to become more sophisticated. The relationship between the type of investment and the skill level of the labour force operated not only across these countries, but also within each country over time. Thus, TNCs that established operations in Singapore in the 1960s, when there was a large pool of unemployed workers, were labour-intensive and in low-technology industries, matching the low skills of the labour force of that period. The companies that began operations in the 1970s were more capital-intensive and in higher-technology industries, and those established in the 1980s were mainly in high-technology areas (Natarajan and Miang, 1992, p. 17). As individual firms shifted their labour-intensive operations to Malaysia or Thailand, their employment in Singapore also continued to grow,

educational institutions in central Scotland, the Greenock plant persuaded the institutions to deliver the courses in the facility itself. The courses selected by the Greenock plant were driven by the business needs of the facility (e.g., graduate degree courses in materials management, electronics, manufacturing, software and procurement management) and employees received substantial support from the company in terms of purchase of course materials and company time dedicated to study.

Since the introduction of that initiative, 320 employees have participated in the programme. Various surveys of participants have demonstrated high levels of satisfaction, with participants recognizing that their skills have improved substantially. Of those attending the courses, 77 per cent have already been allocated additional responsibilities, while 55 per cent have been promoted. In 1988, the management of the Greenock plant had set a target of increasing the level of educational attainment to 50 per cent of the workforce with a graduate qualification by 1993; the actual level reached in 1993 was in fact higher (54 per cent). While the focus of the training initiative is on full-time employees of the Greenock plant, the company encourages employees of subcontractors to participate as well.

Greenock's investment in training has been in response to the changing role and responsibilities of the workforce. In 1987, manufacturing was restricted to basic assembly operations. Now, the Greenock plant aims to ensure self sufficiency in manufacturing (e.g., maintenance of equipment etc.), as well as to acquire some product-development functions. For example, some product-development work has been transferred to the Greenock facility from IBM's laboratory in Hursley, United Kingdom, making this site the worldwide centre for visual display, design and development. Within two years of launching the educational programme, the Greenock plant received two National Training Awards from the Government of the United Kingdom in 1990 and 1992.

The quality of the local educational infrastructure is often cited as a reason for establishing a greenfield production facility in a particular location. The example of the Greenock affiliate confirms the clear benefits of having high-quality education centres in close proximity. Although Greenock continues to send managers to La Hulpe, an education centre owned by IBM in Belgium, it would have been difficult to undertake training on the same scale without the availability of education centres in close proximity and the cooperation assured by them.

Source: information obtained from IBM.

although clearly changing with respect to the type of activity. Singapore has been able to attract higher technology TNC operations over time as a result of large investments in education, including a significant expansion in enrolment in engineering programmes (almost nine-fold between 1970 and 1989) and in technician training programmes (more than 18-fold between 1960 and 1989). In addition, the Government has set up, in cooperation with TNCs, special technical training institutes geared to the needs of particular industries (chapter X).

Despite increases in the output of engineers, Malaysia continued to experience a shortage of trained technicians in the early 1990s. Transnational corporations had to undertake a considerable amount of on-the-job training and allow time for workers to become productive on the job. In Thailand, even though investment by TNCs was largely labour- intensive and in relatively low-technology industries, the rapid expansion of FDI during the 1980s has apparently created a shortage of technical personnel. This demand for high skills, in turn, has caused the Government of Thailand to expand engineering training at home and subsidize overseas study for students to become teachers of technical subjects. Thus, even if TNCs do not train workers themselves, they may induce the government to invest more heavily in training. In Thailand, the turnover of engineers was high, with one or two years at the first job resulting in an increase in market value of their services of between 50 and 200 per cent. This increase in remuneration suggests that, during these few years in a TNC job, a considerable amount of investment in human capital must have taken place (Natarajan and Miang, 1992, p. 29).

Key locational determinants of FDI have changed markedly over time. In the immediate post-war years, the strong demand for natural resources and the adoption of import substitution strategies were important factors influencing the location of international production. Market size and growth rates were increasingly important in determining the geographical pattern of investment during the 1960s and 1970s. More recently, TNC production and marketing strategies have been driven by innovations in information and communications technologies; the accelerated pace of technological change; growing market competition; and policy liberalization, to move towards internationally integrated production systems characterized by increasing locational differentiation as specialist value-adding functions are dispersed in an optimum fashion from the viewpoint of the firms as a whole. Locational decisions are now more likely to be influenced by the presence of sophisticated, created assets, including human resources with innovatory capabilities and marketing, planning and management skills, rather than by plentiful supplies of low-cost labour or natural resources. At the same time, the competitive success of TNCs is increasingly based on their ability to create and coordinate complex transactional networks.

Host countries, for their part, increasingly evaluate international investment in terms of its contribution to the goals of upgrading capabilities and integration into the world economy. It is complex, created factors that unite these objectives. They can only be realized through the services of highly skilled and creative individuals. The presence of such people is now perhaps the key competitive resource for firms as well as for countries. Governments, aware of the importance of providing such skills can do much to increase the locational advantage of their countries in this respect (chapter X).

Conclusions

The relationships between TNCs and human resource development are complex and multifaceted. On the one hand, the operations of TNCs have the potential to make a considerable contribution to human resource development, particularly in developing countries. On the other hand, and perhaps of greater importance, investments by TNCs depend increasingly on the presence of created assets within a local economy. Such assets, which form the basis for economic development and the creation of competitive advantage, are the result of the application of highly

skilled and creative human capital. The interaction between these effects can be important. An economy that is successful in attracting TNCs and achieving a consequent upgrading of labour skills can strengthen its locational position for obtaining further investments.

The contributions of TNCs to human resource development lie mainly in the areas of education and training. In education, their role is largely confined to direct or indirect investment in the provision of tertiary-level education, especially in business management. The major role of TNCs in the development of human resources stems from the training and other learning opportunities they provide to their staff in various forms. Such training may be valuable for workers in developing countries and others in which opportunities for acquiring vocational, technical and management skills are limited.

Training and other forms of learning provided by TNCs are directed towards all categories of workers, although the main focus is on managerial and technical personnel. Evidence suggests that the size and scope of TNCs enable them to provide substantial formal and informal learning opportunities for employees. Moreover, the learning provided by TNCs often relates to new or different production and management methods. Under appropriate conditions, the contributions of TNCs to knowledge, skills and management expertise of their employees can be disseminated more widely in the host economy and complement domestic human resource development in promoting growth and strengthening competitiveness.

As the tendency of TNCs to pursue complex integration strategies proceeds and the links between parent companies and their affiliates increase, the training requirements that are needed to manage successfully the corporate production system and its geographically dispersed segments are likely to increase and become more sophisticated. Foreign affiliates may be progressively involved in higher value-added and more specialized activities, and more training needed to improve the quality of local personnel. The commitment to training in affiliates could be considerably reinforced by the growing interdependence between operations at home and in the various affiliates. This may lead to a wider distribution of training packages throughout the TNC.

The trend towards complex integration strategies and the increasing competition for FDI make it more important than ever for developing countries to build up their own human resource capabilities. In addition to providing the basis for the development of the domestic economy, such capabilities would allow labour and national enterprises to interact more effectively with TNCs. They would contribute to increasing the volume and raising the quality and sophistication of the FDI that a country could attract, thereby strengthening the prospects for further human resource development. At present, only a limited number of developing countries attract sizeable shares of FDI, particularly in areas that are technologically sophisticated. While these countries have the greatest potential and hold promise for significant human resource development by TNCs. For those countries, foreign affiliates linked to TNCs' value chains are an important complement to national programmes for upgrading human resources. However, other developing countries that do not offer similar locational advantages may also benefit, in terms of improving their human research development from FDI and the emerging integrated international production system. They need to consider how to formulate and coordinate policies so as to maximize the benefits to their human resource capabilities. Issues relevant to the formulation of appropriate policies are discussed in chapter X.

Notes

1 See, for developed countries, ILO, 1981a; Buckley and Enderwick, 1985; and Simoes, 1985. For developing countries, see Hughes and Seng, 1969; Willmore, 1986; Kumar, 1990.

2 H.C. Bettignies, "The challenges of management training in Asia", *Euro-Asia Business Review*, 2, 4 (1983), pp. 34-39.
3 On the basis of data for 1990 obtained from the Board of Investment (BOI), Office of the Prime Minister (Bangkok). Data cover 732 BOI-promoted firms.
4 Based on information obtained from the companies.
5 On the basis of information provided and statements by company executives at the International Conference on Transnational Corporations and China, organized by the United Nations Conference on Trade and Development, Programme on Transnational Corporations and the Ministry of Foreign Trade and Economic Cooperation, and University of International Business and Economics, China, Beijing, 9-11 September 1993.
6 Tony Jackson, "Pioneer looks east for profit: the challenges facing ABB's engineering ventures in the former communist bloc", *Financial Times*, 16 April 1994.
7 Anthony Robinson, "The Financial Times 500: on the trail of new potential markets", *Financial Times*, 13 June 1993.
8 Christopher Bobinski, "Lame ducks are the target", Survey on Poland, *Financial Times*, 18 March 1994.
9 "Automotive survey", *Business Central Europe*, 2, 8 (February 1994), p. 34.
10 Henry Copeland, "Top jobs in East Europe becoming tough to find", *The International Herald Tribune*, 28 October 1993.
11 Based on data from United States Department of Commerce (1981), (1985) and (1992).
12 In the survey on which table V.3 is based, the proportion of expatriates was significantly correlated to the age of the investment.
13 On the basis of information provided and statements by company executives at the International Conference on Transnational Corporations and China, 9-11 September 1993 (see note 5 above).
14 Ibid.

Chapter VI

Transnational corporations and industrial relations

Introduction

Industrial relations in transnational corporations (TNCs) are going through a period of great change. This chapter is therefore a snapshot of this transformation. It seeks to highlight a number of issues that are important to the relations between labour and management in TNCs. Underlying them is the basic difference between the international organizational scope of TNCs on the one hand and the mostly national scope of labour organizations on the other hand. As markets become global and production is integrated regionally or internationally, most TNCs are making changes that affect the labour force and the mechanisms that are used to negotiate with labour.

The focus of this chapter is on industrial relations, that is, issues related to organized systems of relations between workers as a collective group — typically represented by trade or labour unions — and the management in TNCs. One reason for focusing on relations between TNCs and organized labour is that unions continue to be important to articulate, explain and present workers' views to management, and as a means to determine, through negotiations with management, general standards of treatment of workers. As in other enterprises, industrial relations in individual TNCs are still traditionally largely driven by union initiatives and management responses. However, in situations in which unions are an established part of labour-management relations, management is increasingly finding it useful to work with unions in dealing with issues related to the workplace. This is taking place within a broader trend towards

increased communication between management and workers and especially a trend towards *direct* management-workforce communication. Moreover, TNCs are typically firms that invest in their workforce and deal with workers' organizations with a view towards establishing an effective relationship. Therefore, industrial relations difficulties do not arise in TNCs more frequently than in domestic firms. This is all the more important because the pattern of industrial relations adopted by TNCs may become a model for domestic firms and that part of the labour force that is not organized.

The process of change that industrial relations in TNCs are undergoing unfolds in an environment that is itself changing. Important in this respect are, among others, a significant increase in the number of TNCs and the volume of foreign direct investment (FDI); the recognition that TNCs can make important contributions to development and the resulting efforts of all countries to attract FDI; the increasingly cross-border nature of the process of corporate restructuring; greater ease of organizing production internationally, facilitated by developments in information and communication technologies; the growth of FDI in services; the participation of TNCs in large-scale privatization programmes undertaken by many countries; and the rapid international diffusion of technological advances and innovative patterns of work organization pioneered by TNCs. These changes have taken place at a time when the influence of trade unions is experiencing a relative decline, particularly in developed countries, due to, among other factors, higher unemployment, large reductions in employment in traditionally well-organized industries, such as steel, coal and shipbuilding, the growth in the number of workers that are in sectors that are generally more difficult to organize, such as small service enterprises employing part-time or temporary employees; the increase in the relative importance of highly skilled workers who often prefer to remain outside unions; the changing attitudes of firms towards "people empowerment"; and the progressive deregulation of the labour market in many countries. The adoption of flexible forms of production and the growing reliance on subcontracting can also weaken union action. Finally, in many countries, especially developing countries, governments tend to dominate formal labour relations, and union influence is often weak to begin with. In fact, throughout this chapter it must be kept in mind that governments and national frameworks play a crucial role in determining the nature of industrial relations systems and the interaction between TNCs and organized labour.

Industrial relations in TNCs are not only changing, but are also highly diversified by sector, TNC home or host country and type of company. It is thus difficult to identify clear-cut patterns or trends. This chapter does not seek to arrive at definite conclusions regarding current trends, but rather focuses on some broad developments, with a view towards informing the ongoing debate on the evolution of industrial relations in relation to TNCs. To some extent, the discussion that follows draws on experience in Western Europe, especially the European Union. Partly, this is because a number of the changes that are taking place are occurring in Western Europe, where the challenges of economic integration and increased competitive pressures have led to large-scale restructuring and rationalization with consequences for workers, and where, at the same time, the social dimensions of integration are recognized and formally incorporated into the agreement following the establishment of a Single Market. Although other countries may not necessarily follow the Western European model, many of them are going through processes of regional economic integration and may therefore find the European experience with respect to industrial relations instructive, even if the concrete outcomes are perhaps entirely different.

More specifically, section A examines issues related to union organization and action in TNCs. Within the basic asymmetry of the organizational scope of TNCs and unions, the question of locational flexibility of production by TNCs assumes particular importance because it can have implications for the effectiveness of union action. Another aspect of the differences in organizational scope is that the decision-making process in TNCs is complex and, by definition, cross-border in nature. This raises the industrial relations issues of access to decision makers and

information, which are examined in sections B and C, respectively. Furthermore, TNCs are often pioneers in the introduction of new production systems and management methods, with implications for established labour-management relations. Section D explores some of these implications, especially regarding the extent to which the emergence of an integrated international production system requires, more than ever, flexible, imaginative and cooperative approaches towards industrial relations that fully recognize that "labour is now regarded more as a multifunctional asset than as a cost and as a critical participant in the wealth creating process" (Dunning, 1994, p. 18).

A. Union organization and action

Transnational corporations adapt their industrial relations systems to the legislations and practices of their host countries; in doing so, their approach towards trade unions might be influenced by the attitudes of the governments of host countries towards organized labour. Industrial relations systems as well as patterns of unionization have features specific to individual countries which are the outcome of history and tradition and differ considerably across countries, even among countries with relatively similar economies. The understanding of, and sensitivity to, differences in work cultures, negotiating procedures and rights and responsibilities of both employers and employees are important ingredients of success in managing affiliates in a foreign country.

The international character of TNCs, however, suggests that they may pursue labour-relations practices that differ in some respects from those of indigenous enterprises in a host country. Transnational corporations' practices are often subject to the influence of home country values and experiences, as well as their own accumulated international experiences. Indeed, many firms maintain a fairly standardized approach to labour relations throughout their corporate systems (box VI.1). Thus, the establishment of foreign affiliates is potentially a force for change in a host country's industrial relations system, including concerning the role of unions. Of particular interest in this context are the acceptance of unions as a mechanism for collective bargaining by TNCs and the effectiveness of union action under conditions of international production. Both issues, in turn, are influenced by the locational flexibility associated with international production which, therefore, is considered first in the discussion below.

1. The influence of locational flexibility

An important aspect of the international character of the organization of production by TNCs is the question of the extent to which the potential geographic mobility of production constrains the ability of labour to organize itself and to bargain collectively. Locational flexibility of TNCs has three major dimensions: the actual physical relocation of existing production, the outsourcing of components from different countries and the redirection of incremental investment.

- The actual closure or scaling down of one plant to restart production in another location, i.e., relocation of production in its narrow sense, is not common. Major constraints to such a strategy include disengagement costs, such as "sunk costs" (investments already made), severance payments, transfer and set-up costs and output losses. Besides, relocation in this narrow sense is only feasible for certain types of production activities. It is not feasible for location-bound activities, such as natural resource extraction and many kinds of services, which together account for about two-thirds of FDI. It is also low for investments made, in the first instance, to serve local markets or where establishment was encouraged by high tariffs or other import barriers. High capital intensity, too, limits the mobility of produc-

tion: heavily amortized capital costs and limited wage-cost savings mean that such facilities are likely to display high levels of stability. None the less, the possibility for splitting up production processes into segments has paved the way for the transfer of labour-intensive stages of production from developed countries to locations characterized by low labour costs and a more liberal labour-market environment; instances of such relocations can be found, for example, in the electronics industry. Plant closings resulting in lay-offs have also involved TNCs located in developing countries. The shift to other locations of labour intensive manufacturing by TNCs from a number of countries in Asia and Latin America in which labour-cost advantages have diminished has occurred in several industries, such as textiles and electronics. Some repositioning of TNC activity has also taken place in the framework of the creation of regional markets.

Box VI.1. Labour relations practices at IBM

IBM follows a fairly standardized approach to labour relations in its various affiliates abroad. Its main elements are:

- *Unionization.* IBM respects the right of employees to be represented when legally required to do so; however few IBM plants worldwide are unionized.
- *Single status workforce.* This implies common terms and conditions of employment for all employees, covering working hours; holiday entitlement; sick pay; company pension schemes; life assurance; private health care; subsidized canteen facilities etc..
- *Salary levels based on individual job evaluation and individual performance appraisal.* Salary ranges are established for each job category and employees' positions within each grade depend on individual performance.
- *Communication.* Maximum communications and consultations at all levels are seen as being central to IBM's personnel philosophy.

Source: information obtained from IBM; Annual Reports.

- The outsourcing of components through subcontracting and similar mechanisms have increased significantly in recent years, as TNCs have tended to concentrate their activities in core areas where they can best develop competitive advantages based on their firm-specific competence. This trend is widespread in the automotive, electronic and textile industries and has perhaps been taken furthest in the case of garments and footwear (chapter IV).
- The redirection of *incremental* investment is part of a constant and broader process of adaptation — of which the relocation of production, as well as outsourcing, are also a part — without which firms would lose their competitive advantage and, ultimately, fail. Driven by competition, it reflects, among other things, shifting comparative advantages, new market opportunities, changing regulatory frameworks and new possibilities to structure and manage far-flung corporate networks. The very fact of FDI is an expression of this process. The decision as to where to locate additional investment is influenced by a complex set of factors, among which issues pertaining to industrial relations typically do not play a primary role (UNCTC, 1992b).

All three aspects of the locational flexibility of TNCs have implications for industrial relations. For example, in the case of the abrupt closure of an affiliate, the adverse effects on the labour force of the affiliate closure need to be mitigated. The issue is not whether or not a firm is allowed to cut back or terminate operations in a given plant under normal circumstances — that

is the prerogative of management.[1] Rather, the issue is to what extent "reasonable notice" should be given of such changes,[2] and the importance of actions to be undertaken by management to seek cooperation with all parties concerned to mitigate adverse effects to the maximum extent possible. In the case of subcontracting, to the extent that it creates a segmentation between a core workforce of those directly employed by TNCs and a periphery of workers employed in independent (or formally independent) small and medium-sized subcontracting firms, the ability of unions in the parent company to articulate, explain and present effectively the collective interests of all workers is affected: peripheral workers are traditionally difficult to reach and to organize, the more so when they are located abroad. Finally, there is always the possibility that, where they exist, the options of relocation, outsourcing or redirection of future investments, enter bargaining situations, if only because they are perceived to exist. There are, in fact, relatively few documented cases of closure or relocation prompted by labour-relations difficulties (OECD, 1985), and the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy of the International Labour Organization, as well as the Guidelines for Multinational Enterprises of the Organisation for Economic Co-operation and Development (see chapter IX) expressly preclude threats of such relocations. However, in some cases, considerations relating to the locational flexibility can inadvertently enter bargaining relationships. This can occur, for example, when management, strictly on economic grounds, considers alternative sites of production or when, drawing on its broader experience, it points to examples of different and more efficient types of work organization elsewhere. And even where industrial relations considerations enter discussions, they do not necessarily determine their outcome. Still, the locational flexibility of TNCs is a factor that is likely to be present in the relations between TNCs and trade unions.

Locational flexibility increases as location is determined less by proximity to final markets or fixed resources and more by relative costs and the existence or enhancement of created assets, such as highly skilled labour, technologies and "social infrastructure" comprising, *inter alia*, industrial relations systems. Increased locational flexibility is also encouraged as governments reduce barriers to trade and investment and introduce a range of policies designed to enhance comparative advantage (education and training, cooperative research-and-development programmes), as infrastructure improves and as information and communication technologies make feasible the coordination of far-flung activities. However, this does not imply the inevitability of increased capital mobility; rather, *locational choice* and the likelihood of mobility are expanded.

The way in which TNCs organize their activities further affects the issues mentioned above. Complex corporate strategies (UNCTAD-DTCI, 1993a), in their interaction with government policies, affect a number of aspects of the locational choices of TNCs. The specialization of affiliates under this strategy means that specific activities are placed in optimum locations. In TNCs pursuing complex integration strategies, corporate restructuring involves a consolidation of employment as duplicate functions are rationalized and as some activities are resited in an attempt to optimize the efficiency of production activities. Under complex strategies, a broader range of corporate functions is also subject to potential reorganization. Research and development, marketing, accounting and other parts of the value-added chain may no longer necessarily be carried out together with production in one site in one country. Trade unions may therefore find it increasingly difficult to use their organizational strength in production to win members and exert influence in other areas. At the same time, labour needs to consider the competitive position of the firms involved; if complex strategies represent best practices that increase the efficiency of a corporate system as a whole, efforts aimed at hindering the pursuit of such strategies ultimately may hurt both the firms and their employees.

The outcome of locational decision-making by TNCs can also be influenced by the increasingly intense competition for FDI, including competition that is based on the terms and conditions under which production can occur. Investment decisions by TNCs adopting complex integration strategies rely on an intricate calculus with respect to a range of competing locations with different

industrial relations structures and performance. For example, among the largest foreign affiliates in the United Kingdom, those organized along global lines and with links between operations in different countries are more likely to collect data on labour performance and compare them across countries (Marginson et al., 1994). This may require special consideration on the part of trade unions if the danger of locational disadvantage is to be minimized. It may also imply growing competition among national unions and the need to re-engineer existing patterns of negotiations to maintain a competitive position.

2. Union recognition

Since union organization directly affects employee cohesion and bargaining power, the acceptance of unions by and within TNCs is an important issue. Union organization brings both costs and benefits. The costs to management may be higher wages, reduced labour flexibility, an erosion of certain managerial prerogatives, greater accountability for decisions, a formalization of labour-relations procedures and, in some countries, demarcation disputes between unions. The benefits that unionization can bring include enhanced communication between labour and management, reduced labour turnover and, possibly (as emphasized by best practices of work organization), higher worker motivation and commitment to quality work. A positive relationship between labour and management is a prerequisite for increased labour productivity and quality of production, the more so under complex integration strategies that emphasize created assets as a main source of competitive advantage. In keeping with this, TNCs typically pursue a pragmatic approach towards unionization, attempting to capture the benefits of union organization whilst simultaneously minimizing attendant disadvantages, and calibrate their policies according to the institutional arrangements, laws and practices of the countries in which they operate. Often, in fact, TNCs even maintain standards that are higher than those of their local counterparts. This is particularly the case when company-wide standards are observed in countries with a weak industrial relations structure. Sometimes, it appears that some TNCs do not respect the right of employees to be represented and, in specific instances, discourage organizing activities of employees (OECD, 1992b, p. 43). It is, however, important to reiterate that, where they are required under national legislation, the norms observed concerning freedom of association and the right to organize are usually observed as closely by TNCs as by their local counterparts. However, the situation inevitably varies across countries, reflecting differences in industrial relations systems, cultural influences, the effectiveness of law-enforcement mechanisms and the management style and size of firms.

Size is, indeed, an important factor. Large TNCs, in particular, have a good record when it comes to recognizing unions in negotiating collective agreements; the "non-union" approach of a number of large TNCs has, however, attracted considerable attention, particularly in Europe, but cannot be considered representative of all TNCs. Large TNCs also tend to be more closely watched as regards their industrial relations practices. In the case of an affiliate of a United States firm in the United Kingdom, the company, responding to allegations of anti-unionism, pointed out that industrial relations were conducted on a company-wide basis and that terms and conditions were uniform throughout the company. It challenged union recognition at its plants in the United Kingdom on the grounds that the level of union membership was too low to warrant it. On that occasion, the company resisted a union organizing drive, relying on its record in terms and conditions of work and obtaining the support of the employees through a ballot (Campbell and Rowan, 1983). The firm does, however, recognize unions in several countries worldwide when the host country institutional framework requires it. More broadly, TNCs tend to be influenced by their home country practices in their industrial relations abroad, even though comparative studies for the United Kingdom and the United States suggest that ownership nationality has only a limited effect on union recognition (Dunning, 1993b, p. 337).

More recently, there seems to be a growing trend towards the establishment of non-union plants, as, for example, in firms of smaller-than-average size established in the United Kingdom (Beaumont and Townley, 1985; and Beaumont et al., 1991). This trend is also apparent for a number of foreign affiliates in both manufacturing and services industries in the United States (Peet, 1987). However, there is limited evidence that investors are disproportionately attracted to areas where unions are weak and unemployment is high (Mair, Florida and Kennedy, 1988) or, more generally, that the existence of weaker unions is an important determinant of investment location. Overall, moreover, the few data available suggest that the proportion of workers unionized is not lower in foreign affiliates than in domestic enterprises. On the contrary, according to a 1989/1990 survey in Australia, for instance, 43 per cent of foreign affiliates were considered "active bargainers", with about three-quarters of their work force unionized (ILO, 1992a p. 160).[3] More systematic data on the United States show that union membership is higher in foreign affiliates than in domestic firms (table VI.1). In goods production, including manufacturing, the proportion of workers unionized in foreign affiliates in the United States in 1987 was similar to the proportion unionized in total United States goods production. In services taken as a whole, however, foreign affiliates were unionized to a considerably higher extent than all United States services firms. There were, however, considerable differences among different service industries. Unionization rates were higher in foreign affiliates than in all firms in wholesale and retail trade, services (narrowly defined) and in construction, but foreign affiliates were less unionized than all firms in finance, transportation, communications, and public utilities. Furthermore, there were few differences in the overall degree of unionization in terms of country of origin of TNCs — affiliates from Canada, Europe and Japan each had a higher unionization level than all United States firms. Affiliates in the United States of TNCs from Japan are slightly more unionized than others in manufacturing and goods industries in general, but less unionized in services, particularly in wholesale trade, which accounts for a major part of Japanese FDI. Data for 1980 (table VI.1) show a broadly similar pattern. Foreign affiliates were, as in 1987, more highly unionized than all United States firms, although unionization in both domestic and foreign firms decreased considerably during the 1980s. Unionization rates for Japanese affiliates were somewhat lower than those of other affiliates in services and higher in manufacturing, but on the whole, there were no significant systematic differences in the degree of unionization of affiliates according to TNC home country.

Such aggregate data hide, of course, a noticeable variation in unionization among individual foreign affiliates. For example, a sample survey of Japanese-owned plants in California showed that only 7.6 per cent of plants with more than 100 employees were unionized; the survey suggested that Japanese managers viewed the demand for unions as symptomatic of management failure (Milkman, 1992, p. 173). More generally, it appears that the rate of unionization of workers in Japanese affiliates worldwide is low (Watanabe, 1993, pp. 143-144; and Woodward, 1992) when compared with the rate of unionization that prevail in the home country. Individual large Japanese TNCs, however, may act differently. The majority of Toyota's plants in Japan, as well as elsewhere, is unionized. A number of plants in Canada and a large plant in Georgetown, Kentucky, in the United States are the exception. The latter, involving the choice to locate in a rural area in a state in which labour unions are weak, was viewed by United States labour unions as an indication of an anti-union practice. According to the company, however, other variables determined locational choice and, in any event, the firm emphasized worker participation through a variety of other instruments (ILO, 1993c, p. 98). In general, where workers are not unionized, the managers of Japanese affiliates maintain close communication with the employees by means of regular opinion surveys and meetings, bulletin boards, newsletters and the provision of information on production for the team leaders (Watanabe, 1993, p. 143).

There is growing evidence that, in those countries where unionization has developed at least in part by craft and not by industry, the primary effect of TNCs on union organization may be on the number of unions recognized, as opposed to, simply, the acceptance of unionization. In

Table VI.1. United States: union membership in foreign affiliates and all firms relative to total employment, by ownership and industry, 1980 and 1987

(Percentage)

Industry	1987					1980				
	Country/area of origin of transnational corporations					Country/area of origin of transnational corporations				
	Canada	Europe	Japan	Total foreign	Total United States	Canada	Europe	Japan	Total foreign	Total United States
Goods production (total)	23.2	..	25.4	21.7	21.6	..	..	..	30.5	33.4
Agriculture, forestry and fishing	-	-	7.1	21.0	2.2	..	..	..	17.2	..
Mining	25.9	33.1	-	30.8	-	33.7	36.6	..	39.9	27.8 [a]
Petroleum [b]	9.1	..	-	9.1	18.3 [c]	10.7	25.1	-	23.0	..
Manufacturing [d]	23.3	21.0	25.9	22.4	23.2 [e]	34.9	30.8	28.8	31.1	33.4 [f]
Services (total)	15.2	..	11.5	16.1	10.0	..	..	..	27.4	17.5
Wholesale trade [g]	..	13.6	5.9	11.6	7.1 [h]	38.3	21	5.3	18.4	7.4
Retail trade [g]	..	26.0	-	20.7	-	..	40.5	2.1	36.4	9.1
Finance, excluding banking	-	-	0.7	0.6	2.3	..	-	-	-	1.5 [i]
Insurance	-	-	-	0.2	..	-	..	..	..	5.8
Services [g]	..	9.3	18.2	14.2	6.3 [j]	7.2	29.2	53.3	27.4	28.5
Construction	..	..	..	41.6	21.0	49.1	48.1	..	47.3	36.2
Transportation	39.0	21.8	..	25.4	33.5	87.8	..	..	62.2	12.5
Communication and public utilities	..	..	100.0 k	20.8	..	..	..	..	52.5	
All industries	19.1	18.9	15.6	18.9	13.2	32.6	30.1	20.3	29.3	20.2

Sources: United States, Department of Commerce, Bureau of the Census (1989), table 684, and (1984), tables 707and 729 and Bureau of Economic Analysis (1990), tables F-3 and F-15 and (1983), tables F-4 and F-12.

a Including oil and gas extraction.
b Foreign-affiliate data include all petroleum operations (extraction, refining, wholesale,and retail trade and services).
c Including petroleum and gas extraction but not other petroleum operations.
d Foreign-affiliate data exclude petroleum refining.
e Including petroleum refining.
f Including petroleum and coal products.
g Foreign-affiliate data exclude petroleum operations.
h Including petroleum wholesale trade and gasoline stations and retail trade.
i Including banking.
j Including petroleum services.
k Numerator and denominator both are 0.1 thousand. Actual percentage could be anywhere from 50 to 100, depending upon the rounding.

countries such as the United Kingdom, where unionization has developed along craft or occupational lines, multi-union representation is commonplace. For the employer, this can bring problems of increased bargaining costs, reduced flexibility and inter-union disputes. And, in the same way as a union seeks to negotiate with one management decision maker, management prefers to negotiate with one union spokesperson. To avoid difficulties in this respect, a number of TNCs have displayed a preference for dealing with one, rather than a number of unions, in their affiliates in the United Kingdom which, in turn, can lead to "beauty contests" among unions (Dunning, 1993b, p. 377; Oliver and Wilkinson, 1988). Such a strategy was found to be popular particularly among recent investors. For example, Nissan, upon establishment in the United Kingdom, extended sole recognition rights to the Amalgamated Engineering and Electrical Union (box VI.2). This gave the company an advantage over the then indigenous competitor Austin Rover, which negotiated with 13 unions in five company-level bargaining groups. However, one of the most interesting consequences of the arrival of Nissan and its industrial relations practices in the United Kingdom eventually, was the conclusion, in Rover, of a new collective agreement with unions which achieved, in a multi-union situation, results similar to those achieved in a single union agreement in Nissan. This suggests that the issue for TNCs is not so much multi-union representation *per se*, but the ability of a firm to deal with a clearly identifiable statement of the position of labour as a group.

The direct or indirect impact of TNCs on union recognition may be significant in developing countries as well. Within export processing zones, and in particular in the electronics industry, there is evidence that workers rights to join a national union, to engage in collective bargaining and/or to strike, have been restricted by governments to increase the attractiveness of a country as an investment location (Grace, 1990). In some cases, employees have been encouraged to join in-house unions. For example, although labour practices in Malaysia generally compare well with those of other developing countries, the Government of Malaysia had restricted attempts to unionize electronics workers in the belief that unions would discourage FDI in the industry. When the Government agreed to allow trade unions in the electronics industry, this decision was opposed by the Malaysian-American Electronics Industry. Under these circumstances, the Government modified its policy, permitting only in-house unions rather than the industry-wide union planned initially (Lim and Fong, 1991, pp. 117-118).

Developing countries vary in their policies regarding trade unions and their role, but improved labour relations generally accompany economic development. While, initially, low labour standards may be one of the factors attracting certain FDI, the positive impact on growth of such investment tends to lead to their improvement, both through market forces and government policy. Needless to say, controls on labour in the absence of other locational advantages fail to attract the desired FDI. In fact, as the experiences of the Republic of Korea and Taiwan Province of China illustrate, countries with high growth rates and expanding markets continue to attract FDI despite rising wages and occasional or periodic labour unrest (Lim, 1990, p. 89).

In Central and Eastern Europe, unions have changed dramatically over the past five years. The old unions have undergone substantial democratization and new independent unions have emerged. Industrial relations are still in transition, with new or substantially reformed structures coexisting with remnants of the old system. For example, in the metal industry in Hungary, some large units have left the Ironmakers Federation to become members of alternative organizations, including in Tungsram, after its acquisition by General Electric (ILO, 1992b, p. 89). Unionization rates were found to be rather low in joint ventures in Hungary, especially in firms with relatively small-scale operations in the services sector, where unionization had traditionally been weak. In larger establishments, workers generally had favourable compensation packages and, as a result, could be dissuaded from joining unions (ILO, 1992a, p. 170).

Box VI.2. Labour relations at Nissan

Labour relations at Nissan Motor Manufacturing (UK) Ltd., illustrate the attempts of TNCs to reconcile host country requirements regarding unionization with the company's own preferences. The main features of Nissan's labour relations policies in the United Kingdom are:

Union recognition. Nissan has negotiated a single union deal with the Amalgamated Engineering and Electrical Union which represents all personnel up to and including senior engineer and equivalent levels in the company. This contrasts with the traditional pattern of multi-union recognition in the British motor car industry. The company encourages employees to join the union and to take an active part in its activities; trade union subscriptions are deducted from salaries, and there is no discrimination against non-union members.

Company council. This is the main forum for consultation and negotiations between the company, its employees and the Union. It consists of elected representatives covering all employees and representatives appointed by the company. Meetings are held at least on a quarterly basis and cover three broad issues:

- matters concerning the company's business including quality, production levels, market share, profitability, investment etc.;
- issues referred to the council under the procedure agreement for resolving disputes;
- salaries and terms and conditions of employment (see below).

Negotiations. Negotiations concerning salaries and terms and conditions of employment are conducted at plant level through special meetings of the company council at which there is no other business. Agreements are normally valid for two or more years duration. Both the company and union are committed to resolving negotiations in-house but in exceptional circumstances disputes may be referred externally to the Advisory, Conciliation and Arbitration Service for conciliation and, if necessary, arbitration. The agreement with the union states that there will be no industrial action during the negotiation process.

Disputes resolution procedure. Most disputes are expected to be resolved informally between the employee(s) and his/her immediate supervisor. In cases where this is not possible, a four stage dispute resolution procedure is applied with the final stage being a referral to the company council.

Salaries. A salary range is applied to each occupational classification with progression through the range being based on individual performance.

Hours of work. The basic working week is 39 hours, with all employees hired on the understanding that they will work shifts including alternating day/nights; double day shifts; and five day continuous shifts. Premium rates of pay are paid for shift and overtime working.

Working practices. Complete flexibility and mobility of employees is expected to ensure the fullest use of facilities and manpower. Training plays a crucial role in allowing such flexibility and mobility.

The basic principles covering working practices in the company are stated in the terms and conditions of employment agreement with the union, as follows:

- To ensure the fullest use of facilities and manpower there will be complete flexibility and mobility of employees.
- It is agreed that changes in technology, processes and practices will be introduced and that such changes will affect both productivity and manning levels.
- To ensure such flexibility and changes employees will undertake training for all work as required by the company. All employees will train other employees as required.
- Manning levels will be determined by the company using appropriate industrial engineering and manpower planning techniques.

Source: information obtained from Nissan.

3. Effectiveness of union action

While negotiation is the framework for the normal relationship between unions and management, there are situations in which this mechanism breaks down and unions feel they need to take other forms of action, if they are allowed to do so by national regulation. (The right to strike — the ultimate union recourse — does not exist or is limited in a number of countries, particularly in export processing zones (box VI.3).) Where the right to strike exists, a potential source of advantage for a TNC, stemming directly from its transnational character, could be its ability to switch production, at least in principle, temporarily across national boundaries.

However, production switching depends on a number of factors, including the existence of duplicate facilities and the ability and willingness to use them:

- Typically it is difficult if not impossible to switch production among affiliates in the natural resources and especially services sectors because the former are location bound and the latter market bound.
- Opposition from employees in related plants may prevent it: an early study of TNCs from the United States revealed that 10 per cent of respondents had accepted, at plants located abroad, union provisions excluding strike-breaking activities in the form of overtime or the handling of shipments with striking plants (Hershfield, 1975).
- Opportunities for production switching are particularly limited within functionally integrated TNCs. The costs of duplicating facilities are likely to be high. Thus, complex integration strategies, by dramatically raising the repercussionary costs of stoppage in a given affiliate, may actually place organized labour in a more powerful position than before, particularly in those affiliates that specialize as single regional or global sources of inputs for a TNC's whole production chain. There is some supportive evidence to this effect. The success of a two-week strike of workers at a Ford affiliate in the United Kingdom in 1988 showed the vulnerability of companies that are part of an integrated regional production network. The strike began a chain reaction of shortages and disruptions that quickly spread to other Ford plants in Europe. After only a week, the strike in the United Kingdom led to shortages of engines and disrupted production at Ford assembly plants in Belgium and Germany (ILO, 1993c, p. 93).

As this discussion suggests, cross-border production switching is not easy. In fact, few cases due to labour-relations problems have been reported.

The effectiveness of union action may also be influenced by the switching of employees between affiliates of the same TNC. In principle, this may be particularly relevant in the area of services because most services need to be produced when and where they are consumed. An example is a dispute relating to a car-rental affiliate in Denmark that attempted to maintain operations during a strike at its affiliate in Denmark by bringing in employees from affiliates in other European countries. That case led to the amendment of paragraph 8 of the OECD Guidelines (chapter IX) which previously generally referred to "threats seeking to influence unfairly good faith negotiations" and now condemns explicitly the actual transfer of employees across borders (Campbell and Rowan, 1983).

B. Access to decision makers

Identifying, and obtaining access to, decision makers in a firm is essential if labour is to interact effectively with management. The principal reason is that labour, in many instances, needs to be informed and consulted on matters having a direct impact on its welfare, both in terms

Box VI.3. Workers' rights in export processing zones: problems persist

If there is one development that has drawn widespread attention to the question of workers' rights, it is the keen competition among countries to attract investors to export processing zones by offering concessions that limit the exercise of those rights, or allowing practices that have the same effect. Such policies are in direct conflict with paragraph 45 of the International Labour Organization's Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (chapter IX) which states that special investment-promotion incentives granted by host country governments "should not include any limitation of the workers' freedom of association or the right to organize and bargain collectively" (ILO, 1991c, p. 8). The ILO's follow-up to the Declaration, through its fourth and fifth surveys, revealed that various problems continued to prevail.

In some cases, there is a normative basis for the different treatment that is meted out to workers in the zones, through the enactment of legislation that explicitly excludes the application of certain labour standards in those areas. For instance, in Turkey, the laws governing strikes, lockouts and conciliation are not to be applied for ten years following the start of operations in the zones. In the case of the Philippines, according to the Confederation of Labour and Allied Social Services, limits had been imposed on labour action, with the banning of unions in that country's export processing zones in the five years following their inception. Similar restrictions were reported in the case of Bangladesh, where the 1980 Export Processing Zones Authority Act denies workers the right to form and join unions, and for Pakistan, where those rights were limited under the 1980 Export Processing Zones Authority Ordinance and the Export Processing Zone (Control of Employment) Rules of 1982. Sometimes, the restrictions were imposed at the initiative of governments that regarded them as essential for creating a favourable investment climate. In other circumstances, they were introduced in response to explicit demands by potential investors. For example, the Government of Pakistan, in its 1989 report to the ILO's Committee of Experts on the Application of Conventions and Recommendations (also referred to as the Committee of Experts), argued that the restrictions had been "introduced in response to conditions laid down by multinational organizations before they were prepared to invest" in the country (ILO, 1989a, p. 209).

In other cases where unions are allowed, in principle, there may be limits on the scope of collective bargaining. In Malaysia, during the first five years of operation, both local and foreign companies that had "pioneer status" could not, without the approval of the Minister of Human Resources, give more favourable provisions than those specified in Part XII of the Employment Act, with respect to hours of work, rest days, paid holidays and sick leave. The aim it said, was to allow "infant industries" to take off without "excessive demands" from labour.

The inadequacy of law enforcement in the zones is another reason why workers' rights are undermined in some export processing zones. For example, in El Salvador, although the law prohibiting discrimination applies to all firms, enterprises in the zones did not hire persons belonging

of improving conditions and in terms of minimizing hardship that may result from corporate decisions. Access to decision makers may be especially important in critical bargaining situations.

One factor that should help in this respect is that labour-management relations are among the most decentralized functions within TNCs.[4] Transnational corporations recognize the importance of local knowledge for the successful management of labour, and they make more extensive resource commitments to the personnel function than to other functional areas.[5] Personnel managers within affiliates tend to be more specialized and more highly and relevantly qualified than their counterparts in domestic firms. However, the position of foreign affiliates in the nexus of corporate decision-making may be complex and change over time. When negotiations or collective bargaining take place, an affiliate may not be empowered to negotiate all aspects of a proposed agreement or take decisions without the approval of the parent company. This may raise problems in identifying and accessing key decision makers within TNCs and acquiring

to unions. In the Dominican Republic, while, on the whole, TNCs did not obstruct the exercise of freedom of association, there were a few exceptions in the zones (ILO, 1993b, p. 191).

Requirements for obtaining union recognition have also militated against efforts to organize workers in certain zones. Under the legislation that was in force at the time, only five unions representing workers in export processing zones in the Dominican Republic were registered and three applications submitted between 1989-1991 were refused. In contrast, over the same period more than 80 unions representing workers outside the zones were registered. Finally, the fact that export processing zones are typically fenced-in for security and other reasons, and that unauthorized personnel is typically not permitted to enter the zones, also constitutes an impediment to organizing workers into unions.

Complaints about anti-union discrimination in export processing zones have been brought to ILO over the years. It is therefore of interest briefly to note developments in the countries mentioned above as reflected in the 1994 Report of the Committee of Experts. In the Dominican Republic, the new Labour Code protects workers against anti-union discrimination and promotes collective bargaining. However, since unions can only negotiate when they have a membership that constitutes an absolute majority of workers in the enterprise or branch of activity, no collective agreement had been concluded up to the time covered by the Report. It should be noted that, subsequently (in April 1994), the Export Processing Zone Association of the Dominican Republic (ADOZONA) and six central workers organizations signed an agreement that makes it obligatory for all labour disputes arising in enterprises in the export processing zones to be settled through direct negotiations or, failing that, to be submitted to the Secretary of State for Labour for settlement by mediation. The Agreement also provides for the setting up of a committee composed of two representatives of the central trade union organizations, two representatives of ADOZONA and the director of the Government's labour education institution. The aim is to draw up plans and programmes that would make employers and workers more aware of the country's labour laws, of the correct procedures for applying them and of ways of organizing activities which could improve the climate of industrial relations. In Pakistan, by 1994, the Government had set up a tripartite task force with a mandate that encompasses industrial relations issues. Discussions have been held between the "direct contacts mission" representing the Director-General of ILO and the Government and the social partners, and continued technical assistance has been requested in an endeavour to deal with the problems. In Bangladesh, according to the Government, amendments to the aforementioned 1980 Act have been submitted to the competent authority for consideration, and some employers in the zones, in anticipation of the changes that may occur, have begun to allow workers to form unions.

Sources: information provided by the International Labour Office.

timely and accurate information necessary for balanced and meaningful negotiations on matters of interest to labour.

However, this does not necessarily mean that the decision makers to whom access is needed are always those in the parent firm. The example of British Oxygen's Swedish affiliate, Viggo, illustrates this. Viggo had announced plans to invest abroad rather than to expand production in Sweden. No lay-offs were contemplated, however, following this decision. Furthermore, in accordance with local regulations, the affiliate's management had discussed its investment plans with the Swedish labour federation. Swedish unions involved in the discussions sought access to the decision makers within the parent company, arguing that, under paragraph 9 of the OECD Guidelines, they were entitled to negotiate "with representatives of management who are authorized to take decisions on the matters under negotiation". The case was referred for clarification to the OECD Committee on International Investment and Multinational Enterprises.

In its clarification, the Committee suggested that, depending on the situation, the ultimate decision-making authority could be at the level of the foreign affiliate, while the headquarters' role remains limited to supervision and approval of the financial commitment related to the planned investment (Campbell and Rowan, 1983, p. 207). At the same time, the Committee provided guidance on the means by which enterprises can comply with paragraph 9 of the Guidelines (OECD, 1986, p. 37).[6]

The locus of decision-making within TNCs depends on a range of factors, including size and scope, organizational strategy, rationale for expansion abroad, the level of experience in investing abroad and types of markets served. Two aspects of the resulting structure are particularly relevant to organized labour:

- The degree of centralization of decision-making is generally higher within TNCs than within domestic enterprises (Enderwick, 1985; Greer and Shaerer, 1981). This generalization is, of course, subject to a number of caveats.
- Although there may not be a single optimum TNC organizational structure, there are some common characteristics (Hedlund, 1993a). Certain activities tend to be grouped by country, including, in many cases, industrial relations and human resources management. By comparison, for less culturally specific functions, such as research and development, structure is more likely to follow product lines. In general, centralization is more likely to occur (and may be easier) in smaller TNCs or where a globally (or regionally) integrated strategy is being developed, rather than in TNCs pursuing stand-alone strategies.

Whatever the organizational structure of a TNC, a considerable decentralization of the labour-relations function tends to be coupled with extensive provisions for upward consultation, at least concerning a number of issues. In comparison with their domestic competitors, personnel managers in foreign affiliates are more likely to get advice from a higher management tier with responsibility for labour-relations matters (Buckley and Enderwick, 1985). This provision for upward consultation can lead to management structures that are complex, broad-based and, at the same time, hierarchical. Such structures may result in a more protracted decision-making process and may create difficulties for identifying authorized decision makers.

However, organizational structure is not static and evolves constantly. The competitive business environment of the 1990s and, in particular, the trend towards complex integration strategies have brought forth organizational structures wherein hierarchical relationships are giving way to a network of cooperative, vertical as well as horizontal intra-firm and inter-firm relationships, within a strategic framework centrally coordinated by the parent company. This has implications for the level of decision-making within TNCs. In integrated structures, strategic decisions about investment and operational practices are increasingly taken outside national boundaries, making access to higher-level decision makers of growing importance for unions. In addition, some of the operating forms and governance structures associated with integrated TNCs — for example, strategic alliances and international subcontracting relationships — may obscure the precise boundaries of a firm, making it more difficult for unions to identify the bargaining counterpart. On the other hand, the flatter organizational structures and network relationships of such corporate constellations encourage the horizontal movement of information and the devolution of cost and profit responsibility to the level of the strategic business unit. In a number of cases, this has meant a shift in responsibility for regional managers from "management by task" to "management by performance" (Marginson and Sisson, 1993). These organizational changes facilitate decentralization of responsibility within the framework of a centrally coordinated policy and, hence, access to decision makers. This, in turn, increases the relative importance of company-specific characteristics in shaping human resource management strategies within affiliates. The French food manufacturing group BSN illustrates this: it brings together, twice a year, all human resource directors from its affiliates worldwide for an exchange of ideas and information. This has

the two-fold effect of not only reinforcing a company perspective, but also allowing the sharing of disparate experiences within an evolving corporate human resources policy. This is not an isolated instance: a survey among the largest TNCs operating in the United Kingdom showed that over one-third of the companies surveyed had a committee of senior managers and directors at the worldwide level to determine personnel policy, while meetings of personnel managers from different countries were reported in one half of the companies (Marginson et al., 1994).

Nevertheless, the pursuit of an integrated strategy may create strains between the centralization and decentralization of authority. Centralization of some strategic and operational aspects with a bearing on the organization of production and labour practices in affiliates abroad need to be reconciled with a decentralization of the industrial relations function and its adaptation to local conditions that have been traditionally adopted by TNCs as a way to ensure smooth labour relations and reduce vulnerability to local conflict. That raises the need for new forms of cooperation, including also the area of access to decision makers.

C. Information disclosure and consultation

To fulfil effectively their function as bargaining agents, labour representatives need timely and relevant information. Depending on the issue at hand, it may include information on national, regional and global corporate performance of both a financial (e.g., revenue, profitability) and operational (e.g., production, productivity) nature, and planned activities such as plant rundowns, new investment or restructuring. Four aspects of information disclosure are particularly important in this respect: the level of aggregation of information; information coverage; the timing of disclosure; and the reliability of information.

- Certain information, such as company accounts, is usually aggregated at the company or, sometimes, regional level. Given the preference of many firms for decentralized bargaining, often at the level of the plant, information at those levels of aggregation may not be sufficient.
- As regards the type of information disclosed, TNCs appear to have a preference for disclosing financial and operational data rather than information on employment and investment plans. In part, this reflects the sensitivity of some of this information and the need to ensure confidentiality. In this context, a distinction needs to be made between actual decisions, for which employees seek prior notification, but accept as non-negotiable, and the implementation of such decisions, where negotiations on the timing or impact may be possible; as regards the latter, information that relates more than purely to the national situation may be important. This concern has been addressed in the OECD Guidelines and the ILO Tripartite Declaration. For instance, paragraph 54 of the ILO Declaration asks TNCs to supply information where national laws and practices so provide, to enable labour to "obtain a true and fair view of the performance of the entity, or, where appropriate, of the enterprise as a whole" (ILO, 1991c, p. 9).
- The importance of the timing of information disclosure, particularly regarding plant closures and the loss of employment has been underlined by the extensive corporate rationalizations that have occurred during the 1980s and 1990s, in particular regarding plant closures and the loss of employment (box VI.4). For example, in the much debated Hoover case, where an affiliate was moved from Dijon (France) to Glasgow (United Kingdom), the fact that adequate information on the transfer of production was not provided by the company was a major point of criticism by local authorities and trade unions; on the other hand, Nestlé avoided criticism concerning its move from Glasgow to Newcastle, precisely by providing timely information and consulting with unions. Unions

from developing countries often also note that reasonable notice of changes in operations is not given by firms operating in their countries (ILO, 1992c, p. 28).

- The reliability of information provided by TNCs is affected by a number of factors. One is the practice of transfer pricing, whereby prices are assigned to internal transactions, a process that can affect the validity of financial data. Little is known about the extent of transfer pricing, and it is not possible to make generalizations about its extent or impact (Plaesschart, 1993). The reliability of information is also influenced by national differences in standards of accounting and reporting (Bellace and Gospel, 1983). A number of efforts have been undertaken in different forums to deal with the harmonization of accounting standards used by TNCs in order to improve the transparency, quality and comparability of financial information (UN-TCMD, 1993e; UNCTAD-DTCI, 1994i).

In many cases, employees of TNCs may need access to information beyond that available to the general public. The principal source of information for union negotiators is, indeed, internal (ILO, 1985). The decentralization of bargaining observed earlier can increase the flow of information within TNCs, principally through consultation processes that can be helpful in this respect (Buckley and Enderwick, 1985). In the case of non-unionized employees, a considerable amount of information can be provided through consultative committees, particularly when there is a legal basis for having consultation procedures or where such practices are entrenched in a national industrial relations setting. The scope of consultation, however, may be quite narrow.

Box VI.4. Labour relations and the consultative process within the Volkswagen Group

Like other automobile manufacturers, the Volkswagen Group currently faces a number of challenges — caused by worldwide recession and ever increasing competition in the automotive sector — and finds itself in a process of restructuring. Affected by this are a total of approximately 242,000 workers worldwide: 144,700 in Germany, 97,400 abroad (Latin America, South Africa, Mexico, Asia-Pacific, Europe excluding Germany). In order to meet these challenges, the company has developed and implemented a number of strategies. The main goal has been to avoid retrenchments where possible and to make use of the creative potential of the human resources of the firm while implementing improvements in order to cut costs and remain competitive. In this process, Volkswagen recognizes the importance of arriving at a mutual understanding with its employees and their representatives concerning the situation of the company, the necessity of the measures implemented and their impact on the workforce.

Measures for reducing costs and increasing competitiveness include the following:

- Continuous improvement process-workshops have been set up at every location worldwide, and are attended by managers as well as workers and member of the local works councils. The aim is to save costs through improved work organization, reducing wastage of time, money and materials, while improving working processes.
- New sourcing-strategies aim at reducing the costs for components, modules and parts, and which are based on a procedure agreed between management and works council.
- Strategy for reducing the number of platforms for cars to a reasonable and competitive amount has been introduced.
- Lean management structures have been implemented in order to improve decision-making and communication.

The well-established labour relations within the Volkswagen Group (80 per cent of its labour worldwide is organized) proved to be very helpful in meeting these challenges. They provided the basis for prior open discussions of the company's strategies with the different bodies of the workers'

representatives at different levels. Besides the traditionally well organized national bodies representing the workforce within the VW Group at the national level, international links have been built up from an early stage: in cooperation with the International Metalworkers Federation (IMF), the first meeting of the Volkswagen World Automotive Committee was organized in 1979. At that time, representatives of the workforces of Volkswagen subsidiaries worldwide met for the first time in Wolfsburg. Since then, two more conferences of that kind have taken place: the second in 1986, the third in 1993, both of them again at Wolfsburg, where the head office of the Group is located. These conferences or world councils do not have the authority of a decision-making body, but rather the function of a plenary for exchange of information, for discussions concerning future tasks etc.. The conferences are deliberately held at Wolfsburg, in order to improve and promote direct communication, discussions and flow of information, not only amongst the delegations, but also between the delegations and the representatives of management. Volkswagen's management supports these conferences not only by financial means, but — based on the understanding and approach of "social partnership" — seeks and takes the chance to present its point of view concerning present and future tasks.

In 1990, a more formal body, the European Volkswagen Group Works Council, having defined rights and duties, was established and this was formally recognized by the company in 1992. At present the Council consists of 17 members, including employee representatives from the European companies and production plants of the Volkswagen Group. Through an agreement on joint cooperation, Volkswagen's management and the European Works Council formulated the principles, aims and characteristics of this body as follows:

- to work together in the spirit of social dialogue at the European level;
- to solve jointly conflicts that may arise;
- the legal rights and duties of the respective national worker-representative bodies remain untouched;
- the Council is guaranteed the right of information;
- the Council is guaranteed the right of early consultation;
- the Volkswagen Group bears the costs incurred by the Council;
- meetings between the Council and Volkswagen Group management are to take place at least once a year;
- the term of the agreement is not limited.

The rights of information and consultation pertain especially to the following issues:

- securing of jobs and plants, and plant structures;
- development of Group structures;
- productivity and cost structures;
- development of working conditions (e.g., working hours, wages and salaries, job design);
- new production technologies;
- new forms of work organization;
- work safety, including plant environment protection;
- the effects of political developments and decisions on the Volkswagen Group.

Above all, consultation is particularly emphasized when cross-border transfers of production are planned. The early establishment and recognition of the European Volkswagen Group Works Council, in advance of a European Union Directive, has enabled the company to avoid potential conflicts that might have arisen due to its restructuring efforts by means of early and timely communication with employees.

So far, five regular meetings between the European Volkswagen Group Works Council and the Volkswagen Group management have taken place, dealing with topics such as new work organization at Volkswagen, financial strategic planning and securing European locations during the employment crisis.

Source: information provided by the Volkswagen Group.

Even within TNCs where extensive consultations with labour representatives are undertaken, this is normally done only on a voluntary basis (Trevor, 1983). As discussed in more detail in chapter IX, it is primarily in Europe that a number of large TNCs has voluntarily adhered to information and consultation procedures through voluntary international company councils; examples include such TNCs as Bull, Elf Aquitaine, Nestlé, Thomson and Volkswagen. The planned establishment of European-level works councils is a further step in this direction (chapter IX).

Consultations of this kind tend to take place at the regional level and, in combination with corporate-level information, provide a context for understanding the rationale behind, and likely impact of, decisions on foreign affiliates. The information gained in this manner is particularly important for labour to conduct negotiations in those affiliates that belong to strongly integrated and centrally coordinated corporate structures. In these structures, as suggested earlier, developments in a given affiliate are dependent on developments in other affiliates in different countries, and key decisions affecting employment and production locally are more likely to be taken at the parent-company level, taking into account the need to ensure the satisfactory performance of the enterprise as a whole.

D. The introduction of innovatory practices

Foreign affiliates normally conduct their negotiations within prevailing local bargaining structures. While adapting to local conditions, TNCs have spearheaded new human- resource management practices, in developed as well as in developing countries (box VI.5); in fact, this is an area in which TNCs can make important contributions to the development of host countries. In the Republic of Korea, for instance, TNCs have introduced advanced practices of operating joint labour-management bodies (Dunning, 1993b, p. 378). In the special economic zones established in the People's Republic of China, foreign investors have successfully introduced a combination of contract labour and wage systems that links rewards to performance, contributing to fundamental reforms of the wage structure and the labour market (Sklair, 1993; Zhan, 1993). It is possible to identify three areas in the introduction of innovatory management practices by TNCs in the post-war period, each of them with immediate implications for industrial relations. The first two are directly linked to the growth of TNCs, the third is linked to globalization and regionalization and the emergence of integrated international production.

1. Independent bargaining practices

The first wave of innovatory practices took place in Western Europe during the early 1960s, with United States TNCs taking the lead. Three areas are particularly worth mentioning:

- Productivity bargaining. In this approach, wage increases are tied to improvements in performance or greater flexibility in certain union practices (Dunning, 1993b). This was facilitated by the fact that the TNCs involved had affiliates in various countries and thus had access to critical comparative information on costs and performance.
- The adoption of multi-year agreements. Transnational corporations from the United States had an influence in introducing multi-year agreements into industrial relations practices in a number of host countries in this respect, e.g., the United Kingdom (Steuer and Gennard, 1971).
- Bargaining at the level of the enterprise or plant. Transnational corporations from the United States, used to bargaining at the level of the enterprise or plant, contributed to this practice in a number of Western European countries (Marginson and Sisson, 1993), although generally in the form of supplementary bargaining within the framework of

multi-employer, industry-wide agreements. Bargaining at the level of the individual plant or enterprise brings a number of advantages to employers. Where wages and conditions are no longer tied to the marginal employer, managers enjoy increased control over both labour costs and utilization. This approach also facilitates the introduction of new technology and negotiations over plant-specific issues such as skill development.

Comparative research of bargaining procedures during the 1980s suggests that TNCs tend to couple their preference for independent bargaining practices with formalized provisions for handling bargaining disagreements. A preference for enterprise-based dispute-settlement procedures could be due, in part, to the absence of procedures available within industry-wide agreements or through employer associations. Transnational corporations were also more likely to utilize independent intervention for the purpose of settling bargaining disputes. Their desire for independence was mirrored, in some cases, in a lower propensity for membership in employers associations; this was the case with respect to TNCs in the United Kingdom (Buckley and Enderwick, 1985). However, in those countries in which collective negotiations are firmly established, TNC managers seem to play an active role in the actions and policies of employers' associations. This occurs, for example, in Belgium where collective agreements achieved through federated bargaining are not only legally binding, but can be imposed on non-participants (Blanpain, 1982).

The introduction of new labour practices by TNCs may be particularly significant where TNCs are involved in privatizations. Potential areas of conflict may emerge between the new labour practices of TNCs and the established industrial-relation systems in former State enterprises (box VI.6). The problems are particularly acute in Central and Eastern Europe. In many cases, the early stage of implementation of privatization programmes was slowed by the initial opposition of the established unions in State-owned enterprises, due to fears regarding the removal of state subsidies and the uncertainties of reforms, especially those affecting the stability of employment and wages. For example, one of the major reasons for slow progress in attracting foreign investors in the privatization process in Poland was the strong role of work councils, many of which were relatively unfavourable to foreign participation.[7] In other cases, however, unions played a pivotal role in facilitating the process of privatization. For example, in Slovenia, the unions at the Tobacco Company Ljubljana, acquired by foreign investors, participated in negotiations with the new management and reached an agreement on a modernization plan that excluded lay-offs, set wage raises and introduced new standards of quality supported by intensive training (Korze and Simoneti, 1994, p. 129).

2. Practices related to the flexible organization of production

A second wave of innovatory labour practices — pioneered by Japanese TNCs operating in Europe, the United States and other developed countries — focused, beginning in the early 1980s, on increasing quality, operational efficiency and flexibility in production (Oliver, Morris and Wilkinson, 1992). That a focus on flexibility was spearheaded by Japanese TNCs is not surprising. Flexibility is an essential feature of Japanese enterprises whose business philosophy is based on achieving a continuous improvement in performance. Incremental change is greatly facilitated by resource flexibility, including the use of labour. The Japanese system calls for highly motivated workers with diverse skills and knowledge. In Japan, such flexibility is associated with a lifetime employment system, a pay and promotion system based on seniority and an egalitarian remuneration system (Watanabe, 1993, p. 141). It also coincides with cooperative labour-management relations and strong enterprise unionism.

In general, novel practices in the area of industrial relations associated principally with the introduction of flexible work-organization methods are reflected in new style agreements that have been concluded by TNCs in the 1980s and early 1990s, particularly in the United Kingdom,

Box VI.5. Euro Disney: the challenge of flexibility

Euro Disney, a wholly-owned affiliate of The Walt Disney Company (United States), started its operations in France in 1987. It developed the Euro Disney Resort located north of Paris, opened to the public in 1992. Euro Disney functions through a number of operating affiliates including, among others, Phase IB Hotels, The Festival Disney Entertainment Centre and Euro Disney Vacances which sells package holidays for Euro Disney Resort. The company has three main areas of business: consumer products, entertainment (including films, shows etc.) and the theme park.

Euro Disney started its operations in France under the close supervision of The Walt Disney Company in the United States. Each manager had a counterpart based in the parent company in the United States controlling the establishment of the parallel function in the affiliate. In the area of labour relations, the influence of the practices followed by the parent group in its different activities and locations worldwide have been less pronounced, as the company had to comply with the local regulations. Euro Disney's labour relations followed, however, the parent company's management practices, including, for example, dialogue with the employees that are part of the show as cast members. In some cases, some labour practices introduced in the French affiliate by headquarters had to be modified. For example, the company offered employment contracts where wages were calculated either hourly, for cast support, or monthly for managers. The job classifications were restricted to a few categories. Following negotiations with local labour representatives, a collective convention was signed to modify the job classifications and expand and assemble them into groups of jobs. Employment contracts were also redefined according to three different statuses: cast member support, cast member *"agent de maîtrise"* and cast member manager.

According to the host country regulation, contracts were set as permanent (full or part-time) or fixed term (full or part-time). Recognizing the specific nature of the business, the convention provides that the cast members holding part-time contracts could be requested to work full time at certain times in the year. Provisions were also made for working on Sundays and holidays.

In the face of a recession in Europe and a higher than anticipated seasonality of the business, Euro Disney Resort has incurred losses. The management is therefore focusing its attention on redressment of the company's financial structure and improving its profitability. Numerous initiatives have been implemented to streamline the organization, reduce management layers and tighten and renew the executive team, which is now a more balanced blend of Europeans and Americans.

The seasonality of the business proved very costly for Euro Disney. The group's performance was affected by the difficulty of adapting variable costs to significant variations in park attendance and hotel occupancy due to seasonal and meteorological factors. Cost effectiveness was also hampered by the recourse to overtime or extra temporary workers in the high peak season. The search for greater efficiency has been accompanied by efforts to introduce truly flexible management practices to achieve cost reduction, manage business seasonality and limit the negative effects of a relative high turnover of labour. Euro Disney has prepared a proposal, after negotiations with the unions, that approaches working time and vacation as a whole in order to meet the requirements of the workers for maintaining stability of employment, as well as the needs of the company for reduced labour costs. This proposal, signed by the unions, calls for the annualization of the working time, combining flexible working hours at time of peak season with the recuperation of overtime hours worked between 39 and 44 hours as vacation. The package also establishes bonus time off in cases where these compensation hours are taken during certain periods of the low season. The annualization of working time would introduce at Euro Disney a system of individual working time schedules, managed by a sophisticated computer programme. Each worker would have his or her personal data bank of hours worked and compensation time off.

This agreement has yet to enter into force for a number of reasons. One is the limited representativeness of unions that might hamper its acceptance by the employees. Unionization at Euro Disney is not high. The company employs people of 93 different nationalities with different labour-relations experiences. Furthermore, young people in their first jobs account for the majority of the workforce. The management moreover has fears that the procedure might be cumbersome. Notwithstanding anticipated difficulties, the proposed agreement is regarded as a possible high performance tool. It has also been well received among a number of services firms facing similar problems of seasonality of business and it might, if successful, be introduced by them in similar forms.

Source: information provided by Euro Disney.

and have begun to influence indigenous enterprises. They have a number of common features (Rico, 1987, pp. 68-69):

- A preference for single-union recognition or at least a much stronger degree of coherence in multi-union bargaining. Foreign affiliates are less likely to bargain through complex multi-union structures still prevalent in a number of host countries.
- The adoption of a single status for workers and/or the harmonization of working conditions. This allows greater flexibility of labour, job rotation and team-work, and it appears to have a positive effect on attendance and motivation.

Box VI.6. Privatization and industrial relations: the New Zealand experience

Since 1984, the New Zealand economy has undergone a radical transformation through a combination of deregulation, liberalization and privatization. Historically, the public sector played a major role in New Zealand's economy, accounting (in 1984) for more than 40 per cent of gross domestic product and 31 per cent of employment. However, a very poor economic performance over a significant period of time, and major changes in the global economic environment stimulated a process of policy reform aimed, among others, at promoting private investment and reorganizing the public sector.

The privatization of State-owned enterprises played an important role in the process of reform. Other measures for reform included the abolition of exchange controls, the deregulation of the financial sector and removals of restrictions on FDI. The Government of New Zealand actively sought the participation of TNCs in the privatization process in order to enlarge the availability of capital, obtain the needed expertise and assure the improvement of services provided to the public. The few restrictions that were placed on the participation of foreign investors in the privatization programme were clearly intended to maintain control of broad national interests. After privatization, TNCs hold a controlling or significant equity interest in the national airlines, railway system, shipping corporation, telecommunications, banking and broadcasting (OECD, 1993e).

The overall contribution of FDI to employment in New Zealand increased from 10 per cent in 1986 to 12 per cent in 1990, and even more in manufacturing, increasing from 18 to 23 per cent over the same period (OECD, 1993e). However, some of the privatized companies have, in the process of becoming more efficient and competitive, introduced quite different management methods and implemented considerable employment reductions and major changes in employment terms and conditions (Duncan and Bollard, 1992).

For example, New Zealand Telecom, which had already reduced its workforce after the privatization of the corporation in 1990, announced in February 1993 its intention to reduce its workforce by a further 41 per cent over the coming four years. Workers expressed their concern with the process of restructuring and have tried to establish better interaction with management. A number of actions (including a six-day strike) were taken to protest certain aspects of restructuring.

The introduction of flexible hours and other arrangements to extend services have also encountered some problems. For example, after the privatization of the New Zealand Rail Cook Strait inter-island ferry business, the management, in an attempt to lower costs and introduce 24-hour service, has engaged in negotiations with the three unions concerned.

The reform of employment conditions and work practices has been facilitated by the introduction of new labour-market legislation. Of particular relevance is the 1991 Employment Contracts Act. This Act has a significant impact upon bargaining structures and practices. It provides a clear right for individuals to decide whether or not to join a union or any other employee organization. In addition, employees are provided the right to decide whether or not they wish to be represented by a third party in negotiations and, if so, which individual or organization they believe can best represent their interest. The Act also strengthens the right of organizations to negotiate individual as opposed to collective contracts.

- The existence of a no-strike clause, generally in combination with some form of binding arbitration. This is designed to minimize disruption within a production system highly sensitive to interruptions.

Many of the new style agreements that contain these elements are supported by considerable investment in training, extensive and intensive screening of employees and a significant commitment of resources to the human resource management function. Underlying them is the recognition that the creation and operation of modern and efficient production facilities needs to regard employees as key assets and requires the cooperation of labour, including trade unions:

> "Transformation is easier in an organization where all employees in a plant or enterprise are represented by a single union than where the workforce is fractionated by multiple, ideologically-based unions or compartmentalized by multiple, occupationally-based unions. The most successful manufacturing organizations today are ones where job classifications are few and broad, and work teams accomplish their tasks in ways which often do not conform to traditional occupational demarcations. [...] Transformation is difficult or impossible without trust and effective communication. An expectation of absence of conflict is unrealistic, but a relationship characterized by continual conflict and adversarialism creates an environment where transformation is difficult or impossible. Successful manufacturing organizations tend to be characterized by a high degree of labour-management co-operation" (Deeds, 1992, p. 2).

It is possible that some aspects of the new style agreements weaken the cohesion and bargaining power of some trade unions, especially where bargaining is decentralized to the plant level and bypasses traditional multi-employer and industry agreements. In addition, the new methods are often accompanied by downsizing and a reduced workforce in plants in various locations. Core workers may benefit while others face unemployment or reduced incomes which give rise to societal problems. At the same time, it is recognized that it is neither possible nor desirable to resist new management methods if these are, indeed, superior and likely to prevail. If anything, pressures of global competition force firms to be as efficient as possible.

3. Complex integration strategies and best practices

A third wave of innovatory practices during the 1980s is linked to complex corporate integration strategies leading to integrated international production. This form of organizing production has implications for industrial relations systems, as can be seen from trends in those regions where the integration of corporate structures has grown fastest in recent years, in particular in Western Europe. As a result of the creation of the Single Market and following a wave of acquisitions, mergers and alliances, large TNCs operating in the European Union have created integrated management structures at a pan-European level, distinct from their formerly national organizational divisions. The new structures indicate a tendency for developing firm-specific employment systems or "organization-based" arrangements for dealing with industrial relations (Marginson and Sisson, 1993).

This development transcends the established industry and sectoral frameworks for collective bargaining in Europe and reinforces the trend towards a decentralization of bargaining to the company or plant level, especially as traditional structures of industry (or multi-employer bargaining) are unable to encompass the growing inter-firm diversity of industrial relations outcomes. The impact on the national industrial relations system can be seen in the United Kingdom, but is also significant in other European countries where TNCs negotiate their own agreements, e.g., the Netherlands, or where TNCs are quite active in bargaining at the company level as a supplement to sectoral agreements, e.g., in France, Italy, Spain and Sweden (Marginson and Sisson, 1993). The number of TNCs that has adopted such arrangements is not large; but given their size, they may play an important role in determining the future of multi-employer bargaining in that region. The establishment of voluntary company councils at the European level (chapter

IX) is an indication of the current trend. It is an open question whether the preference for negotiating company-specific issues outside the established federated bargaining structures may also lead to a change in the attitude of TNCs towards employers' federations. However, there are no clear trends in this respect.

Another development with potential implications for industrial relations is the growing adoption of flexible organization and lean production by integrated firms, introducing elements of "best practices" pioneered by Japanese firms, in all steps of a firm's production process. This impact of TNCs contributes to new approaches to industrial relations, both within and outside TNCs. Union reactions to new practices introduced by TNCs often take an evolutionary course, moving from initial concern to a reconsideration of existing systems. The diffusion of best practice manufacturing and management methods under integrated international production further encourages this process. It could result in a cross-border convergence of work organization and conditions and quality of employment within integrated TNCs. If production is tightly coordinated across affiliates in different countries, each one of them would be under pressure not to diverge from global (or regional) best practice. Although limited and subject to important qualifications, some evidence on the convergence of relatively high performing plants towards a common pattern of workplace relations is available. This pattern tends to be characterized by:

> "(1) Broader and more flexible jobs involving greater use of employee abilities based on teamwork. (2) Organic rather than bureaucratic forms of work organization, including flatter hierarchies and closer functional integration. (3) Reward systems which have a greater element of pay related to performance. (4) Fewer unions — one, two or none at all — and relatedly, (5) Workplace bargaining (where unions exist and within parameters set by higher level management) based on single or dual bargaining units, featuring extensive consultation with union or employee representatives and more direct communication with employees" (Frenkel, 1991, p. 2).

Such a convergence is not likely to occur at the same pace in all TNCs, industries or countries. The prerequisite is a complex set of factors that include quality-based competitive markets that emphasize the comprehensive use of workers' skills, a commitment to technological and organizational change, management style and institutional settings that encourage the development of human resources and do not treat labour as a disposable commodity, as well as deeply integrated corporate structures. Variations in the distribution of these factors may lead to considerable variations in patterns of workplace relations.

In the longer term, as appropriate adjustments work out their effects, labour may benefit from this development, including benefits in the form of enhanced labour cohesion within TNCs as the broad similarity of conditions may lead to a perception of shared interest among workers in affiliates in different countries. At the same time, competition between locations for value-added activities could inhibit such a perception, as a result of which TNC employees may identify less with nationally based union organizations; furthermore, employers may prefer arrangements that reduce the vulnerability of their globally integrated structures to national union action or strengthen efforts to communicate directly with the workforce rather than its representative.

The adoption of best practices could also contribute to the stratification of the labour force. One characteristic of stratified labour systems is that they offer high levels of job security and earnings to core workers, accompanied by a growing secondary or peripheral workforce. Employers may seek a maximum of cooperation with their core employees, which may decrease their incentive to join trade unions; at the same time, it may become more difficult to organize a fragmented peripheral workforce. Transcending this, however, is the growing significance of internal labour markets within TNCs and the challenge that this poses in terms of the need to develop new style industrial-relations systems.

Conclusions

The transnational organization of production poses special challenges for nationally organized labour. The differences in scope of organization create a more complex system of production which, at least in principle, gives certain advantages to TNCs and others to trade unions. There are also signs suggesting that the scope for national systems of industrial relations to determine labour practices and bargaining relationships autonomously is becoming more limited, as a result of globalization, growing economic integration and competition for FDI. Moreover, the shift to complex integration strategies, particularly evident among large TNCs in Europe, has been associated with the emergence of company-based industrial relations structures that are likely to have some impact on established industry-wide patterns of collective bargaining. At the same time, the growing integration of geographically dispersed affiliates of TNCs is likely to make transnational production systems potentially more vulnerable to union action at the workplace level. In addition, the growing importance of created assets and the adoption, by many TNCs, particularly integrated ones, of flexible production methods and new organizational paradigms, such as "just in time" or "lean production", are enhancing the need for workers' commitment to the performance of the firm. Such a need can be best sustained in the framework of a cooperative approach to industrial relations.

It also appears that a number of restructuring strategies implemented by TNCs in recent years, particularly workplace reform and rationalization to refocus on core business, the externalization of non-core tasks and the emergence of dual sourcing could reduce firms' vulnerability to union action. There has also been a noticeable tendency for certain issues to be shifted from the domain of collective industrial relations to human resources management, i.e., management that focuses on individual core employees or groups of employees, and that may fall outside the traditional approach of labour organizations. Within the framework of integrated international production, employees are increasingly recognized as important stakeholders in the enterprise that have a strong interest in ensuring its success. While there may be disagreement about how this is best achieved, how the benefits of success should be shared, how unions may be involved and how national systems of industrial relations may be affected, one effect of expanding integrated international production is the recognition that all employees have much to contribute to the well-being of the enterprises in which they work — in fact, regardless of whether they are transnational or not. Growing acceptance of this view may permit the development of new cooperative arrangements for the conduct of industrial relations within TNCs.

National industrial relations systems and the strategies of trade unions need to adapt and respond to the challenges of internationalization and integration of production within TNCs' organization structures and to seize the opportunities opened up by these developments. The challenge for labour, in particular, is considerable. Evolving strategies in this respect are reviewed in chapter IX.

Notes

1 This was affirmed by the OECD Committee on International Investment and Multinational Enterprises in the context of a clarification of the application of the chapter on Employment and Industrial Relations of the OECD Guidelines for Multinational Enterprises (OECD, 1992b, p. 43). The Guidelines are recommendations jointly addressed by the OECD Governments to TNCs operating in their territories. Their observance is voluntary and not legally enforceable. For more information on the Guidelines, see chapter IX.

2 Paragraph 6 of the chapter on Employment and Industrial Relations of the OECD Guidelines.

3 The average rate of unionization in Australia in 1990 was 40 per cent; see OECD, 1994c, p. 53.

4 See ILO (1989b), Young, Hood and Hamil (1985) and Martinez and Jarillo (1989)

5 See, for instance, Buckley and Enderwick (1985); Hiltrop (1991) and Purcel et al. (1987)

6 According to the OECD, in carrying out their responsibility with respect to paragraph 9 on issues relating to future production and investment plans, management of the enterprise as a whole would seem to have a range of possibilities among which it could choose, depending on various circum-stances. These possibilities include (OECD, op. cit., p. 37): (i) to provide the management of the subsidiary with adequate and timely information and to ensure that it has sufficient powers to conduct meaningful negotiations with representatives of employees; (ii) to nominate one or more representatives of the decision-making centre to the negotiating team of the subsidiary in order to secure the same result as in the preceding example; and (iii) to engage directly in negotiations.

7 "Survey of foreign investment", *Business Central Europe*, 2, 10 (April 1994) pp. 33-48.

PART THREE

POLICY ISSUES

Chapter VII

Liberalizing foreign-direct-investment policies

Introduction

Since the early 1980s, more and more countries have changed their policies on foreign direct investment (FDI), with a view towards encouraging and facilitating it.[1] Developing countries, in particular, are increasingly turning to FDI as a source of capital, technology, management practices, know-how, access to markets and other resources that are vital for sustained economic growth. This trend has become more widespread during the early 1990s, as more developing countries and economies in transition have joined the process of liberalization (table VII.1).

These liberalization efforts at the national level have received further impetus in 1993 from a number of important developments at the international level. The number of bilateral treaties for the promotion and protection of FDI concluded by developed countries has increased from 506 in January 1993 to 570 in January 1994 (table VII.2 and annex table 6). The North American Free Trade Agreement (NAFTA) between Canada, Mexico and the United States was ratified. (The implications of NAFTA for the pattern of FDI were analyzed in UNCTAD-DTCI, 1993a). In addition, efforts continue at the Organisation for Economic Co-operation and Development to formulate a broader investment instrument (box VII.1). Finally, the most important development was the conclusion of the Uruguay Round of Multilateral Trade Negotiations. This chapter looks

first at the implications of the Uruguay Round agreements for FDI before turning to the broader issue of the concept and status of the process of liberalization of FDI policies.

A. Implications of the Uruguay Round for foreign direct investment

The Uruguay Round negotiations were completed on 15 December 1993 and the results were formally adopted in Marrakesh on 15 April 1994. Chief among them is the *Agreement Establishing the World Trade Organization* to which a number of agreements on trade in goods, trade in services and on trade-related aspects of intellectual property rights are annexed. Individual country ratification of these agreements is now underway, the common objective being their entry into force by 1 January 1995, or as early as possible thereafter.

The Final Act of the Uruguay Round contains a package of economic reforms that touches on key economic transactions within the global economy (GATT, 1994). Foreign direct investment, however, was not explicitly negotiated in the Uruguay Round, although a number of the issues discussed there had a notable investment dimension. The effect of the Uruguay Round on FDI is, therefore, partly indirect, arising from an overall strengthening of investors' confidence in the world trading system; the dynamic impact of freer trade on growth and, hence, on FDI; and the impact of tariff reduction on trade and investment. But the effect is also direct, namely where the agreements specifically deal with FDI.

The conclusion of the Uruguay Round is of major importance for the investment climate around the world, both domestic and foreign. Failure to conclude the Round would have been a serious blow to business confidence and would have signalled a risk of trade wars. On the other hand, its successful conclusion is a significant boost for business confidence in the international economy today. Indeed, the general strengthening of the trading system and the extensive liberalization of market access that has been negotiated should open up new possibilities for productive and mutually beneficial investments, both foreign and domestic, in line with the location advantages of countries.

It has been estimated that *annual* increases in national incomes brought about by the trade-liberalization measures of the Final Act as a result of increased efficiency are of the order of at least $230 billion by 2005 (measured in 1992 dollars) (François, McDonald and Nordström, 1993, p. 10). Estimates that have been published on the impact of the results of the Uruguay Round on world

Table VII.1. Liberalization measures, 1991 and 1992
(Number)

Item	*Year*	
	1991	*1992*
Number of countries that have introduced changes in their investment regimes	35	43
Number of changes	82	
Of which:	80	79
· In the direction of liberalization	2	79
· In the direction of control	-	-

Source: UNCTAD-DTCI, 1993a, UN-TCMD, 1992a.

trade have been based on analytical approaches that do not take into account the dynamic effects on, for example, confidence, investment and growth. There are significant benefits in terms of boosting foreign investors' confidence associated with the conclusion of the Uruguay Round. These intangible benefits are dynamic and go beyond estimates of the initial impact of the Final Act provisions on world growth. By raising investors' confidence in the multilateral framework governing international trade, the Uruguay Round is expected to influence positively FDI, especially those types of investment (such as export-oriented or efficiency-seeking) for which the free movement of intermediate and final goods is an important consideration for investing abroad.

Table VII.2.
Bilateral investment treaties concluded by developed countries during 1993 [a]

	Treaties concluded during 1993						
Country	*Total number concluded until January 1993*	*Africa*	*Asia*	*Latin America and the caribbean*	*West Asia*	*Central and Eastern Europe*	*Total number as of January 1994*
Australia	7	-	1	-	-	2	10
Austria	14	-	-	1	-	1	16
Belgium-Luxembourg	34	-	-	-	-	1	35
Canada	6	-	-	-	-	-	6
Denmark	20	-	1	2	-	3	26
Finland	19	-	-	2	-	-	21
France	52	1	-	4	-	1	58
Germany	81	-	1	1	-	6	89
Greece	6	1	-	-	-	2	9
Iceland	-	-	-	-	-	-	-
Ireland	-	-	-	-	-	-	-
Italy	25	-	1	3	1	-	30
Japan	3	-	-	-	-	-	3
Netherlands	40	-	-	-	-	-	40
New Zealand	1	-	-	-	-	-	1
Norway	12	-	-	1	-	-	13
Portugal	5	-	-	-	-	1	6
Spain	9	-	1	1	-	-	11
Sweden	21	-	1	1	-	-	23
Switzerland	56	1	-	2	-	3	62
Turkey	22	-	-	-	1	2	25
United Kingdom	50	-	1	4	-	4	59
United States	22	-	-	1	-	2	25
Total	506 [b]	3	7	23	2	28	570 [bc]

Source: UNCTAD, Division on Transnational Corporations and Investment, based on information provided by Governments.

a For bilateral investment treaties signed after 1993, see annex table 6.

b Including a bilateral investment treaty between Japan and Turkey.

c Including a bilateral investment treaty between Finland and Turkey.

Box VII.1. A new multilateral investment agreement?

For the past several years, the OECD has been examining the feasibility of developing a new multilateral investment agreement. This effort has been prompted by the view that, while existing arrangements have been instrumental in promoting liberal investment regimes, the new international investment environment requires a single, comprehensive set of rules on FDI. It is meant to underpin the continued flow of FDI to the benefit of the world economy.

The OECD has been actively promoting the liberalization of FDI flows among its member countries for many years. Its existing instruments -- the Code of Liberalization of Capital Movements and Current Invisible Operations (1961) and the OECD Declaration of International Investment and Multinational Enterprises (1976) which includes a national treatment commitment -- have contributed substantially to the development of a favourable climate for international investment flows. While there would be certain benefits in simply combining these instruments, this would only partially address today's investment concerns. The OECD has embarked, therefore, on an effort to provide a strong, unified set of rules for FDI that would also generate greater liberalization and extend disciplines to new areas. By setting high standards of liberalization and investment protection, such an agreement is also meant to provide a model for developing countries which are rapidly becoming important FDI partners. The multilateral character of the agreement would obviate the need for reciprocity measures. At their annual meeting in June 1994, OECD ministers expressed their support for this endeavour as a contribution to strengthening the multilateral system and called for a report in 1995. [a]

It is recognized that only a broad investment instrument providing for a satisfactory balance of commitments between countries can attract the necessary support. Substantial progress has been made so far in defining the principal elements of a new agreement. These could include:

- Commitments equivalent to those of an international treaty.
- National treatment for both establishment and post-establishment.
- Liberalization rules not only for governmental measures directly affecting FDI but also, perhaps, new disciplines for dealing with, for example, restrictions resulting from the practices of private companies, governmental measures affecting individual investors or the nationality of corporate managers or members of executive boards, the freedom of key personnel to transfer from one branch of a company to another, monopolies and concessions, privatization, and so-called informal barriers to market access.
- Firm undertakings concerning measures taken at all levels of government, including states and provinces.
- Investment protection provisions, including conditions for expropriation and compensation, and rules on intellectual property.
- Formal dispute settlement arrangement which would provide procedures for state-to-state and also, possibly, investor-to-state, disputes.

OECD has an accumulated experience in developing and applying multilateral investment rules. As liberalization is already very advanced in most OECD countries, it is reasonable to expect that the highest standards of liberalization and investment protection could be achieved. It is envisaged, however, that an OECD agreement would be open to signature by non-member countries.

Business and labour have expressed support for a new multilateral investment agreement. The OECD's consultative process with the social partners ensures that the views of the international business and labour communities will be taken into consideration when elaborating the agreement.

a OECD, "Press release: Meeting of the OECD Council at Ministerial Level, Communiqué", 8 June 1994, mimeo.

It has been estimated that merchandise trade after the implementation of the Uruguay Round provisions will be around 12 per cent higher than in their absence (François, McDonald and Nordström, 1993, p. 11). Given the increasing complementarity between trade and investment flows as a result of the regional core-network and complex integration strategies pursued by TNCs that entail considerable intra-firm trade in components and other intermediate activities of the production process (including services), trade liberalization is likely to be accompanied by higher investment flows. On the other hand, enhanced market access to exporters dictated by the reduction of protectionist measures reduces the need for undertaking investments to service local markets. Nevertheless, serving domestic markets through FDI as opposed to trade has considerable advantages in terms of access to better information, proximity to customers and quick responses to changes in local tastes. Therefore, the reduction of trade barriers is unlikely to diminish the importance of these investments as a means of accessing domestic markets.

Turning to the Uruguay Round instruments of particular relevance for FDI, the *Agreement on Trade-Related Investment Measures* (TRIMs); the *General Agreement on Trade in Services* (GATS); and the *Agreement on Trade-related Aspects of Intellectual Property Rights, including Trade in Counterfeit Goods* (TRIPS) contain provisions directly affecting FDI.[2]

1. The principal relevant agreements

(a) *Trade-related investment measures*

Although this was one of the three new areas that was taken up in the Uruguay Round, the outcome of the negotiations on the TRIMs Agreement is undoubtedly much more modest than that in Services and TRIPs. In fact, the Agreement does not add to existing GATT obligations; rather it clarifies and provides a procedure that should ensure more effective compliance with the national treatment obligations of GATT (requiring that imports receive no less favourable treatment in regard to measures affecting their internal sale and use than that accorded to domestically produced goods), and with GATT rules on the prohibition of import and export restrictions (Article XI, "General Elimination of Quantitative Restrictions").

It was already clear at the outset of the negotiations that the mandate given in Punta del Este in 1986 did not envisage taking up directly key investment issues, such as the rights of establishment, national treatment of foreign companies and compensation in the event of nationalization. However, a long discussion did take place as to what were the trade-related investment measures that should be the subject of negotiation. In addition to the two major categories of measures that are explicitly covered by the final agreement, namely, domestic content and trade-balancing requirements, a substantial list of other measures was proposed by some countries for coverage. These included export-performance requirements, technology-transfer requirements, local equity requirements, remittance restrictions and investment incentives. In response, many developing countries suggested that improved international disciplines and forms of international cooperation should be negotiated with regard to restrictive business practices since, in their view, many of the measures in question were employed to offset such practices. By the time the Ministerial meeting was held in Brussels at the end of 1990, the differences in the area of TRIMs remained so wide that there was still no common negotiating basis. During the course of 1991, when the present text was negotiated, the major issue was whether export performance requirements would also be covered; this would have been an addition to the existing GATT rules and was not agreed upon in the end.

The TRIMs Agreement first clarifies that certain types of investment measures applied to enterprises, figuring on an "Illustrative List", are inconsistent with Articles III and XI of GATT. These essentially concern local content and trade-balancing requirements, but also cover restric-

tions on exports by enterprises. While such measures frequently arise in the context of FDI, TRIMs rules apply equally to measures imposed on domestic enterprises. The rules also apply both to measures affecting existing investments and to those applying to new investments. Second, the Agreement requires that all TRIMs inconsistent with GATT Articles III and XI and which cannot be justified under an exceptions provision in GATT, be notified to the World Trade Organization within 90 days of entry into force. Such measures, although inconsistent with existing GATT obligations, will then benefit from a period of time during which they will have to be phased out (two years for developed countries, five years for developing countries and seven years for the least-developed countries). Measures that can be justified under an exceptions provision -- notably, those relating to balance-of-payments measures -- are not affected by these rules. Moreover, these countries will have the possibility of obtaining an extension of the transition period where they can demonstrate particular difficulties. To avoid distortions of the conditions of competition between new investments and established enterprises already subject to a TRIM, members may apply the same TRIM to a new investment during the transition period. The third important feature of the TRIMs Agreement is that it provides for a review within five years, in the context of which consideration will be given to whether the Agreement should be complemented with provisions on investment and competition policy.

(b) Trade in services

The *General Agreement on Trade in Services* is of the greatest direct relevance to FDI because it covers four modes of delivery in its definition of trade in services, with commercial presence being the mode most directly linked with FDI. The modes of delivery are:

- supply from the territory of one country into the territory of another;
- supply in the territory of a country to the service consumer of another country;
- supply by a service supplier of a country, through presence of natural persons in the territory of another country;
- supply by a service supplier of one country, through commercial presence in the territory of another country. "Commercial presence" is defined as any type of business or professional establishment, including through the constitution, acquisition of maintenance of a juridical person or the creation or maintenance of a branch or representative office. It covers, therefore, FDI.

The provisions regarding commercial presence for the supply of services in a country's territory of companies and other persons of other member countries (FDI measures) concern most importantly the right of establishment and the treatment of such persons once established.

There are three categories of provisions in GATS with respect to measures affecting trade in services, including those carried out through the commercial presence of the supplier of another member country:

- The first set of provisions is applicable to all trade in services. The principal requirement is to give most-favoured-nation treatment to member countries, that is, to give treatment no less favourable than that accorded to similar services and service providers of any other member country. This obligation is subject to a once-off list of negotiated exceptions attached to the agreement that is subject to regular review and, in principle, must be phased out within ten years. Other obligations relate to matters such as the prompt publication of all laws and regulations and measures of general application affecting trade in services; the administration of all measures in a reasonable, objective and impartial manner; the availability of prompt, objective and impartial review and appropriate remedies of administrative decisions affecting trade in services at the request of an affected service supplier;

and the encouragement of mutually agreed, harmonized international criteria for the authorization, licensing or certification of service suppliers. With a view to ensuring that measures relating to qualification requirements, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, the Council for Trade in Services is required to develop any necessary disciplines.

- The second category of provisions concerns the specific commitments relating to market access and national treatment contained in the Schedules of Concessions of each of the member States. Market-access commitments relate to such matters as limitations on the number of service suppliers, on the total value of service transactions or assets and on the total number of services operations or quantity of service output, as well as commitments on measures that restrict or require specific types of legal entities or joint ventures through which a service supplier may supply a service or which limit the participation of foreign capital. Provision is also made for additional commitments to be negotiated, including those regarding qualifications, standards or licensing matters. The concession to give services and service suppliers of other member States national treatment in respect of a given service and mode of supply of that service is dependent on the inclusion of such a commitment in the Schedule of a member and is subject to any conditions or qualifications set out therein. Moreover, these Schedules also contain concessions with respect to market access through the various modes of supply, including that of commercial presence. Where specific commitments have been made, additional general requirements also apply: for example, the requirement to notify to the Council for Trade in Services any new laws, regulations or administrative guidelines significantly affecting trade in services and the requirement not to restrict international payments and transfers for current transactions, except in the event of balance-of-payments difficulties, in which case such restrictions will be limited, temporary and subject to conditions.

All members of the World Trade Organization are required to have Schedules of Services commitments. Close to 100 countries have already submitted them, and they have been attached to the *Agreement Establishing the World Trade Organization*. Least-developed countries have been given an additional period to submit their Schedules. The Schedules annexed in the Agreement differ considerably in length and coverage from country to country. It was recognized in the guidelines for the negotiation of initial commitments during the Round that such commitments by developing countries could be less comprehensive than others. No detailed analysis which would permit any general conclusions about the extent to which FDI issues are covered has as yet been made, but commitments on this subject are commonly found in the Schedules.

- The third category of substantive provisions in GATS consists of those found in various annexes relating to particular sectors of trade in services, including movement of natural persons, air transport, financial services, maritime transport and telecommunications. These provide exceptions, clarifications or additions to the general obligations in a way that takes into account the specific characteristics of services trade in those areas.

The Agreement is conceived as a framework that will permit the progressive liberalization of services trade through further negotiations. Although the initial commitments already attached to the Agreement are sizeable, further negotiations will take place at five-year intervals. Moreover, ministerial decisions taken at Marrakesh provide for negotiations in a number of areas, including those on the movement of natural persons, financial services, maritime transport and basic telecommunications, to resume without delay.

The Agreement is intended to facilitate the increasing participation of developing countries in world trade by providing for the negotiation of specific commitments on such matters as access

to technology on a commercial basis, improved access to distribution channels and information networks and the liberalization of market access in services industries and modes of supply that are of special export interest to them. It also requires developed countries to facilitate access by service suppliers of developing countries to necessary commercial and technical information. The Agreement recognizes that offers of market access by developing countries may be subject to conditions relating to these objectives, for example, on such matters as the strengthening of their domestic services capacity and transferring technology on commercial terms; it further provides flexibility for developing countries to pursue their own development priorities and open fewer industries or to liberalize fewer types of transactions in further negotiations, thus making explicit their right to extend market access in line with their development situation. Special provisions are made for the least developed countries.

(c) Trade-related aspects of intellectual property rights

The TRIPs Agreement does not deal directly with investment issues. However, it does deal with one important aspect of the legal environment affecting the conditions under which FDI takes place, namely, the protection of intellectual property, and this is an aspect that is particularly important for a number of knowledge-intensive industries (UN-TCMD, 1993b). The Agreement covers the main areas of intellectual property rights -- copyright and related rights, trademarks, geographical indications, industrial designs, patents, layout-designs of integrated circuits and undisclosed information or trade secrets. In respect of these areas it contains two main sets of substantive obligations:

- It lays down minimum standards of substantive protection of each category of rights that must be available in the national law of each member country. It does this by requiring that the substantive obligations of the main World Intellectual Property Organisation Conventions, the Paris Convention for the Protection of Industrial Property and the Berne Convention for the Protection of Literary and Artistic Works must be complied with, and by adding a substantial number of additional obligations on matters where these Conventions are silent or seen as being inadequate.
- The Agreement, for the first time in international law, requires member countries to provide within their national law effective procedures and remedies for the enforcement of intellectual property rights, whether through the normal civil judicial process, through customs action against imports of counterfeit and pirated goods or through criminal procedures in respect of wilful counterfeiting and piracy on a commercial scale.

Developed countries are required to meet their obligations under the Agreement within one year of its entry into force; developing countries within five years; and least developed countries within eleven years, with the possibility of an extension. Special transition arrangements apply in situations whereby a developing country does not presently provide product-patent protection in a particular area of technology, such as pharmaceuticals or agricultural chemicals.

Although the TRIPs Agreement is not designed to be a harmonization instrument -- it lays down minimum standards and does not get into detail in questions of procedures -- it will have the effect, over time, of leading to a closer similarity in the level of protection given to intellectual property in countries around the world and, therefore, in this aspect of the legal environment, affect foreign investors.

(d) Government procurement

The revised agreement on government procurement may be of some relevance to FDI issues since it not only requires that there must be no discrimination with respect to other signatories in

procurement covered by it against foreign products, services and supplies, but also that there must be no discrimination in covered procurement against locally established suppliers on the basis of degree of foreign affiliation or ownership or on the basis of the country of production of the goods and services being supplied by it.

The disciplines of the new agreement apply to the procurement specified in each member country's Schedule, which concern not only central government procurement of goods, but have also been expanded to the procurement of goods and services, including construction services, by central and sub-central government entities, as well as by public utilities. Compared to the existing agreement, the coverage of procurement under the new agreement will be a tenfold increase, to something in the order of $400 billion dollars. The procurement agreement is a plurilateral agreement in terms of the parlance of the World Trade Organization, that is, joining the agreement is optional for members of the World Trade Organization. The initial membership is likely to be less than that of the previous agreement, limited (with two exceptions) to the industrial world. The signatories of the agreement, however, hope that it will be possible, progressively, to expand its membership.

In the areas of intellectual property and trade in services, as in the area of trade-related investment measures, questions of restrictive business practices or anti-competitive practices were an important element in the negotiations. Both, the TRIPs and GATS Agreements contain provisions recognising that certain business practices may restrain competition and thereby have adverse effects on trade or impede the transfer and dissemination of technology. The TRIPs Agreement specifically recognises the right of members to take appropriate measures, consistent with its provisions, to prevent or control such practices. Moreover, both Agreements also contain provisions on consultations between members about the control of anti-competitive practices and cooperation through the supply of relevant information.

2. Dispute settlement

The Uruguay Round also reached agreement -- in the form of an "Understanding on Rules and Procedures Governing the Settlement of Disputes" -- on strengthening dispute-settlement mechanisms. The understanding does not specifically focus on FDI, but it is applicable to all areas covered by the World Trade Organization (more automatic adoption of panel reports and the possibility to request the review of a panel report by an Appellate Body). This mechanism is, of course, important for appreciating the legally-binding nature of the substantive obligations. The dispute-settlement system has been substantially reinforced, notably by the elimination of the means by which it has been possible for losing parties to be able to delay or block the dispute-settlement process. This has been done, on the one hand, by the introduction of stricter time limits for the different stages of the dispute- settlement process and, on the other hand, by providing that panel and Appellate Body reports and decisions authorising any eventual suspension of concessions against a member country failing to bring itself into compliance will be considered adopted unless there is a consensus against that adoption. The stages of dispute-settlement mechanism are: consultations between member countries; establishment of panel; first and second panel hearings; circulation and adoption of panel report; any review by the Appellate Body. The implication is that matters related to FDI, to the extent that they will arise in the World Trade Organization, are likely to be subject to disciplines that are backed up by effective dispute-settlement procedures.

* * *

During the course of the Marrakesh meeting, many ministers took the opportunity to put forward suggestions for new items for inclusion in the work programme of the World Trade Organization. In this context, a substantial number of ministers, representing a broad spectrum

of countries, both developed and developing, suggested an examination of the issue of trade and competition policy. This represents a significant development since, in the past, including during the Uruguay Round, there has frequently been considerable reticence on the part of some delegations about taking up the question of restrictive business practices.

B. The process of liberalizing foreign-direct-investment policies

While there are differences in the scope and depth of the liberalization instruments mentioned above, almost all of them share a common purpose, namely, to liberalize existing restrictions on FDI flows and the operations of transnational corporations (TNCs). In fact, in spite of the absence of a multilateral framework for FDI (Fatouros, 1994), unilateral, bilateral and regional efforts towards the liberalization of national FDI frameworks have led to a remarkable level of *de facto* convergence of government policy approaches towards FDI among countries from all regions.[3] Yet, the actual process of liberalization has been far from homogeneous. There are still considerable differences in the nature, breadth and depth of the measures taken, reflecting different political, economic and social priorities, as well as different degrees in the dismantling of State controls and planning and confidence in the ability of governments to guide businesses.

The process of FDI liberalization is embedded in a broader liberalization movement covering international trade in goods, external financial transactions, transfer of technology, the strengthening of intellectual property protection and, recently, services and some aspects of labour movement. Indeed, the trend towards the liberalization of FDI policies can be explained as a natural extension of a broader tendency to pursue greater economic efficiency through the elimination of market distortions caused by discriminatory governmental measures. Thus, the process of liberalization of FDI policies needs to be seen as part of the broader process of liberalization of international markets and cross-border movements of factors of production that is taking place simultaneously, to a varying extent, in many parts of the world. This process both allows the further development of -- as well as receives additional impetus from -- the emerging integrated international production system (chapter III): on the one hand, the liberalization of international economic transactions is a condition *sine qua non* for the integration of international economic activity and, on the other hand, new policy areas become subject of international attention and harmonization as integration deepens (Ostry, 1992).

While the trend of liberalizing FDI policies is pervasive, it is -- in its present strength and depth -- also relatively recent. There is still considerable lack of clarity as to its actual character and contents. The next sections seek therefore to clarify the meaning, and distinguish the various elements that constitute the notion, of liberalization of FDI policies and to examine how far that process has changed investment frameworks worldwide. The precise impact of liberalization on FDI flows and its relative importance compared to that of other factors and conditions that influence these flows is a separate issue that is *not* addressed here. The chapter does not also draw specific policy conclusions -- whether to recommend liberalization policies and, if so, under what conditions -- since these can only be reached after examining their effects in specific country and industry cases, having taken into account the risks that are often associated with them. However, it can be expected that, to the extent that FDI frameworks become similar as liberalization proceeds, specific differences that remain -- other conditions being equal -- may influence decisions as to the location or expansion of investment projects.

1. Conceptual issues

(a) Delimiting the notion of liberalization

While the focus of this chapter is on the process of liberalizing FDI policies, this process needs to be seen in the broader context of a liberal domestic economy. A liberal economy is generally understood as one in which policy and legal distortions to the allocation of resources by the market are minimal, with the government having the responsibility to ensure the proper functioning of markets. The removal of policy distortions regarding international transactions is an integral part of a liberal economy as it allows the realization of maximum gains from these transactions. One type of such transactions is FDI, the focus of this chapter. Establishing a liberal domestic economy and liberalizing international economic transactions -- including FDI -- are, therefore, conceptually and functionally interrelated and mutually supportive.

Liberalization can, as a first approximation, be equated with the elimination of governmental measures that are restrictive or discriminatory and, thus, market distorting. Total governmental control is generally incompatible with the very notion of the market; yet, total liberalization, in an extreme sense, could imply the absence of a functioning legal system. A normative framework is indispensable for ensuring the proper functioning of a market economy, and this entails the application of rules and controls. At the same time, liberalization is a dynamic process, moving in a certain direction. A country's pertinent policies and measures at a particular point in time can therefore only be described as more (or less) liberalized. As a result, the reference to a "liberalized regime" in what follows should be understood to mean "reasonably liberalized", that is to say, a regime that has gone a long enough way on the road to liberalization, so as to exhibit characteristics such as those enumerated later.

The concept of liberalization in the area of FDI denotes the tempering or removal of those market distortions that result from (a) restrictions applied specifically (and hence discriminatorily) to foreign investors; and (b) the granting or withholding of incentives and subsidies that discriminate in favour or against TNCs. It is possible to operate throughout with such an approach to the notion of liberalization, describing all elements of the liberalization process in the area of FDI in terms of the removal of restrictions or discriminatory treatment. Despite its consistency, however, this approach is of limited usefulness because it ignores facets of the liberalization process that are normally understood as involving the establishment of certain standards regarding foreign investors. In particular, key elements of the liberalization process, such as the grant of national treatment to TNCs, lose something of their particular character and function. It is therefore useful to proceed on the basis of the notion that an essential aspect of the liberalization process involves the adoption of certain positive standards.

Furthermore, the overall beneficial effects of the liberalization process depend, to a considerable extent, on the presence and, where necessary, the strengthening of controls aimed at ensuring the proper functioning of the market and promoting broader economic and social concerns. For instance, rules to assure competition and prevent abuse of market power need to be an integral part of a reasonably liberalized investment regime, as does the existence of an adequate regime for the protection of intellectual property. Similarly, prudential supervision of certain activities, such as banking and financial services, is necessary to ensure the reliability, stability and safety of the national financial system. The need to have appropriate health, safety, environmental and consumer standards is another illustration of necessary controls. And disclosure of information becomes more important for governments, consumers and other groups, since they have to be able to act in an informed manner. Meant to facilitate the function of the market, laws and regulations in these and other areas provide the framework within which enterprises conduct their

affairs. In order to be beneficial, the liberalization of FDI policies should be accompanied by the kinds of legal and policy controls that are compatible with it, or indeed may be conditions for it.

A clear distinction must also be drawn between policies aimed at liberalizing FDI and policies aimed at creating a favourable investment climate and, especially, attracting or promoting FDI. The distinction is not an easy one in practice. The two types of policies are closely linked, in a means-to-end relationship: a principal aim of current liberalization measures is to attract FDI. Liberalization, however, is not the only possible method to attract FDI, nor is it necessarily the most effective one under all conditions. In the past (and, in many cases, still today), a variety of restrictive measures (typically, tariff protection) have been used in order to attract FDI. In fact, favouring FDI can be as interventionist a policy as regulating it -- as, for instance, in the case of incentives and privileges offered selectively to TNCs.

A further difficulty in distinguishing between the two types of policies lies in the fact that, in addition to removing obstacles and restrictions to FDI, the liberalization process also includes a number of measures that are specifically addressed to FDI and reflect its special characteristics (e.g., special provisions for the free transfer of funds outside a host country).

In sum, a working definition of the FDI liberalization process includes the avoidance of discriminatory market-distorting measures by tempering or eliminating restrictions on, and special incentives to, TNCs by governments, the establishment of certain positive standards of (equal) treatment and protection for foreign affiliates and the introduction of certain controls and prudential supervision to ensure the proper functioning of the market (figure VII.1). The present discussion focuses first on the restrictions and special incentives to be eliminated or tempered, and then proceeds to the standards of a liberalizing FDI regime, to conclude with a summary appraisal.

(b) *Removal of distortions*

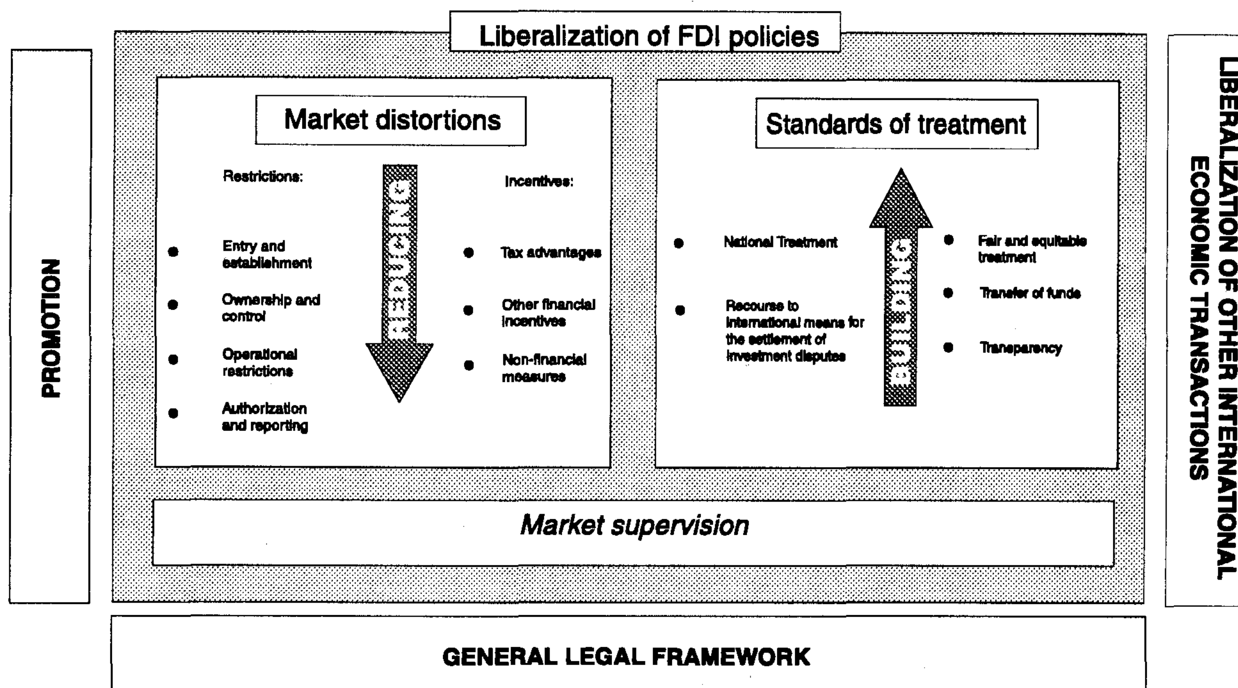
(i) *Restrictions*

Any classification of restrictions on FDI is, to some extent, arbitrary, since fully consistent criteria do not exist. Particular measures and policies usually have more than one purpose or effect, so that significant overlaps between categories cannot be avoided. All that can be attempted here is to review a number of policies and measures that are of importance, with an emphasis on their rationale and function.

Entry and establishment. A first category of restrictions whose elimination is the hallmark of a liberalized FDI regime is that of restrictions on entry and establishment of FDI. Such restrictions generally seek either to limit FDI or to channel it in order to determine or influence its likely effects, with a view to ensuring that the economy andor certain important sectors are not dominated by foreign affiliates. The underlying rationale is the desire to keep the principal benefits from FDI in the hands of nationals of the host country and simultaneously exercise decision-making control over the use of that country's assets. Foreign affiliates are assumed to be less likely to act in response to considerations of host-country national interest, and to be less subject to national governmental or political influence or control. (Proponents of liberalization challenge, of course, both the validity of such assumptions and the desirability of ensuring a degree of national control.)

The explicit purposes of such restrictions vary. One major category is the protection of national security, public order and vital national interests. These considerations tend to be regarded as natural exceptions to the general principles of liberalization and, as such, it is unlikely that they will disappear in the foreseeable future. Since, in the absence of an international

Figure VII.1. Main elements of a favourable investment climate



Source: UNCTAD, Division on Transnational Corporations and Investment

framework for FDI, the determination of what constitutes a matter of public order, or a threat to national security and vital national interests, is left to the discretion of the host country, such considerations may be interpreted narrowly or more broadly. And as this is the most widely accepted and the most "respectable" ground for restrictions on FDI, host countries may sometimes invoke it in order to exclude investments not wanted on other grounds. Restrictions on entry may also be directed at specific countries, as part of policies adopted for political reasons. The economic and social objectives of the host country are another major category of purposes served by such restrictions. In developing countries, in particular, restrictions on FDI are often used to promote specific development objectives.

No country today excludes FDI altogether. Restrictions on entry are generally partial. Typically, they are intended either to exclude or limit FDI from specific industries or activities, or to determine specific characteristics or influence of investments. Such restrictions tend to be justified on the basis of the strategic importance of the activities involved for the host economy or, sometimes, with reference to particular industries or geographical locations, on national security grounds.

Ownership and control. A second category or form of restriction affecting FDI are ownership requirements, especially limitations on the percentage of equity foreign investors are permitted to own in local enterprises (in all sectors or more often in specified industries or activities) or requirements of local participation in the management of an enterprise (e.g., creation of joint ventures). A variety of methods has been used to ensure local participation in the internal decision-making of foreign affiliates.

Other restrictions of a similar character may also be imposed. Fade-out (disinvestment) requirements and requirements concerning the reinvestment of profits fall essentially in the same general category of direct restrictions on FDI, although they are no longer in use.

Operational restrictions. Restrictions may also be imposed on a foreign affiliate concerning its operations after it has been established. Their purpose is to reduce negative impacts and increase the benefits to be derived by the local economy from the operation of a foreign affiliate and to determine in specific terms some of the precise effects of such operation.

Such requirements may involve limitations on the employment of foreign managerial, technical or (less frequently) other types of personnel, priority employment of local labour and, in some instances, restrictions on access to local raw materials and supplies. They may also involve the imposition of performance requirements aimed at the promotion of exports, import substitution, or the encouragement of local production (e.g., through local content requirements). Such requirements may be imposed at the time of entry as a condition for allowing the investment, or they may, more often, be linked to the offer of positive inducements, such as tax incentives; some of them had recently become more common, as substitutes for more rigid entry requirements. After the conclusion of the Uruguay Round agreement on trade-related investment measures, they have become subject to effective international disciplines (Greenaway, 1992, Guisinger, 1989; Symposium on TRIPs and TRIMs, 1990; UNCTC and UNCTAD, 1991).

Authorization and reporting. A fourth category of measures, whose restrictive effect depends on several factors, are those concerning authorization, registration or reporting in connection with various aspects of an investment. Certain distinctions must be made in this connection:

- Restrictions on entry and ownership may be applied on the basis of a screening process, a procedure whereby an investor's projects are assessed by the competent government agency in order to grant or deny authorization to invest.
- Authorizations and permits may also be needed for a variety of other purposes of varying importance, such as transfer of technology, importation or exportation, or to operate in certain activities.
- Registration or reporting are in principle less restrictive measures than authorization. They may be intended to enhance transparency, for general purposes (e.g., statistics), or in order to cope with certain aspects or effects of an investment, for instance, when seeking to determine the amount of funds (revenues or capital) that foreign investors will be entitled to transfer outside the country, or, of course, in response to environmental or consumer-protection concerns.

The actual restrictive effect of reporting requirements depends, in large part, on the mode of operation and the efficiency of the host country's public administration. When coupled with explicit or implied requirements of authorization, they may have a restrictive effect, often depending on the degree of discretion allowed to the pertinent authorities. Bureaucratic requirements and procedures may bring about delays and other restrictive effects (Wint, 1992).

(ii) Incentives

A second category of market-distorting (and sometimes indirectly restrictive) measures consists of tax or other incentives designed to attract and encourage FDI. Broadly speaking, investment incentives are government measures designed to influence the size, location or industry of an investment by affecting its relative cost or potential for profit, or by altering the risks attached to it (OECD, 1989). Investment incentives may be aimed at foreign firms, domestic enterprises, or both. Where such incentives are available to foreign investors only, they are

discriminatory in nature and, thus, introduce distortions to market mechanisms. Evidently, when they are offered to foreign investors, such measures are intended to favour and attract rather than limit FDI, and they differ significantly from those mentioned earlier.

The main categories of investment incentives include tax incentives (e.g., tax holidays, investment allowances, tax credits, lower tax rates) (Larkins, 1991); other financial incentives, such as grants, preferential loan rates, loan guarantees, tariff concessions and priority access to credits, and non-financial measures, including the provision of infrastructure and business services. The cost-effectiveness of incentives is measured by the increased levels of the desired investment attracted, less the cost to governments (e.g., in terms of the loss in revenue). A review of the evidence (e.g., Guisinger et. al., 1985) suggests that, overall, incentives do not produce an efficient allocation of investment. In fact, whether incentives are successful and effective in attracting FDI has been a matter of extensive debate (Lim, 1983; Hughes and Dorrance, 1987).

In addition, incentives frequently have indirect restrictive effects. They are usually offered only to enterprises meeting certain conditions. They therefore require application or screening procedures and may be used (as they often have been in the past) in return for performance requirements, or as an indirect means for regulating or channelling FDI. Foreign investors may nominally be allowed to invest freely in the country concerned, but investors that meet additional conditions, frequently similar to those related to entry and ownership conditions mentioned above, are, subject to various kinds of approvals, granted special treatment -- tax concessions and deferrals, exemptions from customs duties, guaranteed free transfer of funds, or guarantees against unfavourable treatment (e.g., expropriation). Where such incentive systems exist, foreign investors generally prefer to use them and avoid taking the simpler, but less attractive, route of free entry, without special promises. Control through the offer and administration of incentives may be an effective substitute for direct controls over FDI. Although it is possible to establish incentive schemes with minimal regulatory (and restrictive) effects, such practices have not in fact been much in use in the recent past.

* * *

As already mentioned, in a liberalizing FDI regime, market distortions are tempered or eliminated. But the process should not be measured in simple arithmetical terms. In other words, the real outcome cannot be found through mere catalogues or simple calculations of which and how many restrictions or incentives have been eliminated and how many still remain. The relative importance of the various measures enumerated differs widely depending on the broader legal and economic framework and the quality of public administration of the country concerned. Moreover, the situation may vary significantly between sectors. Restrictions may persist in certain sectors while others may be fully liberalized.

(c) *Standards of treatment*

Most of the measures listed above may be addressed solely to foreign investors, whether defined in terms of the nationality of the investors and enterprises involved, or in terms of the origin of the capital. Some market-distorting measures (e.g., entry requirements, discriminatory incentives) are almost necessarily so addressed. In other cases, however, both foreign and domestic investors may be affected; for instance, certain sectors may be closed to all private investment, reporting may be required of all investors and export requirements may be imposed on all. While equality of treatment as between domestic and foreign investors -- that is to say, for most purposes, the standard of national treatment -- is undoubtedly a very significant part of the

liberalization process, it does not exhaust the process. The notions of national treatment and liberalization process are not synonymous.

National treatment. The granting of equality in the treatment of nationals and aliens, especially foreign affiliates, i.e., the national-treatment standard, is an indispensable element of the liberalization process. While there are variations in the formulation of that standard in specific instruments,[4] the basic concept of national treatment is that, in principle, foreign affiliates and domestic firms in similar situations should receive the same treatment, regarding such things as establishment, ownership and control of enterprises, full access to courts and other authorities and equal protection under the law, as well as taxation, labour law, consumer protection or protection of the environment, and free access to credit facilities, or even government aid to enterprises (box VII.2). Such a listing covers most of what is usually meant by liberalization. Limiting the access of aliens and foreign affiliates to the legal process, imposing burdensome requirements for the recognition of foreign companies, denying aliens the right to hold real property and other similar restrictive measures have sometimes been left over from earlier times, when the law treated aliens and foreign companies with a high degree of distrust. In other instances, probably a minority by now, they reflect the same effort to limit and control foreign investments that other measures described here also involve.

On the other hand, equality of treatment with host-country nationals and companies may not, in a number of cases, address some pertinent problems adequately, especially where the situation of foreign investors is significantly different from that of domestic firms, as is the case in the transfer of funds abroad. The measures needed in such cases have to move beyond mere equality of treatment, although they are generally understood as being covered by the notion of liberalization. Traditional, formal definitions of national treatment take care of most such problems by limiting application of the standard to "like situations" and by formulating the standard in terms of treatment "not less favourable than" that of nationals.

Such issues raise important conceptual and practical problems. This is particularly true in the case of **the free-transfer-of-funds requirement.** Where they still exist, exchange restrictions are general in character, that is to say, they apply to local as well as foreign enterprises. No formal discrimination against foreign investors is then necessarily involved in their application. A liberalization of FDI policies, however, is usually understood to cover the elimination of exchange restrictions to the extent that they affect FDI, on the ground that, generally speaking, the conditions of local and foreign investors and enterprises are significantly different with respect to questions of foreign exchange and funds outside the host country. For one, the headquarters, or profit centres, of local firms are by definition in the host country. At the same time, provision for the free transfer of funds means in reality, at least in principle, a guarantee to that effect. The host government undertakes not merely to allow investors to find foreign exchange, but to ensure that they find it. Moreover, procedural and other requirements, including the need for general or ad hoc authorizations and permits, generally intervene in the administration of such measures, so that in practice it is sometimes hard to distinguish between measures favouring (or privileging) investors and restricting them.

Other cases in the same broad category may be more controversial. For instance, in recent years the argument is increasingly advanced that, on lines essentially similar to those just mentioned (i.e., the specific character and needs of FDI), foreign affiliates should have free access to **international arbitration for the settlement of disputes between them and the host State**, over and above the access to the local judicial and administrative machinery which they may have through the operation of a generalized national treatment principle. The specificities of FDI to which this claim corresponds are usually not spelled out in any detail. They may be understood to refer, on the one hand, to the likelihood that local courts and tribunals may lack the specialized competence in modern business law issues that an arbitration tribunal may provide and, on the

other, to the fact that, the investors not being nationals of the host country, do not normally participate in national political processes and are more likely to be discriminated against by national authorities and tribunals. At any rate, provisions on international arbitration on FDI matters, whether under ICSID auspices or otherwise, have found their way in numerous bilateral and multilateral agreements, so that the practice is becoming *de facto* established.

Similarly, a foreign investor's access to a host country's legal process and legal protection, part and parcel of national treatment as well as of liberalization, is in many instances strengthened by corresponding undertakings at the international level. To the extent that the (mostly conventional) international legal norms and concepts that have been developed, such as **fair and equitable treatment**, are now adopted in national legislation as well, it would appear that specific standards of legal protection, stronger or more specific than those applicable to nationals, are emerging.

Transparency of laws, regulations and administrative practices. The effective functioning of the liberalization process requires that reliable information about FDI policies and practices is available. Transparency relates to the need for disclosure and clarity of all government measures that affect the operation of foreign affiliates in a host country. In that sense, transparency involves the publication within a host country of relevant measures in whatever formal manner is provided by national law, and they are to be made available to interested persons within the bounds of the customs and practices prevalent in the country concerned. A gradual approach to the achievement of transparency would involve the elimination of deliberate administrative obfuscation and

Box VII.2. National treatment as defined in the General Agreement on Trade in Services of the Uruguay Round of Multilateral Trade Negotiations

One of the most recent formulations of the standard of national treatment in a multilateral instrument relating to FDI is that contained in Article XVII of the General Agreement on Trade in Services (December 1993) which was approved by consensus. Article XVII states:

"1. In the sectors inscribed in its schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.

2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service providers.

3. Formally identical and formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or services providers of any other Member."

Source: GATT, 1994.

secretiveness. Important is also a system of formal publication of laws and regulations. Notification or other special forms of publication may be feasible only with respect to limited, precisely defined issues and types of measures.

2. How far has the liberalization process gone?

A detailed survey of the current situation with respect to normative frameworks on FDI is not undertaken here. Yet, drawing on surveys and a review of other pertinent data (European Round Table of Industrialists, 1993a, 1993b; UNCTC, 1992a, 1992d, UN-TCMD, 1993b; UNCTAD-

DTCI, 1993a, 1994a; USTR, 1992; World Bank, 1992; OECD, 1992d and 1993f), it is possible to provide a reasonably faithful summary account of the extent to which the liberalization process has gone today, starting with the elimination or decrease of market distortions and moving to the establishment of standards of treatment.

(a) Market distortions

(i) Restrictions

Entry and establishment. Today, all countries admit FDI in principle, i.e., total prohibition of FDI no longer exists. On the other hand, no single country (even amongst the strongest advocates of a liberal FDI regime) grants an unrestricted right of entry to all sectors and activities. It is difficult, however, to make generalizations about the types of industries that remain restricted, as these vary considerably from country to country.

In the developed countries, some activities in the natural resources sector that had traditionally been kept in the hands of the State, have been liberalized, although many restrictions remain (e.g., in the fishing, mining, oil and energy industries). The manufacturing sector of these countries is now practically open to FDI, while many of the restrictions and regulations previously maintained in the services sector are being gradually lifted (some restrictions remain in a few, but important, services industries, such as telecommunications, maritime, land and air transport, media activities and professional services) (UN-TCMD, 1993b; OECD, 1992d; Khan, 1990) (table VII.3).

In the developing world, the picture is more complex and diverse. The liberalization process of the 1980s has been selective, with a tendency to focus mainly on export-oriented manufacturing industries, or projects involving advanced technology. Gradually, other manufacturing industries have been opened to FDI. Access to certain services industries traditionally closed or restricted to FDI has started to be liberalized, although, in general, the liberalization of services has not yet reached the levels typically found in developed countries, other than within regional integration schemes. More recently, certain restrictions in the natural resources sector have been lifted, including through privatizing what had been nationalized in previous decades (UNCTC, 1992a, 1992d; UNCTAD-DTCI, 1993a, 1994a) (box VII.3 and table VII.4).

It is likely that the process of liberalization initiated in all sectors will continue in the future, supported by regional and multilateral initiatives aimed at achieving that goal. For example, the adoption of the European Energy Charter Treaty, currently under negotiation, could have major implications for the liberalization of the energy industry of Eastern Europe. Similarly, the recently concluded agreement on trade in services within the framework of the Uruguay Round of Multilateral Trade Negotiations will provide impetus for the removal of additional restrictions in services industries, both in developed and developing countries (GATT, 1993).

Ownership and control. Compulsory majority and minority shareholdings have lost importance over the years as a means of restricting the entry of FDI. Most developing countries that used to impose such restrictions across the board now generally allow full ownership of foreign affiliates. However, ownership limitations continue to be used as a means of restricting FDI in specific industries and activities. Developed countries sometimes use restrictions in shareholding to limit access in privatization cases or in services industries (e.g., telecommunication, broadcasting, air transport) that have not yet been completely liberalized. Moreover, some countries, both developed and developing, continue to impose limitations on the number of foreign firms allowed in certain industries, such as banking, financial, professional, telecommunications, air transport and broadcasting.

Table VII.3. Restrictions on main industries in developed countries, mid-1992

country	Banking	Insurance	Radio	Telecommunications (post and telephone services)	Road transport	Rail transport	Air transport	Marine transport	Mining	Oil andor gas	Fishing and fish processing	Real estate	Tourism	Audiovisual work (inclu-ding film distribution)	Publishing	Public utilities (including energy, water, gas and electricity distribution)	Gaming, casino, lottos and lotteries etc.
Australia	LR		L	L		C	L		L a	C	L a	L	L	L	L	C	L a
Austria	R	R	C	C	C	C	C	L	L	L	L	L	LR	L		L	C
Belgium	R	R		L	C	C	L	L		C	L		R			C	
Canada	LR a	RL a	L	L	C	C	L	L	L a	L a	L a	L a		L a	L a	L a	
Denmark	R	R	L	L	C	C	L	L			L					C	
Finland	LR a	R	C	L	R	C	L	L	L		L					C	C
France	LR	LR	L	L	R	C	L	L	L	R	L a		R	R	LR	L	L
Germany	LR		L	L	C	C	LR	L a									C
Greece	LR	LR	C	C	C	C	C	L	L	C	L	L	R			C	C
Iceland	L	L a	L	C		C	L			C	C	L	L			C a	
Ireland	LR	LR		C		C	C	LR			C					C	
Italy	LR	LR	C	C	C		LR	L	R		L		R			C	C
Japan	LR	L	L	L		L	L	L	C	C	L					L	
Luxembourg			C	C	L	L	L									C	
Netherlands	LR	L	L	L	C	C	L	L			L					C	
New Zealand			L	L		C	L	L			L						
Norway	LR	LR	C	L	C	C	L	L			L		L			C	C
Portugal	LR	L	L	C		C	C	R						L		C	
Spain	R	R	L	L		C	L	L				L				C	L
Sweden	L	L	L	C		C	L	L									C
Switzerland	R	L	L	C		C	L	L				L		C		L	
Turkey	LR	LR	C	C		C	L	L			L		L			C	C
United Kingdom	R	R	L	L		C	L	L	L		L		L			C	
United States	R	R a	L	L		C a	L	L	L		L	R a				L a	

Source: OECD, 1992b.

Key: L = Limited. R = Reciprocity. C = Closed (including monopolies).

Note: This table covers mainly measures upon establishment that are regarded as restrictions in the sense of OECD Code of Liberalisation of Capital Movements and not covered by the general authorization procedures.

a Measures at a sub-national level.

Box VII.3. The changing regulatory framework for foreign direct investment in mining: a study in liberalization

During the 1980s and early 1990s, major policy and regulatory changes have taken place in many countries intended to promote FDI in mining. At the same time, the introduction of stricter environmental protection requirements, especially by developed countries, has affected a number of important conditions and mining management practices.

In the early 1980s, the main features of the FDI regimes in the mining industry can be summarized as follows (Brown, 1986):

- *In developing countries:*

- Exploration by TNCs was permitted, but security of tenure linking exploration to mining was weak.
- Foreign direct investment in mining was allowed but often only with majority or minority participation by either State enterprises or local private investors.
- Ownership and control were restricted mainly in order to avoid politically unacceptable exploitation of the national resources endowment by TNCs; developing host countries firmly upheld the principle of national sovereignty over natural resources.
- The terms of an investment agreement normally included conditions aimed at fostering broader goals of national and local development.
- Fiscal regimes were designed to encourage upstream and downstream linkages to the national economy (e.g., import duties on equipment and export duties on ores and concentrates).
- Tax levels were relatively high, strict foreign-exchange controls were in effect, repatriation of profits was limited directly or indirectly and substantial withholding taxes applied to the repatriation of dividends and interest.
- Environmental obligations were minimal.

- *In the countries of Central and Eastern Europe:*

- Exploration was closed to TNCs.
- Foreign direct investment in mining was usually limited to investment agencies of other countries of the region, and involvement by private transnational mining companies was restricted to occasional sales of essential technology, equipment or purchases of surplus minerals.
- The State held the ownership rights of all mines.
- Investment decisions were based on planned industrial demand, not on profit potential.
- Where fiscal systems applied, they emphasized income distribution in such a way as to remove all economic rent.
- Environmental obligations were minimal.

- *In developed countries:*

- Exploration was open to all corporations.
- Foreign direct investment in mining was allowed (except for certain "strategic" minerals), although often the investment had to be made through a locally incorporated affiliate or through a joint venture arrangement with a local company.
- The ownership and control of an investment could reside with the foreign affiliate.
- Exploitation was guided by market economy principles.
- Tax levels were relatively low.
- Environmental obligations were moderate.

Since the mid-1980s, over 75 countries have either adopted new mineral laws, made major revisions to existing laws or are currently working on draft legislation. [a] While the basic legal frameworks applying to FDI in the mining industry vary considerably from country to country, some general trends are clearly discernible (Otto, 1992a; Gabre-Maryam, 1989; Melo, 1989; Radetzki, 1986; Waelde, 1991).

- *In developing countries:*

  - *Ownership restrictions.* Increasingly, most countries favour a risk-free and competitive fiscal take, as opposed to getting involved in the mining venture through a share in the equity of a foreign affiliate. Where an equity stake is required, the trend is towards the State or a local private enterprise taking a minority participation by means of "carried interest". Under a carried-interest type of arrangement, the share of equity of the State or local enterprise is paid for through a loan from the foreign affiliate; the loan (plus interest) is repaid from the dividends of the State or local enterprise after production has started and profits are being made.[b] Governments interested in a minority equity participation have moved towards investment options which they can exercise either at the mining-decision point or after mining has commenced. Many governments have come to the conclusion that mandatory majority government equity participation requirements can lead to lower levels of sectoral investment and tax returns. Other than in exceptional "bonanza" situations, it is uncommon today to see governments asking for and receiving free equity.
  - *Operational control.* The trend has been to move away from government control arising out of equity participation towards requirements imposed through legislation or agreements. For example, at the exploration stage, a government-approved exploration plan may contain, by law, a minimum expenditure requirement or performance bond.

The movement towards a more open market system is evident. Many developing countries have backed away from former policies intended to promote upstream and downstream linkages in mining. Stringent requirements for local downstream processing of minerals and high levels of import duties on essential equipment are becoming increasingly rare. Likewise, on the export side, previously high export duties on raw ores and concentrates (with the intent to encourage local processing to add value) have fallen. [c] Restrictions on the repatriation of earnings and capital originating from the mining industry have also tended to diminish.

- *Exploration rights.* The search for commercial ore bodies has become increasingly complex over time as relatively-easy-to-identify surface deposits become scarcer. Modern exploration methods and efforts require larger areas and longer time spans than did the simpler methods of the past. Most new legislation and recent agreements have taken this into account; the maximum size of an exploration area, if at all specified, is now generally larger and the exploration period is either longer or a provision is made for a succession of renewals. The security of a right to explore has been strengthened, with many codes now recognising that right as exclusive within the respective exploration area. In many cases, exploration rights are not restricted to a single, named mineral. Most of the new and emerging mining regulatory systems require either an approved exploration workplan or impose a minimum exploration expenditure requirement.
- *Linkages between exploration rights and the right to mine.* Linkages between the exploration right and the right to mine have also been strengthened in many codes. Most countries, however, do not automatically grant the right to mine to a successful holder of an exploration licence. The grant of the right to mine is usually conditional on the investor meeting a number of predefined requirements. Such requirements vary widely from country to country but, in general, address issues such as whether the investor has the technical expertise and financial means by which to commence and carry on mining. Most codes and agreements contain conditional provisions, whereby the investor must submit and gain the approval of a variety of key plans (e.g., mine plan, marketing plan, environmental protection plan, feasibility study) before a mining right is granted. In some cases, the mining right is granted but does not come into force until the requisite plans are approved. While

the approval of such plans is, in most cases, discretionary, there is a growing tendency to impose some limits on this discretionary power and afford a means of appeal or recourse to arbitration. Most new mining codes now contain increasingly detailed reporting requirements for both the exploration and mining phases.

- *Fiscal regime*. The trend has been to reduce fiscal requirements. In the 1990s, many countries appear to be moving towards adjusting the effective level of taxation to be competitive with the following emerging baseline:
  - income tax rate at around 35 per cent;
  - provision for accelerated depreciation and carrying forward losses;
  - interest and dividend withholding tax at around 15 per cent or less;
  - royalties based either on profitability or no more than five per cent of the value for base metals; and
  - low levels of, or exemption from, import and export duties.

It should be noted that fiscal systems vary considerably from country to country, but the general trend is towards an overall lower effective tax burden than that in effect during the past several decades. In some cases, developing countries have moved to attract increased investment by offering sector-specific fiscal incentives, investment guarantees, long-term tax stabilization and foreign exchange guarantees.[d]

- *Environmental obligations*. The number of environmental laws has increased considerably throughout the developing world. However, only a handful of these laws address specifically the mining industry in detail. An important objective in most mining regulatory schemes is to manage the environmental consequences of mining at a level acceptable to the host country. In a competitive environment, measures that policy makers in developing countries perceive as dissuading FDI, such as costly environmental protection regulations, may not be passed or, if passed, may fail to be implemented or enforced. The trend in developing countries during the 1980s was to put emphasis on introducing enabling legislation and not to impose burdensome regulations which might dissuade FDI.[e]
- *Legal protections and guarantees*. Mining tends to be a lengthy affair and it is recognized that there is a high likelihood that sometime during the life of a project a disagreement will arise between the foreign investor and the host country government. Many recent agreements provide for international or technical arbitration of specified disputes.[f] Additionally, many countries have now entered into various bilateral and multilateral investment treaties that accord investors some forms of protection against unilateral actions by host country governments.

The developing country nationalizations that took place in the late 1960s and early 1970s were in part caused by a belief that the TMCs were exploiting the national mineral endowment with little benefit flowing to the country (Jodice, 1980). The advent of new mining technologies which further reduce multiplier effects through reduced forward and backward linkages with the local economy may focus the attention of policy makers on the direct fiscal benefits. The risks associated with FDI arrangements, which may come to be viewed as skewed in the investor's favour can, to some extent, be managed by making provision in the laws or agreements to allow for periodic reviews to reexamine the allocation of the mining revenues between the government and the company. However, in the early 1990s, some companies have moved away from agreeing or desiring such provisions favouring instead provisions which guarantee the stability of all investment terms.

The general trends described above are not of course applicable to every developing country. While there may be similarities between the types of changes affecting investment in the mineral industry taking place in some countries, the pace of change varies considerably from country to country. Each country's approach is unique. Some developing countries have only recently begun to effectively allow FDI in mining. For example, in Asia, both China and Viet Nam initiated legislative drafting efforts in the early 1990s specifically targeted at attracting and managing FDI in mining industries. India

announced a new national mining policy in 1993, partially opening up its mineral industry which until then -- and to an extent also after the policy -- remained closely regulated. In Africa, Mozambique has introduced a new mining code allowing FDI and, in the Caribbean, Cuba has also begun promoting FDI to bolster its mineral industry.

- Central and Eastern Europe

The economic reforms in Central and Eastern Europe during the 1980s and early 1990s have affected the natural resources sector and have led to important changes in the mining FDI regime and in related tax regimes. Thus, new mining laws have been adopted in Poland, the Slovak Republic and Hungary, while most other countries in Central and Eastern Europe have begun to prepare or revise new legislation allowing FDI in mining. Progress to allow FDI in mining in the successor States of the former Soviet Union has been slow (Humphreys, 1994).

A problem faced by many countries in the region is that, although FDI is now allowed in principle, in practice the necessary legislation and administrative frameworks have yet to be put in place. Furthermore, in order to commence mining, an investor has to comply not only with the mining law, but with other laws as well. These regulate important matters associated with the establishment and operation of a foreign affiliate, such as conditions of establishment, taxation, national security, labour, safety, access to land, transportation, environment and foreign exchange controls. Where new laws affecting FDI have come into force, administrative procedures are, in some cases, inadequate or lagging the legislation.

Although many of the countries in the region had allowed FDI in mining by the beginning of 1994, most have not yet defined the associated tax structures. Moreover, policy makers have been slow to develop fiscal regimes aimed at attracting FDI while ensuring reasonable tax revenues for the government. In some countries, the lack of an integrated and compatible free market legal system has been sidestepped by the use of all-inclusive mineral agreements.

- Developed countries

In developed countries, most countries with substantial mining industries (e.g., Australia, Canada, United States) allowed TNCs relatively free access to their mineral industries during the 1980s. While a few countries maintained some barriers, such as maximum foreign ownership restrictions (Australia) and kept certain "strategic" minerals off-limit to foreign investors,[g] these were not as substantial as restrictions typically imposed elsewhere in economies in transition and developing countries. However, a number of new regulatory measures aimed at protecting the environment emerged during the 1980s. Looking at the mining environmental regulations in Australia, Canada and the United States, it is clear that they are becoming increasingly comprehensive, stringent and complex and are imposing increasing restrictions and prohibitions on exploration, mining and processing. The environmental approval process is becoming more comprehensive and often leads to approval delays; liabilities and penalties for non-compliance have greatly increased, and environmental agencies are becoming more resolute in identifying and prosecuting offenders. Public attitudes are also changing in the same direction (IWGMI, 1993b, 1993c, 1992).

Fiscal trends in developed countries are not straightforward. While some countries have implemented measures to reduce effective tax rates, others have raised taxes.[h] In part, these raises may reflect policy decisions supporting a perception that the current generation of investors needs to recompense governments for cleaning up long abandoned mine sites. Even with the rises seen in the 1980s, the overall effective tax rates remain lower in the major mineral-producing developed countries than in many developing countries (IWGMI, 1993a).

Looking forward

The competition between nations for exploration and mining investment has resulted in a realisation by many countries that they must have a regulatory and fiscal system which is at least as favourable as that offered in other countries with similar geological prospectivity. Today's mineral-development

market is an investor's market. Mining companies now have more options to choose from than at any time during the earlier part of the century. For those who follow the school of thought that emphasises bargaining power as a key determinant shaping the terms offered by countries to foreign mining firms (Smith and Wells, 1975), it should be noted that the power of these firms has been rising in the early 1990s, while that of governments has declined.

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a According to a list compiled in February 1994 by the Centre for Petroleum and Mineral Law and Policy, University of Dundee, United Kingdom.

b Indonesia, Mali and Papua New Guinea have opted to retain terms that require an investor to offer phased equity participation to either the government or local private investors on a carried or working interest basis. This requirement typically comes into force at the mining phase rather than during exploration.

c For example, prior to 1991, Malaysia imposed high export duties on raw ores and concentrates. In an effort to promote increased FDI in the mining industry, almost all such export levies were reduced to a zero-level assessment rate.

d For example, Argentina, Colombia, Indonesia, Mexico, Venezuela and Zimbabwe have improved their mineral investment regimes in recent years (IWGMI, 1992, 1993a).

e For a description of the problems encountered in drafting and implementing environmental mining legislation in developing countries see Otto (1992b). Illustrative case studies of mining environmental regulation in Mexico and Chile highlight the difficulties of moving towards more stringent regulation in developing countries (IWGMI, 1992).

f For example, arbitration under international rules or international arbitral bodies is provided for in the 1993 version of the Indonesian Contract of Work, the 1987 MaliUtah International Syama gold project agreement and the Papua New Guinea model mining agreement.

g Such as the coal industry in the United Kingdom.

h Corporate income tax rates have decreased over the past ten years in Australia, Canada, South Africa and the United States. However, other types of taxes have risen, and some income tax deductions and credits have been reduced or eliminated. For example, Australia has imposed a royalty on gold and in Canada, the federal mineral depletion allowance has been eliminated and investment tax credits have been reduced.

Restrictions affecting the structure of control in foreign affiliates continue to be used in developing countries, and less frequently in developed countries, particularly in large investments in industries or activities of crucial strategic importance for the local economy. They are also used in cases of privatization of public monopolies in which the State continues to play a role. A common instrument of internal control is the granting of "golden" shares to the host government; this, among other things, permits the government to appoint a certain number of members on the boards of directors and to intervene if a foreign investor captures more than a certain percentage of the investment. In addition, it is still not uncommon for developing countries to impose restrictions on the national composition of management, or to require local participation in the management of a foreign affiliate.

Another modality of FDI restrictions that was used in the past by developing countries (in particular by the Andean countries, as part of the common regime for FDI promulgated by the Andean Pact) consisted of "fade-out" requirements, whereby foreign investors were obliged to pass on the investment to national hands over a specified period of time (normally 10 to 15 years). With the change of the Andean Pact regulations on this point, "fade-out" requirements have virtually disappeared (UNCTAD-DTCI, 1994a).

Operational restrictions. Restrictions on the employment of aliens are ubiquitous, most often on the basis of general legislation on immigration and employment rather than of laws

Table VII.4. Changes in the regulatory and policy framework for foreign direct investment in the mineral industry of Mexico, 1980 to 1993

Changes in policy and legislation	Changes in the fiscal regime
In the late 1980s large areas of the national territory previously designated as national mineral reserves (that is, unavailable for exploitation by foreign investors) began to be opened.	Since 1989, tax laws have been changed to recognize problems caused by inflation.
Beginning in 1988, a number of parastatal mining companies were put up for bidding to the private sector (of about 50 such companies, about 30 parastatals remain).	The withholding tax affecting foreign companies was reduced in 1989, from 50 per cent to 35 per cent.
Prior to privatization, parastatals held monopoly rights to mine several types of minerals. An increasing number may now be mined by the private sector.	Major tax reforms began in 1989 resulting in lower tax rates and a significant reduction in effective corporate tax rates.
Despite the Constitutional ownership limitation on FDI in mining operations (49 per cent for most minerals, 34 per cent for iron ore and coal), new regulations provide mechanisms whereby foreign participation can be significantly increased; since 1989, up to 100 per cent foreign ownership is possible.	The production tax of 5 per cent on base metals and 7 per cent on precious metals has been abolished.
New regulations since 1989 simplify the requirements for processing applications for exploration licences.	The tax on corporate dividends has been eliminated.
As of 1993, substantial offshore areas were opened to foreign mining companies.	Federal mining laws now restrict the ability of individual States to levy taxes on mining companies.
The overall investment process has been greatly simplified.	The annual tax on exploration and exploration concessions has increased in order to discourage the holding of property without engaging in active exploration.
Foreign participation in strategic industries (petroleum, radioactive minerals and minerals in the National Reserves) is now possible through joint venture arrangements.	

Source: based on data collected by the Centre for Petroleum and Mineral Law and Policy, University of Dundee, United Kingdom.

relating to FDI. The latter deal in many instances with issues that specifically affect FDI, in particular the employment of professional and managerial personnel. Employment matters may become the subject of performance requirements, when developing countries require employment and training of local labour as a condition for allowing an investment or for granting it special treatment (tax incentives).

Performance requirements have shown in recent years a tendency to lose their compulsory character and, instead, tend to be related to positive inducements. While data from the late 1970s and early 1980s showed a fairly widespread use of various types of performance requirements, developing countries have already been relaxing some performance requirements during the 1980s (UNCTC and UNCTAD, 1991).[5] Performance requirements can also be found in private agreements with specific investors.

There are, of course, other types of operational restrictions. One of them, important for many companies, concerns the ability of foreign affiliates to raise capital locally. Restrictions of this sort are now being lifted in a number of developing countries, at times in connection with the promotion of domestic capital markets.

Authorization and reporting. While in a considerable number of countries the laws may not impose explicit restrictions on FDI, governments may continue to exercise significant controls over entry by imposing screening procedures. Such procedures have been abolished in most developed countries and tend to disappear gradually in developing countries as well, being replaced by registration or notification. Yet, some kind of screening continues in many instances, for example, where authorization or special permission is still required for entry into specific industries or types of activities; for investments above certain amounts; or where the government reserves its right to deny entry to foreign investors on grounds of national security (UNCTC, 1992a, 1992d, 1992e; UNCTAD-DTCI, 1993a, 1994a; Wint, 1992) (table VII.5).

(ii) Incentives

Countries, both developed and developing, use a wide variety of incentives to promote their policy objectives. When incentive programmes discriminate in favour of foreign affiliates, it is to attract them to certain industries, or to link them to export promotion, structural adaptation, training or the introduction of advanced technology. Among the many types of incentives schemes, industrial estates, special economic zones, bonded areas, export processing zones, and -- more recently -- science parks, have attracted considerable attention. In addition, a broad variety of financial incentives, particularly in the form of subsidized sites, other infrastructure facilitation and business services are offered by regional and city authorities to encourage regional development. In recent years, countries have become more selective and focused in their granting of incentives, often made conditional upon certain performance requirements being fulfilled by the investor. This responds to the general perception that incentives are only a "second-best" solution to attract investment: as host countries compete with each other in the granting of incentives, these tend to cancel each other out and simply raise the rents to private investors without increasing the social benefits of the investment projects for the countries concerned.

As already noted, many countries that otherwise do not require authorization for entry have established various criteria and requirements as prerequisites for the grant of tax concessions and other kinds of privileged fiscal regimes and other incentives. The administration of investment incentives involves by necessity screening on the part of the competent authorities. Such procedures can be painless in the ideal case of a perfectly functioning civil service but, in actual cases, they can constitute problems for the foreign investor. A number of countries are moving away from special incentives, towards reformulating their overall fiscal regimes.

(b) Standards of treatment

National treatment. Most developed countries in principle grant national treatment unilaterally to all potential foreign investors, as part of their constitutions and basic laws (including civil and commercial codes) (OECD, 1992d and 1993f). In addition, many of them have undertaken international commitments in that respect, in the context of regional integration schemes. Moreover, in the context of regional agreements and bilateral investment treaties with developing countries, many developed countries have adopted reciprocal obligations to grant

Table VII.5. General authorization/notification procedures on foreign direct investment in developed countries, mid-1992

Country	*Authorization required*		*Notification required* [a]	
	Greenfield investment	*Acquisition*	*A priori*	*A posteriori*
Australia	X	X		
Austria				
Belgium		X		
Canada		X		
Denmark				
Finland	X	X		
France	X	X	X	X
Germany				
Greece	X	X		
Iceland	X	X		
Ireland	X	X		
Italy				
Japan			X	X
Luxembourg				
Netherlands			X	
New Zealand	X	X		
Norway	X	X		
Portugal			X	
Spain	X	X	X	
Sweden		X		
Switzerland				
Turkey	X	X		
United Kingdom				
United States			X	

Source: OECD, 1992d.

a Notification could potentially lead to modification or refusal of the investment proposal, either generally or for reasons of public order or essential security interests.

Table VII.6. Standards of treatment for foreign direct investment in bilateral investment treaties, autumn 1992 [a]

Standard	*Number of treaties that provide the standard*				
	Africa	*Asia andthe Middle East*	*Latin America and the Caribbean*	*Eastern Europe and Central Asia*	*Western Europe*
1. Admission					
a) In accordance with legislation, regulations, administrative practices and economic policies	78	78	40	51	11
b) Endeavour to admit in accordance with the laws (regulations)	0	9	0	0	0
c) In accordance with national treatment most-favoured-nation treatment standards	4	2	4	4	0
d) No admission clause	36	17	2	9	4
2. Treatment					
a) Fair and equitable treatment	99	81	46	55	14
b) National treatment (and fair and equitable treatment)	8	1	0	0	0
c) Most-favoured-nation treatment (and fair and equitable treatment)	39	86	6	59	9
d) National treatment (and most-favoured-nation treatment)	160	98	86	50	20
e) Treatment not to privileges granted on basis of customs union, taxation treaty etc.	66	66	39	56	10
3. Transfer of capital and return of funds					
a) Without delay	111	102	44	59	13
b) Instalments	19	18	15	6	5
c) Interest for delay	6	5	4	6	1
d) Rate of exchange officialmarket	29	43	25	45	6
4. Settlement of disputes					
a) Arbitration clause	111	102	46	60	11
b) Reference to ICSID	50	66	35	46	6
c) No arbitration clause	1	0	0	0	0

Source: Based on a survey of 335 bilateral treaties undertaken by the World Bank (World Bank, 1992; Parra, 1992).

a Bilateral investment treaties undertaken with the following OECD countries: Australia, Belgium and Luxembourg, Canada, Denmark, France, Finland, Germany, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, United Kingdom and the United States.

Table VII.7. Standards of treatment for foreign investors in selected national investment codes, December 1991

	Number of codes that provide the standard			
Standard	*Africa*	*Asia*	*Latin America and the Caribbean*	*Central and Eastern Europe*
1. Admission				
a) Authorization required	11	9	6	5
b) No special restrictions for entry	17	0	2	1
2. General standards of treatment				
a) National treatment	19	3	5	4
b) Fair and equitable treatment	1	2	0	0
c) No provision	8	4	3	1
3. Transfer of capital and profits				
a) Unconditional transfer	1	0	0	1
b) Transfer subject to regulations	22	4	5	3
c) Transfer subject to regulations and instalments on liquidation or only after a specified period	5	4	2	1
d) No provision	1	0	1	0
4. Dispute settlement				
a) Local courts	2	4	0	0
b) Courts or domestic or international arbitration	23	3	2	9
c) No provision	3	2	5	3

Source: Based on a survey of 51 national investment codes conducted by the World Bank (World Bank, 1992; Parra, 1992).

national treatment (Khalil, 1992) (table VII.6). As a result, there is now a broad network of international commitments on national treatment covering a large proportion of developed and developing regions.

According to a recent survey of 51 investment codes adopted by developing countries conducted by the World Bank (World Bank, 1992; Parra, 1992; UNCTC, 1988b and 1992d) (table VII.7), the overwhelming majority of the developing countries surveyed have adopted provisions to the effect that there shall be no discrimination against foreign as compared with local investors. At the same time, many of those countries have favoured a definition of national treatment as being treatment similar or equal to that given to local investors, thus excluding the possibility of granting more favourable treatment to FDI.

When a country commits itself to grant national treatment to FDI, it is normally assumed that the principle applies to all aspects of the operations of a foreign investment in the host country, unless specifically indicated by way of exceptions. The categories of exceptions may vary from country to country, but tend to be largely similar to those imposed on entry and establishment (e.g., national security, the protection of vital political and social interests, the furtherance of development objectives) (box VII.4).

Box VII.4. Restrictive measures affecting the national treatment standard in countries members of the Organisation for Economic Co-operation and Development

Recent surveys on the application of the national treatment standard among OECD countries have identified a number of areas where discrimination between foreign affiliates and national enterprises tends to be particularly significant.[a] These include:

- **Investment by established foreign-controlled enterprises**. Limitations on reinvestment are found in a number of developed countries, particularly in the natural resources and services areas. The most common are those affecting the scope of business operations and the volume and range of production. In the area of banking and financial services, limitations on the scope of business operations for established foreign affiliates are still being used.
- **Official aids and subsidies.** While the general approach in developed countries is not to discriminate between foreign and local investors regarding official aids and subsidies, at times these are granted on a discriminatory basis in order to promote local industries and activities, for example in the areas of subsidies by local authorities and those relating to research and development. The opposite is also true sometimes: foreign investors may be given advantages or facilities not available to national enterprises, typically as a means to encourage them to invest at the particular location.
- **Taxation** is another area in which the treatment of foreign affiliates and branches is often less favourable than that accorded to national enterprises in the same situations. In particular, developed countries tend to discriminate in the treatment of dividends paid abroad, the differences in tax rates applied to local enterprises and the tax treatment of branches of foreign-controlled enterprises.
- **Government procurement.** Governments often give preferences to national firms in bidding on public procurement contracts. Pertinent examples of policies pursued by developed countries include outright prohibition of foreign sourcing, formal criteria for allowing foreign sourcing, and procedures favouring procurement from national firms. In addition to the distinction between national and foreign firms, rules of origin might qualify as foreign the products of foreign-controlled enterprises established in the host country, thus excluding them for public procurement purposes. Most developed countries still continue to reserve government procurement to nationally-owned firms.
- **Access to local credit by foreign-controlled firms.** Foreign affiliates may be prevented from borrowing or raising capital in the host country and thus need to rely on foreign finance for their capital needs. Such restrictions may respond to a host country's need to avoid shortages of capital or foreign exchange, or to prudential considerations. These limitations are imposed by developed countries, although their use has diminished significantly during the past decade.
- **Access of foreign-controlled firms to communication and distribution networks** may be restricted by government measures or discriminatory practices, since many telecommunications, postal, computer networks or similar services are public monopolies. Such practices tend to be less frequent in developed countries today.

a OECD, 1993f.

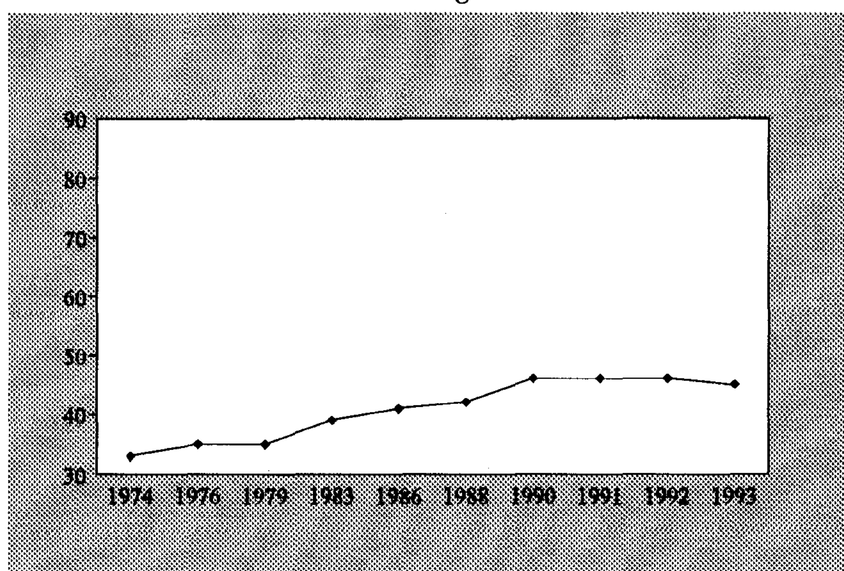
Transfer of funds. While exchange controls are far less prevalent now than they were forty years ago, they are still present today all over the world, although their precise form and extent vary widely (table VII.8).

At present, all developed countries allow, in principle, the free repatriation of the foreign capital invested. Most restrictions on transfers of profits and dividends have also been abolished in most developed countries (OECD, 1992d). With respect to the developing countries, two opposite trends concerning exchange regulations took place during the 1980s. On the one hand, developing countries faced with debt-servicing problems increased their controls in order to stem foreign exchange outflows. On the other hand, most surveys (UNCTC and UNCTAD, 1991) noted a general relaxation of foreign exchange controls, as the outcome of developing countries engaging in intense competition for FDI. According, however, to the World Bank's survey of developing countries mentioned earlier, only two of these countries grant foreign investors an unrestricted transfer of payments and capital (table VII.7). A small number of countries requires that capital be repatriated only after a specified period of time, or in instalments. The majority of the remaining countries, including countries from all developing regions, guarantees transfers of both capital and profits in principle, while making such a guarantee subject to foreign exchange regulations. Thus, an increasing number of countries have accepted, in principle, the commitments of Article VIII of the International Monetary Fund's Articles of Agreement to avoid restrictions on current payments, including remittances of profits (figure VII.2) while, at the same time, a number of these countries have continued to impose temporary restrictions on such transactions invoking the balance of payment exception authorised under the Agreement (figure VII.3).[6]

Most countries continue to screen capital movements through direct controls administered by the monetary authority. Transfers over a given amount may require the central bank's prior approval. In the event of a balance-of-payments crisis, the central bank may even withhold permission for overseas payments for an unspecified period (figure VII.4). There are also various restrictions affecting short-term capital movements.

Figure VII.2. Countries that have undertaken commitments to avoid restrictions on remittances of earnings, 1974-1993 a

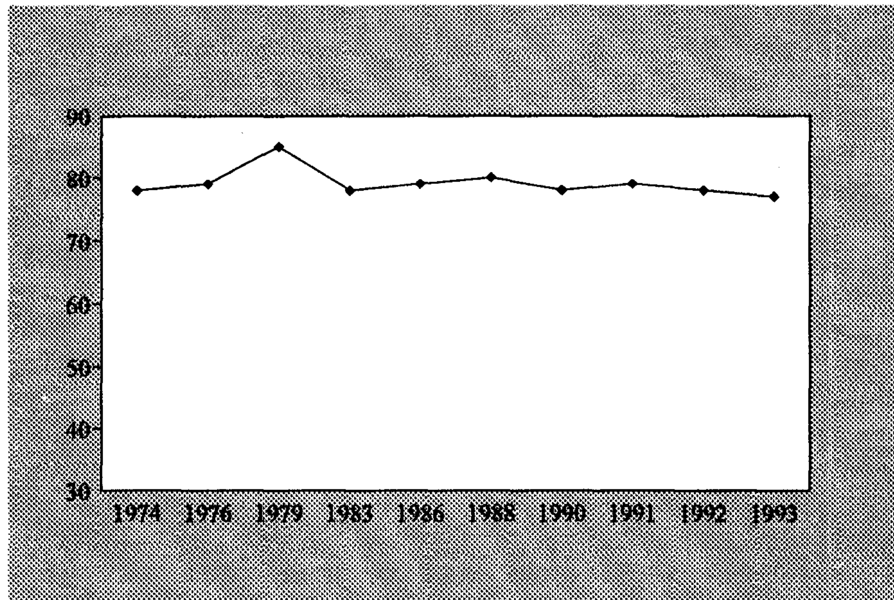
(Percentage)



Source: International Monetary Fund (1974 through 1993).

a As part of the general commitments undertaken by members on the avoidance of restrictions on current transactions under article VIII of IMF Articles of Agreement.

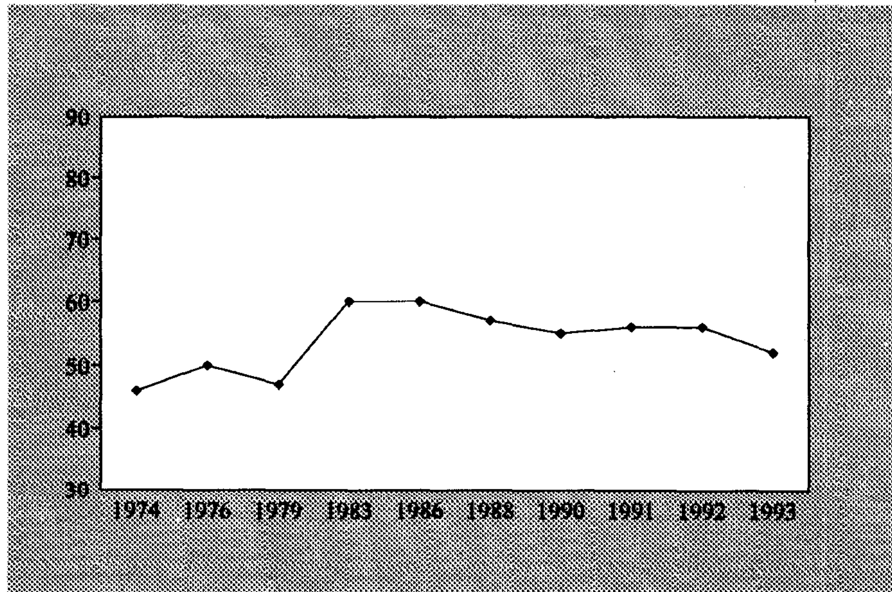
Figure VII.3. Temporal restrictions on current transactions, including repatriation of earnings, 1974-1993[a]
(Percentage)



Source: International Monetary Fund (1974 through 1993).

a Within the exceptions allowed by IMF Agreement for balance-of-payments considerations.

Figure VII.4. Restrictions on capital transactions, 1974-1993
(Percentage)



Source: International Monetary Fund (1974 through 1993).

In addition, many countries continue to impose taxes on the remittance of profits, dividends and capital. These fiscal instruments are meant to stimulate reinvestment of profits in the host country. But outright obligations of reinvestment of profits, which were used in the past by developing countries, seem to have been discontinued.

Transparency of laws, regulations and administrative practices. In recent years, governments have made considerable efforts to publicize and disseminate information on their policy, normative and administrative frameworks relating to FDI and to ensure that this information reaches potential foreign investors. Such efforts are usually part of broader promotion activities to attract FDI. They seek to facilitate the understanding of their countries' FDI regimes by presenting the key features of such regimes in a simple and concise manner. Governments that screen foreign investors through authorization procedures have also sought to improve the transparency and efficiency of such procedures by establishing "one-stop shops" dealing with all the approval requirements. Some of these agencies are charged with both screening and promoting FDI and, thus, furnish foreign investors with relevant information to assist them in their establishment and operations. Frequently, however, the impact of these one-stop shops is negligible.

Transparency in regard to FDI can be expected to be increased as part of the implementation of the *General Agreement on Trade in Services* and the *Agreement on Trade-related Investment Measures*, negotiated as part of the Uruguay Round. These commitments underscore the fact that transparency of regulations play an essential role in the liberalization of FDI policies. Other international organizations -- such as the International Monetary Fund, the World Bank, OECD -- and various regional integration schemes routinely collect information regarding various FDI policies and measures. However, a mechanism for international transparency in all areas of FDI and for all countries does not exist, reflecting the fact that FDI is not governed by an international framework of rules that would necessitate international notification and reporting as a means of ensuring that the signatories adhere to their commitments.

(c) A summary appraisal

The wave of liberalization measures in the 1980s and 1990s has changed investment regimes considerably in today's world. The most important changes have taken place in the following areas:

- The number of industries and activities closed or restricted to FDI has been considerably reduced.
- Compulsory joint ventures with government or local private participation are now limited to a small number of "strategic" activities in a few countries.
- Fade-out requirements have virtually disappeared.
- The requirement of authorization for entry and establishment for all FDI has been generally eliminated; registration has replaced it, mainly to facilitate the repatriation of capital and remittances of profits and other current payments. In some industries (e.g., banking), authorization requirements remain, often in the context of such requirements for both foreign and domestic firms.
- Certain performance requirements have been discontinued or are now prohibited under international commitments, while others have become more focused and tend to be voluntary, required mainly in return for incentives.
- Incentives programmes tend to discriminate less in favour of foreign investors.

- While exchange controls are still in effect in many countries, there are indications that they are administered in a more liberal fashion with respect to the remittances of profits and the repatriation of capital of registered investments.
- The principles of non-discrimination and national treatment are gaining acceptance, and are in fact recognized in the basic laws of many countries, or as part of international commitments.
- Internationally acceptable standards of legal protection for foreign investors, particularly in the areas of expropriation, State contracts and settlement of disputes, are now guaranteed by the State in many countries, as part of their national legislation and increasingly through international commitments.
- Many governments have taken steps to publicize and disseminate their laws and regulations on FDI, increasing in this manner the transparency of their regulatory frameworks.
- A number of countries have adopted or are strengthening their antitrust laws, health, safety, consumer and environmental standards, and have established mechanisms to supervise international mergers and acquisitions, stock exchanges and financial markets.

A more accurate and detailed picture of the status of the liberalization process would have to be reached through a sectoral analysis of its operation. While certain broad uniformities obtain, the limits, the needs and the possibilities of liberalization differ in each of the major economic sectors.[7]

C. Beyond liberalization

The basic elements of the liberalization process reviewed above, namely, the elimination of discriminatory market-distortions, adherence to certain standards and the establishment of controls and prudential supervision to ensure the proper functioning of the market, are central, immediate and direct aspects of the policy and normative framework for FDI and TNC operations. Yet, the broader context within which foreign affiliates operate inside a host country is also relevant and, as the liberalization process progresses, becomes increasingly visible; in fact, certain aspects of the internal normative framework are essential to give meaning and effect to that process. This applies, in particular, to the broader regulatory and administrative framework and the investment climate in general:

The effectiveness of the liberalization process in the area of FDI depends on the existence of a reasonably comprehensive legal framework for business activities in general, including, for example, appropriate legislation on companies, industrial relations and insolvency (Rubin and Wallace, 1994). In fact, a properly functioning legal order, including well functioning courts, is required to provide predictability and certainty, including, for instance, respect for such basic principles as due process of law. Furthermore, reasonably well functioning administrative infrastructures are necessary to ensure the effective implementation of the legal framework within which business operates. In the absence of a reasonably complete framework and legal order, a case-by-case treatment of investments and enterprises would be necessary. In a country lacking adequate legislation on the exploitation of natural resources, for instance, each "concession" to a prospective investor would be fashioned on the basis of the State's needs at the moment, short-run conditions in the relevant market, the investor's ability to persuade local officials and other factors. The result may be a situation in which different investors in the same industry operate under different rules negotiated by contract. Subsequent investors typically try to improve on previous ones. The experience in many developing countries rich in natural resources has shown clearly the dangers of such a situation. Regardless of intentions, or fairness of approach, case-by-case treatment does not provide adequate predictability to investors and has in itself the potential for

arbitrary action and for restrictions of various kinds. In such a situation, moreover, such fundamental facets of a liberalized regime as the grant of national treatment can have no precise meaning and function. Liberalization is a fragile process that needs the support of a sturdy legal framework to survive.

Given the close interlinkages between FDI, trade and the dissemination of technology, the policy framework for FDI can not be divorced from that for other international economic transactions. For the process of liberalization of the FDI framework to be effective, therefore, the frameworks for other international economic activities would have to move in the same direction. The requirements of integrated international production would make a country that takes any other approach less attractive as an investment location.

Furthermore, this is only part of what constitutes a good investment climate. Of course, certain issues like political and economic stability may not be under a government's immediate control. Similarly, the establishment of a sound macroeconomic framework, the upgrading of a country's human resources and the strengthening of its physical infrastructure may require some time. But there are a number of measures a government can take, where appropriate, with an immediate effect on the investment climate. For example, entering into bilateral or multilateral commitments to guarantee foreign investors against non-commercial risks, may boost investors' confidence. Also, a variety of promotional efforts can be undertaken to attract investment. Apart from their intrinsic value, promotion measures send positive signs of the "good will" of the host country towards foreign investors and, therefore, constitute important ingredients of a favourable investment climate. The same effects can be obtained from a positive attitude of the governments to the private sector (both domestic and foreign) which, among other things, can find its expression in privatization programmes.

Overall the liberalization of FDI regimes does not imply a weakening of the role of government, but rather a redefinition of some of its functions and the strengthening of others (Osborne and Gaebler, 1992). In particular, the process of reducing distortions and establishing positive standards occurs simultaneously with the strengthening of controls meant to ensure the proper functioning of markets and other actions aimed at improving the investment climate. Furthermore, and recalling the relative character of liberalization and the fact that there are more and less liberalized regimes, it must be stressed that a description or even an analysis of the liberalization process cannot involve a quest for perfection. It would be difficult to define in clear terms what constitutes a perfect investment regime, in terms of liberalization, even from the viewpoint of a single investor, and even more so if one had to take into account the interests of other investors, domestic as well as foreign, and the long-term interests of the countries concerned. Lastly, the nature of the FDI liberalization process depends on the concrete circumstances in each country and each industry and needs to take into account that the introduction of liberalization often entails a number of risks. Liberalization should, therefore, be introduced with care. Different industries may need to be approached differently, keeping in view the specific situation and objectives of a given country.

The liberalization process is a policy process; like all such processes, it involves difficult choices between desirable outcomes and trade-offs between objectives. Any discussion must accept that it necessarily involves trends and patterns, and moves in areas of approximation and uncertainty.

Conclusions

While the process of liberalization has led to a certain convergence of the characteristics of FDI regimes, numerous -- and at times considerable -- differences remain. These differences, in

turn, become more important for the decisions by TNCs on where to invest. As a result, efforts to attract FDI can lead to "policy competition" which, in the final analysis, may be detrimental to the interests of the countries involved.

Such competition could potentially be carried into more policy areas than in the past, since the increasingly integrated nature of international production elevates more and more policies that concern the production process from the domestic to the regional or international domain. This internationalization of part of the domestic policy agenda poses new challenges for policy makers and, in particular, increases the need for policy coordination among governments. It also points to a potential role to be played by international organizations. Exchanges of experiences among governments about their FDI and related policies would be one way to increase the transparency in regard to these processes.

Finally, the FDI liberalization process, by its very nature, leads to an increased role of the market and, hence, the principal actors in the market, including TNCs. This, in turn, raises the question whether this increased role is -- or should be -- accompanied by increased responsibilities, especially social responsibilities. The next chapter addresses this issue.

Notes

1. Foreign direct investment is defined as follows: "Direct investment -- reflecting the lasting interest of a resident entity in one economy (direct investor) in an entity resident in another economy (direct investment enterprise) -- covers all transactions between direct investors and direct investment enterprises. That is, direct investment covers the initial transaction between the two and all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated. Direct investment transactions (abroad and in the reporting economy) are subclassified into equity capital, reinvested earnings, and other capital (intercompany transactions)..." (IMF, 1993a, para. 177, p. 41; see also OECD, 1992a). A foreign-resident affiliate (hereafter "foreign-affiliate") of a TNC may be an enterprise incorporated in the host country (a subsidiary or associate company) or an unincorporated branch.

2 For a more detailed examination of the drafts of these Agreements, see UN-TCMD, 1992.

3 It should be noted, however, that many countries started the liberalization process in the context of bilateral investment treaties and regional schemes; indeed, it is in the context of these commitments that the highest levels of liberalization have been achieved. The liberalization process discussed here involves national measures, as well as bilateral, regional and (when applicable) multilateral instruments.

4 For an in-depth analysis of the various elements involved in the definition of the standard of national treatment, see UNCTC (1990).

5 For instance, Andersson (1989) and Globerman (1988) found some evidence of general relaxation of host country performance requirements already in the early 1980s.

6 Article VIII of the International Monetary Fund's Articles of Agreement prescribes general obligations for Members with respect to the avoidance of restrictions on current payments, including remittances of profits, avoidance of discriminatory currency practices, convertibility of foreign-held balances, furnishing of information, consultation between Members regarding existing international agreements, and collaboration regarding policies on reserve assets.

7 For a detailed study of the characteristics of liberalization in the services sector, see UNCTAD-DTCI and World Bank (1994).

Chapter VIII

Corporate social responsibility and transnational corporations

Introduction

The widespread liberalization of policies regarding foreign direct investment (FDI) observed in the preceding chapter, as part of a broader deregulation and liberalization trend, has given enterprises more freedom to make their investment decisions and to operate, both at home and abroad. More freedom also means more responsibility, including social responsibility. This fact is recognized by firms when they adopt codes of corporate ethics and by business schools that have given this topic an enhanced place in their curricula. It is also being recognized by shareholders and movements emphasizing social responsibility. Transnational corporations (TNCs), being central actors in domestic and international markets, are perhaps more directly and diversely involved with it than other firms, partly because they are among the largest firms and partly because their functional and geographic scope is broader than that of domestic firms; the emergence of an integrated international production system, if anything, underlines the increasingly international nature of their strategies and structures. As a result, responsibility, including social responsibility, extends beyond borders as well. In this process, a tension (and dynamic) may arise between being a good corporate citizen — a concept grounded in the values of individual countries — and being a socially responsible transnational corporation — a concept grounded in values that are shared more broadly.

More specifically, the term "good corporate citizenship" suggests that TNCs have an obligation to act as responsible members of societies that grant them legal standing. Corporate social responsibility is a related but broader concept. Its application to good corporate conduct

generally implies responsibilities that go beyond meeting minimum legal requirements. Thus, corporate social responsibility involves notions of voluntary corporate conduct that is both acceptable and beneficial to various social constituencies that surround business enterprises.

By their very nature, TNCs operate simultaneously in often dissimilar societies around the world where values, standards and expectations of corporate conduct may differ quite radically. This great diversity in cultures, attitudes and systems makes it more difficult than in a relatively homogeneous national business setting to determine common standards for desirable corporate conduct.

In its application, the concept of TNC social responsibility relies on the notion of appropriate roles as ordered and directed by the subsidiarity principle according to which responsibility is best exercised closest to a given situation (box VIII.1). Societies are organized and administered by governments, which bear primary rights and responsibilities regarding the welfare of their people. By contrast, corporations are principally responsible for matters most directly related to their own economic purpose and function, operating within prevailing legal frameworks. However, voluntary corporate actions on broader social goals can derive from business capabilities and impacts. In exceptional circumstances, TNCs may even be called upon to assume added responsibilities where other actors, including governments, do not or cannot carry out critical duties. In this respect, the role for TNC social responsibility may be broadest in developing countries and countries with economies in transition where the liberalization trend described in the preceding chapter is underway, but governmental or free market regulating mechanisms are not yet fully formed or effective (Tavis, 1982). In a sense, therefore, the growing convergence towards the acceptance of free market principles and the new openness of formerly centrally planned and developing economies to foreign investors increases, almost by default, the self-regulatory burden on corporations. A TNC's intersocietal presence presents it with a distinct challenge, and a special opportunity, in addressing social responsibility issues, especially where prospective host countries lack the legal framework, societal infrastructure or established traditions and experience of a market economy system (De George, 1993, chs. 3 and 8).

Simultaneously with the growing diversity among host societies, TNCs themselves are undergoing fundamental transformations. In particular, the spread of complex corporate strategies, a growing number of international strategic alliances and the expansion in low or non-equity forms of investment can alter a TNC's organizational structure and require closer coordination among business units that are increasingly linked through novel mechanisms. These changes, in turn, increase the difficulties of establishing and maintaining a corporate identity (UNCTAD-DTCI, 1993a) that can support corporate social responsibility actions through a consistent set of policies implemented over widely dispersed and perhaps only partially controlled affiliates. For example, with the emergence of an integrated international production system, TNCs develop common organization and governance systems to coordinate production functions. An increasingly interdependent global economy clearly motivates these organizational changes; but, just as clearly, the world's political, legal and social issues remain predominantly national or regional in character. Glaring disparities exist in economic development and living standards while differences in culture and social values persist among and within countries. Such a multi-variate global environment raises difficult issues regarding when, where and how to define and implement a TNC's social responsibility.

This chapter discusses the concept of corporate social responsibility, explores its special application to TNCs and examines how this concept relates to important human resource management issues. More specifically, section A reviews several theories and approaches that describe the general concept of corporate social responsibility. Section B applies the concept to TNCs, examining special dimensions and issues that give the social responsibility of TNCs a distinctive character. Section C explores how TNC social responsibility relates to some employ-

ment and human resource management situations, the special topic of this volume. Taken together, these components depict how TNCs can relate to individual societies while simultaneously operating in the midst of an evolving international political and economic milieu.

Box VIII.1. The principle of subsidiarity

The principle of subsidiarity in political decisions

The principle of subsidiarity is commonly associated with political decision-making, and European institutions, in particular, have emphasized it. The principle is well stated in Article 4.3 of the Council of Europe's European Charter of Local Self-government:

> "Public responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizen. Allocation to another authority should weigh up the extent and nature of the task and requirements of efficiency and economy."[a]

The Treaty on the European Union ("Treaty of Maastricht") expresses the spirit of subsidiarity in its Article A, which talks of "decisions taken as closely as possible to the citizen". Article 3b explicitly names the principle of subsidiarity. A reference to the principle can also be discerned in Principle 10 of the Rio Declaration on Environment and Development, which states that "environmental issues are best handled with the participation of all concerned citizens, at the relevant level".[b]

Social entities and the principle of subsidiarity

The origins of the principle do not lie so much in the political world as in that of other social institutions. It developed largely within the Christian churches. The Protestant Synod of Emden (1571) is considered as providing one of the earliest statements of it: "One will not submit to provincial and general synods questions which have already been handled and collectively decided [at a lower level] ... Questions will be submitted only if they could not be settled [at a lower level] or if they concern all the parishes of the province".[c] The Roman Catholic Church developed the principle of subsidiarity in canon law, applying it clearly to social groups in general:[d]

- Negatively: a large group should not accomplish tasks that a small group is capable of accomplishing.
- Positively: the large group must do everything possible to enable the small group to fulfill to the greatest extent it can the functions it is capable of fulfilling.
- Subsidiarily: the large group will intervene with respect to the small group only to provide functions or services which are beyond the possibilities of the latter.

"Subsidiarity" and "subsidy" have the same etymological root. Subsidiarity concerns providing *subsidium*, i.e., support, to lower levels when they are unable to cope on their own.

Enterprises count among the social groups of society. Indeed, subsidiarity reflects a common approach to management practice within TNCs. The usual rule is that matters are not submitted to higher-level management for decision unless they cannot be settled at a lower level.

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a Adopted on 15 October 1985 (*European Treaty Series,* No. 122).

b Adopted by the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992.

c This passage on the roots of subsidiarity in Christian Churches draws extensively on Commission of the European Communities, Forward Studies Unit, *Note de dossier: histoire philosophique du concept de subsidiarité,* No. 64/92, 1992, pp. 7-8.

d Ibid.

A. The concept of social responsibility of firms

The concept of corporate social responsibility can be understood and applied by combining three defining elements:

- The first asserts that an enterprise is a distinct, identifiable actor with both a capability and responsibility for its collective actions.
- The second element describes the nature of a corporation's relationship with society, which includes (but is not delimited by) legal requirements that are more narrowly drawn than a firm's social charter.
- The third component provides organizing principles to help determine which societal groups fall within a corporation's circle of social responsibility, and why.

Although these propositions have their critics as well as defenders, they constitute the basic core of most broadly accepted notions of the social responsibility of firms (Hoffman et al., 1994; Hoffman and Moore, 1984; Desjardin and McCall, 1990; Donaldson, 1989).

1. Corporate versus individual actions

The concept of corporate social responsibility requires an acceptance of the corporation as a collective entity, with a discernible identity, decision-making power and action capability (Goodpaster and Matthews, 1984; De George, 1986, pp. 92-99). An alternative concept is to perceive enterprises as simply a grouping of individuals in which each individual bears personal responsibility for his or her action, but neither praise nor blame can be attributed to the collective organization. The notion of a distinguishable corporate personality is a central feature of market-oriented legal systems where corporations can be chartered as legal entities distinct from their individual employees, managers or shareholders. An analogous approach to establishing a collective corporate identity for purposes of discussing social responsibility can be developed from the description of a "corporate internal decision" structure that permits attribution of responsibility for action (or inaction) to a corporate entity (French, 1984).[1] As described in this approach, actions that pass through a firm's chain-of-command approval procedures and are consistent with established policies are deemed corporate undertakings; those that lack one or both of these official sanctioning processes are more properly seen as actions of individuals who quite possibly are breaching their corporate authority and should not be seen as acting on behalf of the corporation. This theory therefore suggests that the corporation, as a collective entity, can also assume social responsibilities. A firm can incorporate accepted standards of good corporate conduct into its established policies and approve corresponding actions through its management decision-making structure. These processes are often embodied in company statements of corporate responsibility that set forth a firm's guiding principles, policy standards and decision-making procedures (for an example, see box VIII.2) (Leisinger, 1994; Kline, 1985, pp. 120-22).

2. Social contract theory

Social contract theory offers a way to define and contrast the concept of corporate social responsibility with the realm of legal rights and obligations (Donaldson, 1984; 1989, chapter 4). Several general theories posit the existence of mutual rights and responsibilities among all members of a society by virtue of their membership. A distinction can be drawn, however, between the inherent human rights of an individual person that exist independently of his or her membership in a particular political society, and the role of a corporation as an artificial legal person. Corporations are granted a right to exist by each political society in which they operate; they have no independent right of existence.

Box VIII.2. Statement of corporate responsibility: the example of General Mills

General Mills published a "Statement of Corporate Responsibility" in 1985, reissuing the document several times, most recently in 1994. This document addresses corporate policy on a range of issues, essentially constituting a code of conduct for the firm's operations. The following excerpts from the Statement focus on two portions of the "Key Issues" section that reflect some basic concepts of corporate social responsibility, including its application to international business.

"Business Ethics

General Mills has a strong commitment to corporate citizenship and the concept that companies, as well as individuals, must contribute to the well-being of society. The corporation believes it makes a contribution by providing quality products and services, by conducting its business with integrity, and by taking an active interest in the quality of life enjoyed by its employees and members of the communities in which it exists.

Obeying the law is a minimum. Ethical business conduct should normally exist at a level well above the minimum required by law and company policy.

One of our most valuable assets is our reputation for integrity. If that is tarnished, customers, investors and desirable employees will seek affiliation with other, more attractive companies. We intend to hold to a single standard of integrity everywhere. We will keep our word. We will not promise more than we can reasonably hope to deliver nor will we make commitments we do not intend to keep.

International Business

General Mills believes that the pursuit of business excellence and profit is the best means yet found for enhancing economic development and for efficiently producing and distributing goods and services. Therefore, we seek out profitable opportunities for growth in many parts of the world.

People throughout the world have differing beliefs, customs, and laws. Any corporation operating on an international scale may occasionally be confronted with conflicting laws, regulations, and social standards in the various countries in which it conducts business.

We respect these differences among peoples. It is not for us to say what is right or wrong in another people's culture. But we can and do state the moral and ethical standards governing our own behavior wherever we may do business.

We have no separate corporate policy for our international operations. Each of the policy statements included in this corporate responsibility pamphlet applies to all General Mills' operations, both foreign and domestic".

Source: General Mills. "Statement of Corporate Responsibility" (Minneapolis: General Mills, 1994), mimeo.,pp. 4, 6.

A social contract evolves over time in line with changing societal expectations of corporate social responsibility (Anshen, 1993; Bowie, 1993a; CED, 1971, chapter 1). Social contract terms are conceptual, enabling enterprises to respond flexibly to meet their responsibilities under diverse circumstances and conditions. By contrast, except for founding constitutional documents, laws are usually specific but reactive, setting forth mandates to correct abuses or omissions serious enough to merit the time and attention of political leaders. Thus, the social contract theory suggests it is in a corporation's self-interest to respond voluntarily and proactively to changing societal expectations before these desires are turned into new legal mandates (Cavanagh, 1984; CED, 1971, ch. 3; Mintzberg, 1989). The adoption of specific legal requirements reduces business operating flexibility and may produce less responsive and effective results under diverse socio-economic conditions than voluntary corporate actions (Kline, 1992).

The social contract theory can also be linked to notions of minimal and maximal corporate social responsibilities (Donaldson, 1989, chapter 4):

- A minimum "floor" is established because, presumably, societies would not grant (or continue) a corporation's right to exist unless the enterprise meets two conditions: first, the firm must produce some benefit for the society (otherwise, why permit its creation or continuation?); second, the enterprise must not intentionally do any harm, and any harm that occurs must be sufficiently outweighed by the benefits produced. This normative condition constitutes a minimal duty or obligation under a social contract theory,[2] even though it is not taken for granted in every society.
- Maximal corporate social responsibilities rise above this minimum floor to add further benefits that a firm can voluntarily provide. The full package of benefits can vary considerably, depending on a firm's operations, its product, competitive and comparative advantages and other factors. Not all types of benefits can be expected to accrue in equal proportion from every firm. Thus, compared to the minimal obligations floor, corporations do not have a determinative duty to provide a specific package of maximal benefits to each society. Competitive market forces operating within a prevailing legal framework determine the availability of corporate resources and the firm's permissible and expected role within a given society.[3]

A corollary distinction should also be drawn concerning corporate social responsibility and corporate philanthropy. The former term focuses on the nature of a firm's operations and includes both minimal and maximal responsibilities. Philanthropy, on the other hand, is only one possible component of maximal social responsibility actions. Corporate philanthropy is a fully voluntary action, generally guided by self-interest considerations, whose appropriateness is determined by the individual enterprise and by societal circumstances. In addition, philanthropic programmes cannot excuse or offset violations of minimal operational standards.[4]

3. Shareholder versus stakeholder approaches

Narrow definitions of corporate social responsibility hold that a private corporation's responsibility in a market system is to pursue profits for its shareholders. According to this view, undertaking additional social responsibilities, including philanthropy, that might detract from this obligation would violate a firm's fiduciary duties and would involve it in inappropriate activities that are rightly the province of other societal groups, particularly governments (Friedman, 1983; 1984; Levitt, 1983).

A broader concept of corporate social responsibility suggests that firms should also consider their impact on a range of stakeholders, i.e., parties that affect or are affected by a corporation's actions (Freeman, 1984). This approach reaches beyond shareholders to include other groups such as employees, managers, suppliers, customers and even competitors, local communities and governments (box VIII.3). The nature and degree of corporate social responsibility that an individual firm may have towards these various groups depends on an examination of the characteristics that relate an enterprise to a specific issue. Among such characteristics are an enterprise's capability (with greater power goes greater responsibility), proximity (under the subsidiarity principle, the capable agent closest to the problem has the greatest responsibility to act), awareness, knowledge and impact on the issue (Davis, 1983; Simon, Powers and Gunnemann, 1993).

The size and power of large modern corporations give them an enormous potential impact on the societies around them. In terms of social responsibility, this influence can be exercised through acts of both commission and omission. The former presents a clearer cause-and-effect

relationship, but the latter can be just as serious in terms of societal impact when a highly capable corporate entity decides not to act.

The narrow view of shareholder responsibility argues that profit-making goals are sufficient because a firm plays its proper societal role by taking directives from the economic market-place, within the accepted framework of public regulation. Stakeholder theorists (Carroll, 1989; Donaldson and Preston, 1994; Freeman, 1984) point out that many parties affected by institutional corporate activity may have neither the economic ability to signal their needs through market-place mechanisms nor the political power to ensure their representation through government regulation.[5] These situations can therefore invoke the subsidiarity principle where both a firm's capability and its impact on those around it become critical factors in determining the nature and degree of a corporation's social responsibilities. Taking into consideration the concept of "last resort", firms may be called upon to accept maximal corporate social responsibilities where market and governmental regulatory rules and mechanisms prove insufficient or ineffective (Simon, Powers and Gunnemann, 1993).

Box VIII.3. Shareholders and stakeholders: Caterpillar's approach

First issued by Caterpillar in October 1974, "A Code of Worldwide Business Conduct and Operating Principles" has served as a model for other TNCs considering the formulation of a code dealing with corporate social responsibilility. The following excerpts are drawn from its 1 August 1992 revision:

"*Business mission*

The overall purpose of Caterpillar is to enhance the long-term interests of those who own the business -- the stockholders.

This in no way diminishes the strong and legitimate claims of employees, dealers, customers, suppliers, governments, and others whose interests touch upon our own -- nor, indeed, of the public at large. . . .

. . . We believe we can best serve stockholders and the long-term profitability of the enterprise through fair, honest, and intelligent actions with respect to all our constituencies.

Competitive conduct

Fair competition is fundamental to the free enterprise system. We support laws prohibiting restraints of trade, unfair practices, or abuse of economic power. And we avoid such practices everywhere -- including areas of the world where laws don't prohibit them.

Public responsibility

We believe there are three basic categories of possible social impact by business:

1. First is the straightforward pursuit of daily business affairs. . . . developing desired goods and services, providing jobs and training, investing in manufacturing and technical facilities, dealing with suppliers, paying taxes, attracting customers and investors, earning a profit...
2. The second category has to do with conducting business affairs in a *way* that is socially responsible. It isn't enough to successfully offer useful products and services. A business should, for example, employ and promote people fairly, see to their job safety and the safety of its products, conserve energy and other valuable resources, and help protect the quality of the environment.
3. The third category relates to initiatives beyond our operations, such as helping solve community problems. To the extent our resources permit -- and if a host country or community wishes -- we will participate selectively in such matters. Each corporate facility is an integral part of the community in which it operates. Like an individual, it benefits from character building, health, welfare, educational, and cultural activities. And like individuals, it also has citizen responsibility to support such activities."

Source: Caterpillar Inc. "A Code of Wordwide Business Product and Operating Principles" (Peoria: Caterpillar, 1992), mimeo., pp. 1, 7, 9.

B. Corporate social responsibility applied to transnational corporations

General concepts of corporate social responsibility pertain equally to both domestic and transnational enterprises. However, applying these concepts to TNCs established in diverse global settings raises special considerations and issues that may modify a firm's specific response. In fact, it gives rise to a tension that is specific to TNCs, namely, on the one hand, the duty to behave as good corporate citizens in the host countries in which a TNC is established and, on the other hand, the duty of adhering to broader self-imposed social responsibility standards formulated to apply across the TNC's system as a whole. This tension is, furthermore, a dynamic one, at least in two respects:

- In defining social responsibility for itself, a TNC as a system (like any other system) is subject to constant learning, both from its environment and from its individual constituent parts. In the process, new values may enter the corporate system from any of the countries in which the firm operates.
- When operating in host countries (including through forward and backward linkages), introducing various components of its business culture and carrying out their social responsibilities, TNCs invariably affect the host country's business culture system, including precepts of social responsibility. In this respect, TNCs are agents of change.

This dynamic tension that TNCs face makes the formulation, adaptation and, above all, implementation of social responsibility a particular difficult challenge for them.

1. Social contracts and transnational business

Transnational corporations secure competitive advantage from their transnational organization, enabling them to utilize resources on an international, intra-firm basis to benefit the corporation as a whole. In this sense, TNCs develop and promote unity in corporate organization, purpose and strategy, giving the enterprise the type of collective identity (and social responsibility attributes) associated with a corporate internal decision system. Social responsibility standards and actions therefore relate to the TNC as an integrated enterprise and not just to its national constituent units. A corporate code of conduct is sometimes used to provide some unity and consistency in social responsibility policies and their implementation across a TNC's global network, although individual affiliates may further elaborate their own standards on its basis (box VIII.4).

Comparing a corporation's legal status with its theorized social contract also becomes more complex when applied to TNCs. Because firms cannot be incorporated through a global charter, the TNC as a whole has no legal personality and therefore possesses no formal nationality (UNCTAD-DTCI, 1993a, p. 187). Politically, TNCs are generally associated with the State in which their parent firms' headquarters are located, an image that can be reinforced if that country also claims some extraterritorial jurisdiction over the parent firms' foreign operations. On the other hand, individual foreign affiliates gain legal standing as conferred by each host country's government under the laws of that State.

A particularly critical time for TNCs is the decision to invest in a country, an action that establishes both a legal and, de facto, a social contract with that society. No TNC will invest — nor should it be expected to invest — under legal conditions that do not permit it to conduct its business properly, effectively and profitably; similarly, no TNC should invest where social contract responsibilities cannot be carried out in an equally proper, effective and beneficial manner (Werhane, 1994).

Legal contracts and social contracts often overlap, but they are not necessarily coterminous, even in terms of minimal obligations. Some, but not all, minimum social responsibility conditions may be identified and defined by legal regulations governing a firm's existence in a society. Transnational corporations may also find their operations caught between competing and perhaps conflicting legal mandates from different political sovereigns. In a parallel fashion, national legal requirements may occasionally require corporate actions that would violate basic human rights that supersede national political standards. On these occasions, corporate social responsibility may lead firms to decline investment (or withdraw from operations) in a society

Box VIII.4. Providing a framework for social responsibility: the example of Royal Dutch/Shell

The following excerpts are taken from the "Statement of General Business Principles" issued by the Royal Dutch/Shell Group of Companies in June 1990:

"10. *Application*

The reputation of the Royal Dutch/Shell Group of Companies depends on the existence and knowledge of clearly understood principles and responsibilities and on their observance in day to day practice in widely different environments. Individual operating companies may elaborate their own statements to meet national situations, but this Statement of General Business Principles serves as a basis on which companies of the Royal Dutch/Shell Group, in their operations, pursue the highest standards of behaviour.

Group companies are involved in many joint ventures. Shell companies participating in a joint venture will promote the application of these principles and will take into account their ability to do so in deciding whether to participate in any joint venture.

2. *Responsibilities*

Four areas of responsibilities are recognized:

a) To shareholders

   To protect shareholders' investment and provide an acceptable return.

b) To employees

   To provide all employees with good and safe conditions of work, good and competitive terms and conditions of service; to promote the development and best use of human talent and equal opportunity employment; and to encourage the involvement of employees in the planning and direction of their work, recognizing that success depends on the full contribution of all employees

c) To customers

   To develop and provide products and services which offer value in terms of price and quality, supported by the requisite technological and commercial expertise. There is no guaranteed future: Shell companies depend on winning and maintaining customers' support.

d) To society

   To conduct business as responsible corporate members of society, observing applicable laws of the countries in which they operate giving due regard to safety and environmental standards and societal aspirations.

These four areas of responsibility are seen as inseparable. Therefore, it is the duty of management continuously to assess the priorities and discharge its responsibilities as best it can on the basis of that assessment.

4. *Voluntary Codes of Conduct*

Policies of Shell companies are consistent with the two existing internationally agreed voluntary codes of conduct for multinational enterprises, namely the OECD Declaration and Guidelines for International Investment and Multinational Enterprises and the ILO Tripartite Declaration of Principles."

Source: Royal Dutch/Shell Groups of Companies. "Statement of General Business Principles" (London: Shell, 1990), mimeo., paras. 10, 2, 4.

where they cannot operate legally without causing harm to fundamental human rights; a number of TNCs made that choice in South Africa during the days of apartheid (Donaldson, 1989, chapter 8; Kline, 1991).

Once established, TNCs are expected to fulfill local legal requirements and meet minimal social responsibility obligations as these evolve in the interaction between TNCs and the host society. In pursuing maximal social responsibility objectives, corporations will normally work cooperatively with legitimate governmental authorities to produce benefits desired by the society, consistent with local culture, values and expectations. At the same time, TNCs are especially valuable for sharing intangible assets related to business culture derived from their broad and varied international operations. Among the areas that can benefit in this respect are labour relations and safety standards, environmental protection processes, financial accounting procedures and product-quality and servicing requirements (box VIII.5). However, the appropriateness and impact of externally-derived practices on a host society and its culture need to be evaluated prior to their introduction, recognizing at the same time that their introduction may change the host society.

2. Social responsibility in global operations

Several characteristics of the concept of social responsibility suggest that differences may exist in the nature and degree of TNC social responsibility dependent on the type and structure of a firm's operations. For example, both TNC capability and impact may prove unusually large in relative terms when a TNC is an established global enterprise from a developed country and is operating in a small developing country. A TNC's capability to affect the host economy, and the impact of its actions, can be especially significant in the case of foreign direct investment (FDI) in the natural resources sector of developing countries that are dependent on a single commodity export. The capability and potential impact of large TNCs in the financial industry can be equally significant for smaller, highly indebted countries whose export trade and development projects are often linked to services provided by international financial markets. Traditionally, distinctions between trade and investment operations helped determine the nature and degree of corporate social responsibility in a particular country. Foreign investors are more proximate, aware and knowledgeable about local social circumstances in the countries in which they are established than companies that engage only in external trade and are geographically and socially separated from the foreign buyer or supplier. Therefore, an exporter or importer without a significant local presence abroad does not have as extensive a capability or social responsibility to the foreign society compared to a TNC established there.

Social expectations may be changing as the definition of TNCs expands to cover more low or non-equity business arrangements, such as subcontracting, franchising and licensing. For example, long-term contractual agreements for the purchase of imports from an otherwise unaffiliated foreign supplier may establish a non-equity TNC-related link that can be interpreted to involve some expectations of social responsibility for the TNC importer.[6] In an increasingly interdependent world, a major TNC importer becomes closely connected to foreign suppliers, leaving its corporate reputation vulnerable to questionable practices by its foreign partner as well as gaining potential capability to affect certain conditions surrounding the foreign firm's operations. Such business tie-ins may require a responsibility on the part of TNCs to be aware and knowledgeable about the production practices of long-term subcontractors, franchisees, licensees or other business partners on issues such as product and process safety, environmental protection and employment conditions, including the possible use of child or prison labour.

It is not, in such cases, that TNCs are directly causing harm. However, the commercial ties connecting a TNC to possible abuses, even indirectly and at a great distance, are perceived to give a TNC some capacity to affect the outcome. The question is, therefore, to what extent, in such

Box VIII.5. Areas of contribution: guiding principles at Toyota

The first comments printed below were signed by Shoichiro Toyoda, President of Toyota Motor Corporation, as an introduction to the firm's 1992 "Guiding Principles at Toyota"; the subsequent excerpts are drawn from those Principles.

"A Word about the Guiding Principles

Our activities at Toyota are assuming an increasingly global dimension as we approach the 21st century. Our company is becoming a member of the community of nations worldwide. More than ever, we need to adapt our operations, our organization, and even our corporate culture to accommodate the different values and circumstance of our employees, partners, and neighbors in each country and region.

Toyota always has been a company devoted to enhancing the quality of life for people around the world by providing useful and appealing products. Toyota also is a company committed to addressing issues of common concern to people everywhere, such as safety and the environment. In the years ahead, we must accompany our growth and development as a corporate citizen of the world with unflagging efforts to help resolve the pressing issues of our time.

I want to call on everyone at Toyota to take part individually and collectively in reinforcing our corporate identity as a company where the greater good of society is the first consideration in all endeavors..."

* * *

"1. *Be a company of the world*

Observe internationally accepted standards of corporate ethics.

- Conduct business in a manner consistent with international concepts of fairness and openness.
- Solicit opinions and advice about pertinent issues from authoritative third parties, and take their views into consideration in framing corporate policy.

Implement personnel policy that reflects the international scope of the company's operations.

- Foster managers in every nation who understand and implement the tenets of Toyota philosophy, and provide them with meaningful opportunities for advancement, including career paths that lead to positions at corporate headquarters in Japan.
- Implement systematic programs to ensure that executives dispatched to overseas operations adopt an international perspective and a sense of involvement in the local community.

2. *Serve the greater good of people everywhere by devoting careful attention to safety and to the environment*

Assign top priority to safety and the environment in products and in operations.

Develop applied technology and basic technology to heighten safety and to minimize environmental impact.

Find ways--such as setting up new enterprises--to share the benefits of original advances in safety and environmental technologies...

4. *Become a contributing member of the community in every nation*

Handle as much work as possible locally in every market.

- Provide operations in principal markets with capabilities for handling the entire sequence from product development through production to marketing and after-sales service.
- Equip operations in every nation with state-of-the-art technology, and provide the necessary training to develop a productive, world-class workplace.
- Manage operations in each nation in ways that maximize opportunities for employment and advancement and that promote the cultural values of the local community.

Distribute management functions globally.

- Invest local management in every region with sufficient authority to manage their operations in ways that accommodate local circumstances and values.

- Establish a clear division of labor in management between overseas operations and headquarters in Japan.

Support and upgrade local management functions overseas with an eye to making local operations individually accountable for profitability.

5. *Foster a corporate culture that honors individuality while promoting teamwork*

Generate synergistic gains in productivity through a dynamic fusion of individual creativity and group teamwork.

- Combine the virtues of Japanese-style teamwork with the creativity of Western-style individualism.
- Evaluate employees with objective measures of ability and performance.

Strive to heighten the appeal of careers in the automotive industry and in manufacturing in general.

- Develop new production systems and modes of work in response to changing values and lifestyles.
- Lead an industrywide effort--encompassing other automakers and suppliers--to enhance working conditions"

Source: Toyota Motor Coporation, "Guiding Principles at Toyota" (Tokyo: Toyota, 1992), mimeo., paras. 1, 2, 4, 5.

situations, TNCs have a responsibility to seek to curtail any abuses, or to terminate their commercial ties that might be supporting them. Some TNCs have accepted this responsibility (box VIII.6).

Few observers contend that importers far removed from overseas production sites have a primary responsibility in such cases. Under the subsidiarity principle, more proximate and capable public or private actors would bear the principal responsibility to act. However, when an abuse is serious enough, a chain of social responsibility could extend back through long-term purchasing contracts to involve even major foreign importers.[7] Transnational investors who are actually present with personnel, assets and relevant commercial authority or influence carry correspondingly greater social responsibility under such conditions. The more directly connected the social problem is to the nature of a TNC's operations, the higher that situation should rank on the firm's corporate social responsibility agenda.

3. Developing countries and economies in transition

The subsidiarity principle applied to TNCs (box VIII.7) does not mean that corporations are responsible for correcting or improving all the social ills that may be present in a host country. However, it does mean that TNCs may have a compelling reason in many countries to opt for a stakeholder rather than a shareholder view of corporate social responsibility. Despite the growing internationalization of TNC listings on global stock exchanges, most host countries, and certainly the vast majority of peoples affected by TNC operations, would be excluded from a corporate responsibility circle if a narrow shareholder perspective were adopted. Without voluntary corporate concern and attention, the unequal distribution of world wealth means that the human interests of most people might be dismissed because they lack the financial capacity to become partial owners of the corporation. The impact of TNCs in societies around the world may simply be too large to accept the notion that a TNC's only responsibility lies with a relatively small core

Box VIII.6. Global social responsibility at Levi Strauss & Co.

Levi Strauss & Co. is the world's largest apparel manufacturer with one of the most famous consumer brand names in the world. This privately-held TNC markets products in over 60 countries through a variety of arrangements, including wholly owned affiliates, joint ventures, licensees and distributors. In 1993, the company recorded $5.9 billion in sales, had 76 production facilities in 24 countries and employed about 36,000 people worldwide, some 9,000 in its international division. The firm is well-known and recognized for its corporate social responsibility programmes that are guided by a series of corporate documents and policies. Perhaps the briefest, its "Mission Statement", reads:

> "The mission of Levi Strauss & Co. is to sustain responsible commercial success as a global marketing company of branded casual apparel. We must balance goals of superior profitability and return on investment, leadership market positions, and superior products and service. We will conduct our business ethically and demonstrate leadership in satisfying our responsibilities to our communities and to society. Our work environment will be safe and productive and characterized by fair treatment, teamwork, open communications, personal accountability and opportunities for growth and development."[a]

These broad goals are supplemented by other more specific statements, policies and programmes to carry out the objectives. According to Bob Dunn, a company vice-president and member of a team that devised the criteria for selecting the firm's global contractors: "As we expanded our operations to diverse countries, we felt we needed to set standards to ensure that our products were being made in a manner consistent with our values, that would not be damaging to our brand image."[b] The firm's internal policy specifies "Terms of Engagement and Guidelines for Country Selection" with its business partners that provide, among other things, for environmental requirements, ethical standards and policies on worker health, safety and employment practices (reprinted below). For example, the firm favours partners who utilize less than 60 hour work weeks, with one day free each week; workers must be paid fairly with wages meeting local standards and there must be no use of child or prison labour. In light of these policies, after evaluating nearly 700 clothing manufacturers in some 50 countries with whom it does business, the firm terminated its relations with about five per cent of its contractors and demanded improved conditions from nearly one-quarter.

In one difficult case, Levi Strauss & Co. became aware that two of its foreign contractors in Bangladesh were employing children under 14 years old, reportedly legal under local law but below the standards set by the company's "terms of engagement" policies. Normally, the children would have to be fired if the contractors were to retain Levi's business. However, after studying the situation, the company also discovered these children were their families' only source of income and likely would turn to begging in the streets if they were not employed. In an agreement illustrating a maximal social responsibility approach to improving this situation, the contractor agreed to pay the children full wages and benefits if they attended school until age 14. Levi Strauss pays for the childrens' tuition, books and school uniforms. When the children reach age 14, they will be offered the choice of returning to work in the factory. This action is in line with comments made by Peter Jacobi, President of Levi Strauss International, when he was discussing the firm's "terms-of-engagement" standards. "Keep in mind that we are talking about guidelines, not laws. To reach the best possible outcome, you must draw heavily on your own best judgment, personal background, expertise, values, and vision of the future." He termed the compromise solution in Bangladesh "an honest effort to reconcile our corporate idealism with Third World realities" (Nichols, 1993, p. 16).

The corporation also uses a list of criteria for "country selection" that excludes States that are politically and socially unstable as well as countries where there are pervasive violations of human rights, using the United Nations Declaration of Human Rights as a benchmark. The firm made headlines when, following months of study, it decided, in May 1993, not to make direct investments in China and to phase out its business with 30 Chinese clothing contractors. Similarly, in 1992, the firm withdrew from Myanmar after determining that it was impossible to do business there without directly supporting the country's military Government that was charged with serious violations of human rights.

In terms of human resources management policies and programmes, a published interview with the firm's Senior Vice President of Human Relations, Donna Goya, claimed that Levi Strauss and Co. has

become truly global. She explained that becoming global means using good ideas from everywhere, no matter where they originated, and "developing global human resource managers" by drawing people from their overseas operations and creating opportunities for others to move abroad. Human resource managers are allowed flexibility in developing programmes in their own countries, but the results turn out very consistent. According to Goya, "Our values aren't San Francisco values, or California values, or U.S. values. They're global values" (Laabs, 1992, p. 39).

LEVI STRAUSS & CO.: BUSINESS PARTNER TERMS OF ENGAGEMENT AND GUIDELINES FOR COUNTRY SELECTIONc

"Levi Strauss & Co. has a heritage of conducting business in a manner that reflects its values. Because we source in many countries with diverse cultures, we must take special care in selecting business partners and countries whose practices are not incompatible with our values. Otherwise, our sourcing decisions have the potential of undermining this heritage, damaging the image of our brands and threatening our commercial success.

Business Partner Terms of Engagement

Terms of Engagement address issues that are substantially controllable by our individual business partners.

We have defined business partners as contractors and subcontractors who manufacture or finish our products and suppliers who provide material (including fabric, sundries, chemicals and/or stones) utilized in the manufacture and finishing of our products.

1. Environmental requirements

   We will only do business with partners who share our commitment to the environment and who conduct their business in a way that is consistent with Levi Strauss Co.'s Environmental Philosophy and Guiding Principles.

2. Ethical standards

   We will seek to identify and utilize business partners who aspire as individuals and in the conduct of their businesses to a set of ethical standards not incompatible with our own.

3. Health & safety

   We will only utilize business partners who provide workers with a safe and healthy work environment. Business partners who provide residential facilities for their workers must provide safe and healthy facilities.

4. Legal requirements

   We expect our business partners to be law abiding as individuals and to comply with legal requirements relevant to the conduct of their businesses.

5. Employment practices:

   We will only do business with partners whose workers are in all cases present voluntarily, not put at risk of physical harm, fairly compensated, allowed the right of free association and not exploited in any way. In addition, the following specific guidelines will be followed.

- Wages and benefits

  We will only do business with partners who provide wages and benefits that comply with any applicable law and match the prevailing local manufacturing or finishing industry practices.

- Working hours

  While permitting flexibility in scheduling, we will identify prevailing local work hours and seek business partners who do not exceed them except for appropriately compensated overtime. While we favor partners who utilize less than sixty-hour work weeks, we will not use contractors who, on a regularly scheduled basis, require in excess of a sixty-hour week. Employees should be allowed at least one day off in seven.

- Child labor

  Use of child labor is not permissible. Workers can be no less than 14 years of age and not younger than the compulsory age to be in school. We will not utilize partners who use child labor in any

of their facilities. We support the development of legitimate workplace apprenticeship programs for the educational benefit of younger people.

- Prison labor/forced labor

  We will not utilize prison or forced labor in contracting relationships in the manufacture of our products. We will not utilize or purchase materials from a business partner utilizing prison or forced labor.

- Discrimination

  While we recognize and respect cultural differences, we believe that workers should be employed on the basis of their ability to do the job, rather than on the basis of personal characteristics or beliefs. We will favour business partners who share this value.

- Disciplinary practices

  We will not utilize business partners who use corporal punishment or other forms of mental or physical coercion.

6. Community betterment

   We will favor business partners who share our commitment to contribute to the betterment of community conditions.

Guidelines for country selection

The following country selection criteria address issues which we believe are beyond the ability of the individual business partner to control.

1. Brand image

   We will not initiate or renew contractual relationships in countries where sourcing would have an adverse effect on our global brand image.

2. Health & safety

   We will not initiate or renew contractual relationships in locations where there is evidence that Company employees or representatives would be exposed to unreasonable risk.

3. Human rights

   We should not initiate or renew contractual relationships in countries where there are pervasive violations of basic human rights.

4. Legal requirements

   We will not initiate or renew contractual relationships in countries where the legal environment creates unreasonable risk to our trademarks or to other important commercial interests or seriously impedes our ability to implement these guidelines.

5. Political social stability

   We will not initiate or renew contractual relationships in countries where political or social turmoil unreasonably threatens our commercial interests."

Sources: Material for this description is drawn from printed company fact sheets and published news accounts, including Louise Kehoe, "Levi makes bold fashion statement: US jeans maker chooses principles over profits", *The Financial Post*, 12 May 1993; Laabs, 1992; "Levi only comfortable dealing with countries that fit its image", *The Dallas Morning News*, 9 January 1994; "Levi Strauss decides against investing in China", *Los Angeles Times*, 4 May 1993; "A stitch in time", *The Economist*, 6 June 1992; and Nichols, 1993.

a Levi Strauss, "Mission Statement" (San Francisco, Levi Strauss, 1994), mimeo., p. 1.

b Kehoe (1993).

c Levi Strauss & Co. "Mission Statement, Business Partner Terms of Engagement and Guidelines for Country Selection" (San Francisco, Levi Strauss, 1994), mimeo.

of shareholders disproportionately concentrated in just a few of the affected countries. Such a conclusion would effectively ignore, as far as the TNC decision-making is concerned, a great number of people, whatever the firms' effects on their lives.

A concept that partially bridges the gap between the shareholder and stakeholder perspectives is the productivity/social separation principle (Tavis, 1982). This principle also offers a way to apply the social contract theory to TNCs in a manner that recognizes differential corporate responsibilities in the diverse societies where they operate. Under this principle, corporations that operate in a society governed by efficient market forces and effective democratic institutions can responsibly concentrate on enhancing productive outputs without assuming extra responsibilities for non-production issues. In the "ideal" democratic market model, the societal impact of corporate operations is best directed by competitive market forces, adjusted where necessary by responsible governmental institutions. In these systems, efficient free markets direct economic activity within the framework of effective laws and regulations enforced by a Government representative of a social consensus. Competitive markets and Government regulation essentially relieve firms of a responsibility to address the non-productivity needs of society because these devices will assure that the corporation produces its best benefit package for the society.

Box VIII.7. Subsidiarity and the social responsibility of transnational corporations

One application of the subsidiarity principle to the relationship between public authorities and private organizations is that the State should leave room for private organizations to take responsibility for their own affairs. More specifically, in a properly functioning democracy, political processes establish the regulatory framework within which private organizations, including enterprises, are free to act. A basic application of the subsidiarity principle in business relates to a decentralization of authority, suggesting that the most responsible, proximate and capable person -- the one closest to the issue -- should make decisions and take resulting actions. This formulation combines three important elements. First is the definition of roles as individuals define their degrees of responsibility differently depending on their relationship to the issue involved. The second element, proximity (in terms of geography, hierarchy or function) suggests that the actor closest to a problem is likely the most aware, knowledgeable and capable of effectively and efficiently resolving an issue. Capability, however, implies more than proximity and thus can also be seen as a third element. Capacity to act can bring a responsibility to do so if an essential need would otherwise go unmet because more responsible and proximate actors fail to fulfill their responsibilities.

Within this framework, enterprises can pursue their business in the strict sense of the term, since the authorities are responsible for other matters. However, a sort of *de minimis* consideration applies. Even properly functioning political processes respond only to abuses or omissions serious enough to merit the time and attention of political authorities. There remain areas in which enterprises must exercise social responsibility if it is to be exercised at all. Similarly, if political authorities are confronted with problems beyond their means, TNCs may themselves have a responsibility of *subsidium*, an obligation as social organizations to come to the assistance of the weaker body by providing the functions or services which are beyond the capabilities of the authorities; this raises the question of the duty to intervene.[a] In extreme cases, where the requirements of the authorities or the expectations of the host society are utterly at odds with the outlook of a corporation, a TNC may do better to take its business elsewhere. Some TNCs made this choice with respect to South Africa in the days of apartheid.

Hence, although the subsidiarity principle is generally based on identifying the most responsible, proximate and capable actor, its application can also trace backwards in a chain of links to locate the next most responsible, proximate and capable actor if the primary ones fail to meet their responsibilities. It is this application of the subsidiarity principle to TNCs that suggests the need for greater voluntary corporate actions in societies where normal governmental or market-place mechanisms do not function effectively.

a That is, *devoir d'ingérence*; see Millon-Delsol, 1993.

However, TNCs encounter numerous situations in their host countries in which these posited ideal conditions are not present. While even many developed countries fail to reach the "ideal" model, developing countries and the countries in transition usually lack efficient free market mechanisms and often suffer political instability as well. Over the past decade, many of these countries have moved away from centrally planned economies towards free market models while also enhancing or establishing democratic institutions. Nevertheless, until new competition and regulatory mechanisms are efficient and effective, the "ideal" conditions allowing firms to concentrate solely on business productivity goals are absent.

Consequently, in countries in which societal guidance and protection mechanisms are not fully effective, TNCs have a greater corporate social responsibility for self-regulation to assure they do not harm, and do positively benefit, the people of those host societies (box VIII.8). For instance, where fair market practices are not enforced, corporate social responsibility standards would still call for firms to behave in a responsible manner rather than seeking to extract exploitative profits to the society's detriment. Social responsibilities do not give TNCs a right to make political or social choices for a society. Instead, the concept calls for greater TNC sensitivity to the corporation's capability and impact on a country's social condition as well as its economic productivity goals. Cooperation with governmental authorities and other local leaders is essential to help guide appropriate corporate responses to the society's needs (Tavis, 1988; Werhane, 1994).

Operating in numerous individual societies as well as in an interdependent global economy, TNCs are subject to broader, more numerous and different societal expectations than solely domestic enterprises. This reality raises the issue of cultural relativism, i.e., whether firms should follow the edict "When in Rome, do as the Romans do", or instead be guided by certain universal principles that are transcultural in their application (Leisinger, 1994, pp. 11-12). There are strong arguments that corporate self-interest requires adherence in any culture to at least basic normative standards that permit markets to function on fundamental assumptions, such as trust, credibility and the honouring of contracts. Support for minimum standards of justice are also necessary for societal stability that permits long-term business planning (Bowie, 1993b). Other norms derive from human rights standards that must be respected for all individuals, regardless of particular cultural or societal circumstances (Frederick, 1993).

The challenge for TNCs is how to foster cultural responsiveness without falling prey to cultural relativism.[8] Historically, many TNCs exhibited ethnocentric tendencies flowing from heavy reliance on directives from a centralized headquarters in the parent firm's home country. The increased use of complex corporate strategies and the proliferation of international strategic alliances introduce more organizationally dispersed authority and operations. This change could enhance a TNC's learning experiences, thus improving its responsiveness on social issues and reducing its ethnocentrism by making it more sensitive, knowledgeable and adaptable to globally diverse societies. A TNC still requires a common core of selected values if it is to maintain a unified corporate identity. However, by drawing on more globally diverse experiences, these internal norms may come closer to matching external public expectations regarding how corporations should behave in relation to evolving international standards.

No authority yet exists to issue a global legal charter for TNCs, and no single social contract defines comprehensively the corporate social responsibilities of TNCs. However, societal expectations do extend to cover TNC conduct outside a single society's boundaries and a variety of international guidelines promote standards of good corporate conduct, applicable in any country (Frederick, 1993). Examples of relevant intergovernmental instruments are the International Labour Organization's Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (ILO, 1991c) and the Organisation for Economic Co-operation and

Box VIII.8. Social responsibility in developing countries: the example of Ciba

The following policies and programme descriptions were excerpted from the 1993 *Report of the Ciba-Geigy Foundation for Cooperation with Developing Countries* to illustrate a particular application of TNC social responsibility principles to business in developing countries:

"*Ethical behavior*

Corporations that act responsibly in a number of obvious areas reduce the potential for conflict between a socially and economically viable development policy and the impact of a corporation's involvement in a developing country. In this context these are the minimum requirements for good business practices:

- As far as the consumer is concerned, there should be no fundamental difference between industrialized and developing countries in the quality of products and services, their safety and information for their use (e.g. indications and side-effects of drugs).
- The same objectives and principles must be adopted in the safety of production and environmental protection all over the world. Double standards in areas which affect the lives and health of people are unacceptable.
- If better information or greater insight reveals problem areas which fall within the responsibility of a company, it must take corrective action, regardless of existing regulations.
- Multinationals should set an example in their wage and social policies. Applying the standards of local industry or simply observing the legal minimum is, in many cases, inappropriate for the social conditions in poor countries.
- A multinational corporation which operates in different legal and social frameworks, and which strives for uniform ethical standards, is well advised to develop corporate policies for sensitive activities in the developing world--whether in marketing environmental protection or other areas. Not everything legal is morally acceptable.

* * *

Basic principles for Ciba's activities in developing countries

Convinced that the best basis for long-term corporate success is that all parties benefit, Ciba observes the following basic principles in its business activities:

1. Ciba acts in partnership with developing countries to advance their economic potential in the interest of both parties. It fully observes the rights and duties arising out of such a partnership.
2. In making business decisions about the developing world (for example, about products, services, technologies and investments), Ciba takes into account their impact on the development of the host country in addition to economic criteria. Ciba is prepared to take a long-term view of profit in developing countries.

Development's Guidelines for Multinational Enterprises (OECD, 1992e) (see chapter IX). Other principles and guidelines can evolve from initiatives by private sector groups, including steps by the business community to establish voluntary standards. Examples are:

- International codes. An example is the International Chamber of Commerce's Business Charter for Sustainable Development (ICC, 1991) which has also been used by firms to formulate their own codes (box VIII.9.)
- National codes by business associations. An example is the Japanese Guidelines for Overseas Direct Investment adopted by a group of Japanese business organizations (Keidanren, 1987 — box VIII.10). Naturally, codes adopted by business organizations tend

3. If a developing country adopts measures to protect its economy (for example, import restrictions, export obligations, or conditions for ownership), Ciba cooperates as long as partnership and adequate returns are not jeopardized in the long-term.
4. Ciba considers it its duty to advise its partners against undertakings of doubtful benefit (for example, prestige projects), even if such a move proves detrimental to our economic interests.
5. Ciba has progressive social and personnel policies in the developing countries, adapted to local conditions. In particular Ciba trains employees locally if possible, and abroad if necessary, allows capable staff to gain international experience in the company and considers nationals for executive positions.
6. The quality of Ciba's products is the same in all countries.
7. In environmental protection and safety Ciba pursues the same objectives in all countries. Through the transfer of technology Ciba helps to make chemicals more environmentally sound and safer.
8. Information and advice is based on the same scientific knowledge in all countries. Ciba thus pursues safe and proper use of its products.
9. The prices of Ciba products are determined by the particular national market and competitive conditions.

The Risk Fund

Ciba's corporate management authorized the establishment of an in-house Risk Fund in the summer of 1988. This was based on the conviction that long-term profitability in the developing world also depends on finding new creative and innovative approaches to its markets and the courage to take risks. The Fund should encourage Divisions, even in economically unfavorable times, to take on projects with new strategies, long lead times, high initial investments or costly services, if they make long-term commercial sense. The Risk Fund is intended to help the company to overcome the special conditions which limit entrepreneurial action in developing countries and to live up to our "vision" (i.e. striking a balance between economic, social and ecological obligations) even under difficult conditions. The Risk Fund is yet another step forward to our objective of selling not only products, but solutions to problems."

* * *

Among the projects supported by Ciba's Risk Fund are a social marketing programme for the treatment of epilepsy, implemented in collaboration with local epilepsy associations initially in Ecuador, Egypt, Indonesia and Kenya; studies in India, Mexico and Zimbabwe to develop methods to foster the safe and effective use of plant protection products among small-scale farmers; the promotion of printed fabric exports from Senegal's labour-intensive textile industry; and agricultural advisory assistance for a farming resettlement colony in Bolivia.

Source: The Ciba-Geigy Foundation, *Report of the Ciba-Geigy Foundation for Cooperation with Developing Countries*, (Basle: Ciba-Geigy Foundation, 1993), pp. 29, 33-34.

to be less forceful than codes adopted by individual firms, as they need to reflect the consensus of all their members.

Individual corporate codes of conduct (Kline, 1985, Business Roundtable, 1988). Examples of such codes were cited in a number of boxes in this chapter. A review of these documents and others suggests a range of topics relevant to TNC social responsibility, including relations with governments and local communities, competition practices, consumer rights, marketing methods, anti-bribery standards, environmental protection, and employment and employee relations.

C. The social responsibility of transnational corporations in human resources management

As examined in Part Two of this volume, TNCs play an important role in employment, human resource development and industrial relations in the countries in which they operate. Corporate social responsibility will often lead TNCs to exceed legal requirements, drawing on their international experience to assist and advance local practices. Issues of appropriateness and choice may be raised where foreign methods and standards are introduced into different cultural and socio-economic settings. Under these circumstances, the concept of TNC social responsibility could suggest principles and processes to maximize the benefits and minimize possible disruptions related to the impacts of foreign affiliates. Many TNCs set forth their policies towards employees in documents ranging from brief statements of principles to detailed policy manuals (box VIII.11 contains an example). A review of such documents reveals a distinction between policies that focus on specifying the responsibilities of employees to the corporation, and an approach that recognizes and addresses corporate responsibilities to employees as well as vice versa (Kline, 1985, pp. 99-102). Corporate social responsibility standards would recognize the mutual nature of these rights and responsibilities. For TNCs, these standards need to be crafted so as to address diverse global conditions and provide management guidelines for operating on an intersocietal basis.

The following sections analyse — by way of example — some of the key issues that constitute core topics for TNC social responsibility discussions regarding human resource management.

Employment. As was discussed earlier in this volume, total direct TNC employment is less significant for most host countries than the general economic stimulus and multiplier effects associated with the operations of those firms. Social responsibility considerations therefore focus

Box VIII.9. Using international documents as a basis for corporate codes: the example of Unilever

Transnational corporations can use internationally-agreed public and private sector documents, such as the ICC's Business Charter for Sustainable Development, to help guide application of their social responsibility standards on specific issues. The excerpt below is drawn from "Introducing Unilever 1993", a publication of Unilever External Affairs in London and Rotterdam:

"*Social Responsibility*

In meeting the needs of consumers across the world, Unilever takes care to respect the physical, economic and social environments of the communities in which it operates. It has a strong tradition of commitment to good citizenship, believing that the success of the company and the welfare of the community go hand in hand.

Minimising the use of raw materials and the production of waste in both products and packaging so as to reduce their impact on the environment is an important element in Unilever's business strategy. Recent product advances include the introduction of a fabric conditioner formulation based on a new active ingredient with an excellent environmental profile, being easily and completely biodegradable. Unilever has expressed its commitment to the goal of sustainable development by signing the International Chamber of Commerce Business Charter for Sustainable Development, and takes a leading role in efforts to promote responsible environmental initiatives, such as those on packaging and recycling.

Unilever is committed to maintaining the highest standards of fairness and integrity in all its dealings with consumers, customers, suppliers, employees and other stakeholders."

Source: Unilever. "Introducing Univelever 1993" (London: Unilever, 1993), p. 7.

more on the treatment of TNC employees and industrial relations than on their total numbers, although actions responsive to national job creation merit consideration whenever competitively feasible.

Conditions of work. Non-discrimination is a widespread tenet of corporate social responsibility standards on employment. In their global operations, TNCs encounter individuals with

Box VIII.10. National codes of business associations: the Japanese guidelines for foreign direct investment

A group of major Japanese economic organizations issued a set of "Guidelines for Investment Activities in Developing Countries" in June 1973. These guidelines were reviewed and updated, and new "Guidelines for Overseas Direct Investment" were issued in April 1987. The sponsoring organizations included the Japan Federation of Economic Organizations (Keidanren), The Japan Chamber of Commerce and Industry, the Japan Association of Corporate Executives (Keizai Doyukai), The Japan Federation of Employers' Associations (Nikkeiren), the Japan Foreign Trade Council Inc., the Kansei Economic Federation (Kandeiren) and the Japan Overseas Enterprises Association (JOEA). The excerpts below on foreign employee relations are taken from the English translation of the original Japanese edition "Kaigai Toshi Kodo Shishin":

4. "*Establishment of Sound and Fair Labor-Management Relations*

To establish sound and fair labor-management relations by deepening both knowledge and understanding of labor union organizations and labor practices of the host country, and by promoting mutual understanding between labor and management through exchange of information and opinions.

5. *Employment and Promotion of Local Personnel*

To employ local personnel and to promote those qualified to higher positions in order to contribute to the expansion of employment opportunities in the host country.

Furthermore, to take into consideration local circumstances when deciding working conditions and to improve the work environment so as to ensure safety and hygiene for employees.

6. *Promotion of Education and Training for Local Employees*

To organize in-house education and training programs for local employees to improve their job-related abilities, and if deemed necessary, to provide them with the opportunity to acquire skills and techniques (including business and management skills) by sending them to Japan and/or elsewhere for training and education.

To give consideration to the necessity of technology transfer when implementing education and training programs, particularly in developing countries or wherever it is required."

Source: Japan Federation of Economic Organizations (Keidanren) et al., "Guidelines for Overseas Direct Investment" (Tokyo, Keidanren, 1987), mimeo., pp. 2-3.

widely varying personal characteristics and cultural backgrounds. Both in hiring practices and in the treatment of individuals once employed, TNC social responsibility standards could be expected to prohibit discrimination on the basis of distinctions such as race, sex, religion or ethnicity.[9] As with other global norms, the challenge is in the application in particular countries where such discrimination is legally required or socially entrenched.

Basic terms of employment are governed by local laws that may introduce some variations into the specific application of general standards. For example, international norms recognize the need to regulate the employment of groups such as children or prisoners who would not have the competence or freedom to choose their terms and conditions of work (ILO, 1988, pp. 29-64). In practice, societies may define and interpret child labour standards differently, choosing age limits

in line with their own culture and traditions. Enforcement of local laws may also be a problem for TNCs themselves, as reflected in the recent decision to address labour issues in the World Trade Organization in the context of practices that can create unfair trade conditions (see chapter IX). Transnational corporations cannot avoid deciding the extent to which they will respect local laws that the authorities do not enforce. In terms of social responsibility, it is often suggested that TNCs ought to promote practices that adhere to the spirit of recognized international principles without violating local laws or offending official standards. Following this rule would promote the globalization of these principles. In so far as they are principles endorsed by recognized international bodies like the United Nations, the ILO or UNEP, or in so far as the principles are important to the efficient working of TNCs that bring widespread benefits, this approach merits attention (box VIII.12 contains an example; others are contained in chapter IX).

Wages and fringe benefits. Transnational corporations are often subject to contrasting standards when measured against home and host country practices. Social responsibility considerations include both minimum subsistence norms and an evaluation of fair and beneficial compensation standards relative to local requirements and practices. As shown in chapter IV,

Box VIII.11. Social responsibility and employees: the example of S.C. Johnson & Son

The following excerpts on employee policies are drawn from "This We Believe", a statement of company philosophy first discussed and ratified by delegates at a Johnson Wax Global Management Conference held in 1976 and subsequently refined and reissued after more than ten years of experience:

"Introduction

Our statement of corporate philosophy has been translated and communicated around the world -- not only within the worldwide company, but also to key external audiences. It has served as well by providing all employees with a common statement of the basic principles which guide the company in all the different cultures where we operate. It has also provided people outside the company with an understanding of our fundamental beliefs. It communicates the kind of company we are.

. . .

Employees

We believe that the fundamental vitality and strength of our worldwide company lies in our people, and we commit ourselves to:

* Maintain good relations among all employees around the world based on a sense of participation, mutual respect, and an understanding of common objectives, by:
  - Creating a climate whereby all employees freely air their concerns and express opinions with the assurance that these will be fairly considered.
  - Attentively responding to employees' suggestions and problems.
  - Fostering open, two-way communications between management and employees.
  - Providing employees with opportunities to participate in the process of decision-making.
  - Encouraging employees at all levels and in all disciplines to work as a team.
  - Respecting the dignity and rights of privacy of every employee.
* Manage our business in such a way that we can provide security for regular employees and retirees, by:
  - Pursuing a long-term policy of planned, orderly growth.
  - Retaining regular employees, if at all possible, as conditions change. However, this may not always be possible, particularly where major restructuring or reorganization is required to maintain competitiveness.
  - Retraining employees who have acceptable performance records and are in positions no longer needed, provided suitable jobs are available.

TNCs generally compensate employees somewhat above the local average but not to a degree that unfairly disadvantages local employers or offsets international comparative advantage considerations.

Given the widely varying economic, political and social settings within which they operate, TNC social responsibility standards do not dictate that firms set the same compensation levels across their entire network. Geographical differences in production cost factors, including labour, underlie the fundamental economic principle of comparative advantage. For TNCs to establish the same compensation standard for their workers worldwide would create short-run distortions in local labour markets while reducing longer-run investment in many labour-surplus countries by negating their comparative cost advantage.

Compensation policies by TNCs conform to local law while being bounded by minimal obligations to provide subsistence wages under any conditions, and maximal responsibilities to grant additional real benefits consistent with local regulations, competitive conditions and the need to make a profit. Fringe benefit policies offer opportunities to aid employees through

* Maintain a high level of effectiveness within the organization, by:

- Establishing clear standards of job performance.
- Ensuring that the performance of all employees meets required levels by giving appropriate recognition to those whose performance is good and by terminating those whose performance, despite their managers' efforts to help, continues below company standards.

* Provide equal opportunities in employment and advancement, by:

- Hiring and promoting employees without discrimination, using qualifications, performance, and experience as the principal criteria.

* Remunerate employees at levels that fully reward their performance and recognize their contribution to the success of their company, by:

- Maintaining base pay and benefit programs both of which are fully competitive with those prevailing within the relevant marketplaces.
- Maintaining, in addition to our fully competitive pay and benefit programs, our long-standing tradition of sharing profits with employees.

* Protect the health and safety of all employees, by:

- Providing a clean and safe work environment.
- Providing appropriate safety training and occupational health services.

* Develop the skills and abilities of our people, by:

- Providing on-the-job training and professional development programs.
- Helping employees qualify for opportunities in the company through educational and development programs.

* Create environments which are conducive to self-expression and personal well-being, by:

- Fostering and supporting leisure-time programs for employees and retirees.
- Developing job-enrichment programs.
- Maintaining the long tradition of high quality and good design in our offices and plants.

* Encourage initiative, innovation, and entrepreneurism among all employees, thereby providing opportunities for greater job satisfaction while also helping the worldwide company achieve its objectives."

Source: Johnson Wax, "This We Believe" (Racine: Johnson Wax, 1993), mimeo., pp. 1, 3-5.

Box VIII.12. Observing international labour standards: the example of Reebok

In mid-1992, a task force at Reebok completed work on a set of formal, uniform guidelines that establish standards for the treatment of workers in factories worldwide that produce Reebok products. Some fifty independently owned and managed companies in more than six countries manufacture such products. Drawing from their own experience and advice from the United Nations, human rights organizations and Levi Strauss & Co. (box VIII.6), the company issued the "Reebok Human Rights Production Standards", reprinted below:

"Non discrimination

Reebok will seek business partners that do not discriminate in hiring and employment practices on grounds of race, color, national origin, gender, religion, or political or other opinion.

Working hours/overtime

Reebok will seek business partners who do not require more than 60 hour work weeks on a regularly scheduled basis, except for appropriately compensated overtime in compliance with local laws, and we will favor business partners who use 48 hour work weeks as their maximum normal requirement.

Forced or compulsory labor

Reebok will not work with business partners that use forced or other compulsory labor, including labor that is required as a means of political coercion or as punishment for holding or for peacefully expressing political views, in the manufacture of its products. Reebok will not purchase materials that were produced by forced prison or other compulsory labor and will terminate business relationships with any sources found to utilize such labor.

Fair wages

Reebok will seek business partners who share our commitment to the betterment of wage and benefit levels that address the basic needs of workers and their families so far as possible and appropriate in light of national practices and conditions. Reebok will not select business partners that pay less than the minimum wage required by local law or that pay less than prevailing local industry practices (whichever is higher).

Child labor

Reebok will not work with business partners that use child labor. The term "child" generally refers to a person who is less than 14 years of age, or younger than the age for completing compulsory education if that age is higher than 14. In countries where the law defines "child" to include individuals who are older than 14, Reebok will apply that definition.

Freedom of association

Reebok will seek business partners that share its commitment to the right of employees to establish and join organizations of their own choosing. Reebok will seek to assure that no employee is penalized because of his or her non-violent exercise of this right. Reebok recognizes and respects the right of all employees to organize and bargain collectively.

Safe and healthy work environment

Reebok will seek business partners that strive to assure employees a safe and healthy workplace and that do not expose workers to hazardous conditions."

Source: Reebok International Ltd.. "Human Rights Production Standards" (Stoughton: Reebok, 1992), mimeo..

assistance in areas such as health care, education and housing that are particularly needed in developing countries. However, these benefits need to be shaped to the appropriate local culture and social circumstances and ought not to skew the entire compensation package beyond the comparative competition considerations already discussed.

Safety. Concern for worker safety is a core social responsibility requirement to avoid doing harm. Levels of acceptable risk may vary among countries, but TNCs can adopt standards for risk minimization, and informed consent regarding retained risk, that are applicable throughout their operations. Corporations could also continually assess and improve production processes to enhance safety, including the transfer of beneficial experience and technology from affiliated enterprises.[10]

Training. Personal and societal advancement can come from worker and management training programmes that are self-interested corporate goals increasingly vital to maintaining competitiveness in a dynamic global economy (chapter V). Host societies benefit both from a firm's improved performance and from the transfer of skills through collaboration ventures with local partners and job mobility between the TNC affiliate and local firms. Sharing skills and knowledge with local employees can be an expression of a TNC's responsibility to fill a role when governments cannot. Transnational corporations can work with local governments, labour unions and other societal representatives in exploring cooperative links between public and private sector programmes to benefit the socio-economic needs of particular host societies (box VIII.10).

Special advantages accrue to host economies when TNCs integrate lessons from their global experience into local training programmes and rotate key personnel through overseas affiliates to broaden their skills and provide a deeper understanding of foreign markets (UN-TCMD, 1992a, pp. 175-82; Kline, 1994). The best results for host countries emerge when a cooperatively designed strategy coordinates available public and private sector resources to meet basic education and training needs while avoiding a wasteful duplication of effort. Social responsibility calls for a willingness to cooperate in such undertakings which will, not coincidentally, also help assure a necessary base of properly skilled personnel for business ventures.

Closures and adjustment. Disruptions and dislocations are unavoidable in an interdependent global economy. Plant closures, employee lay-offs and the accompanying personal and community adjustments that follow are among the most traumatic and criticized effects of TNC activity. Non-TNC businesses cause similar impacts, but a TNC's size and international options engender more concern about its responsiveness to local needs. On the other hand, major foreign investors have a longer-term self-interest in taking socially responsible actions in these circumstances compared to smaller enterprises or those that are engaged principally in external trading relationships. Affiliated TNC investments in the host country or even unrelated business interests elsewhere could be damaged by negative reactions to socially irresponsible behaviour whereas smaller firms and foreign traders have relatively less at stake.

Several types of actions could be undertaken by TNCs consistent with social and business conditions, and a number of them have been specified in the ILO Tripartite Declaration and the OECD Guidelines (chapter IX). Independent of these, the stakeholder concept would call for communication with significantly affected parties, such as employees or community leaders, along with a willingness to explain decisions being taken and to discuss possible ways to avoid or ameliorate resulting dislocations (chapter IX). It is a mark of evolving societal expectations that a regulatory proposal on transnational mechanisms for corporations to inform and consult with their workers is under consideration in the European Union (chapter IX).

Possible corporate actions regarding displaced employees could include retraining programmes and/or relocation assistance that aids individual adjustment while retaining valuable human resources within the firm. These efforts can complement governmental programmes such as the adjustment and retraining initiatives sparked in the United States by the North American Free Trade Agreement (Hufbauer and Schott, 1993). Outplacement support and incentives for early retirement have also become more common, particularly for middle management affected by recent restructuring or "downsizing" moves in some industries. However, if societies place

extensive adjustment obligations on corporations by law, turning social contract expectations into legal mandates, the unintended effect can lead to labour sector rigidities. Firms can become reluctant to hire more permanent workers in order to avoid costly adjustment regulations if market dynamics compel labour-force reductions.

Trade unions. The basic relationship between TNCs and organized labour is defined principally by national law. Most TNCs are experienced at professional labour-management relations and work with labour unions under conditions specified by a society's law and practices (chapter VI). Depending on the extent of the legal provision, however, socially responsible behaviour could suggest a more forthcoming behaviour of both social partners, with a view towards establishing productive cooperative relationships between management and trade unions. Of course, corporations can also pursue maximal social responsibility goals, for example by supporting employee efforts to form union representation where it will serve the workers' interests in a collective bargaining process as well as promote other societal objectives.[11]

Conclusions

The concept of corporate social responsibility helps to organize and apply abstract notions about how a firm relates to its surrounding society. Corporations are governed by law, but specific regulations cannot cover the full range of corporate activities. More general societal expectations regarding business conduct are often subsumed under the term "good corporate citizenship." For TNCs, the notion of both citizenship and social responsibility are more complicated than for enterprises that operate only in a single country. Applying theories of corporate social responsibility to TNCs requires adjustment for the more numerous and diverse social circumstances they encounter as well as for their complex business patterns of operation and control.

The emergence of an integrated international production system is going hand-in-hand with new TNC organizational structures. Traditional models of a single headquarters controlling hierarchically a set of wholly-owned foreign affiliates are being replaced by an array of international intra- and inter-corporate arrangements where equity, research, production, marketing and other business functions are shared among many variously related enterprises, often including principal competitors. In terms of corporate social responsibility, these complex and shifting structures make it difficult, but important, to establish and maintain a consistent corporate identity that will define and operationalize voluntary good conduct standards across a TNC network.

As TNCs alter management and organizational processes to accommodate the demands of an integrated international production system, broader agreements are likely to evolve in areas such as accounting rules and financial management standards to facilitate operational coordination at the international level. There is an equal need to search for common grounds of understanding and applying corporate social responsibility principles to TNC operations. Broader agreement on what the concept of corporate social responsibility entails would make it easier for TNCs to set their own standards and pursue complex corporate strategies within a commonly understood boundary of international good corporate citizenship.

The globalization of TNC structures and strategies is taking place in a world undergoing fundamental change, particularly as many states move to more democratic political systems and market-driven economies.[12] A concept of global corporate social responsibility could help TNCs meet the realities and challenges of this new world. Transnational corporations are sought throughout the world as agents of development; they can also play a leadership role in promoting high standards of corporate social responsibility, including serving as an example for evolving or emerging local enterprises that lack direct experience or even other types of private sector models.

This role could be especially important to sustain support for market economy principles in countries in which both free markets and representative democratic structures are not yet fully efficient, effective and stable.

The social responsibility of TNCs is driven by the dual forces of corporate goodwill and public opinion (UNCTAD-DTCI, 1993a, p. 199). Long-run corporate self-interest argues for socially responsive actions that generally rises above the floor set by strict legal mandates. Corporate decision-making could include a specific assessment of a firm's social responsibilities, guided by reference to concepts such as the subsidiarity principle outlined in this chapter. These concepts can be applied to human resource management as well as to other types of issues facing TNCs in their evolving global operations.

Notes

1 For dissenting views on the corporate internal decision structure, see Danley, 1984 and Keeley, 1983.

2 The content of exactly what constitutes a minimum benefit or creates an unacceptable harm is subject to debate. For a well developed argument applied specifically to TNCs, see Donaldson, 1989, ch. 5.

3 A different conceptual formulation of corporate social responsibilities suggests categories of economic, legal, ethical and discretionary responsibilities. See Carroll, 1981, pp. 32-37.

4 To quote from the 1993 "Report of the Ciba-Geigy Foundation for Cooperation with Developing Countries", p. 49: "Humanitarian commitment is no substitute for ethical behavior. The overall impact on development of a multinational company depends largely on its structure and the quality of its activities in normal business. Humanitarian assistance is always desirable as it helps reduce distress and human suffering. But charitable projects and programs are no substitute for ethical behavior. Nor do they compensate for economic, social or ecological irresponsibility."

5 For a summary of basic arguments for and against these two views of corporate social responsibility, see Davis, 1977.

6 For example, see Dinah Lee and Rose Brady, "Long, hard days: at pennies an hour," *Business Week,* 31 October 1988, pp. 46-47; Matt Moffett, "Underage laborers fill Mexican factories, stir U.S. trade debate," *The Wall Street Journal,* 8 April 1991; Frank Swoboda, "Apparel firms on U.S. Pacific island accused of 'slave labor' conditions," *The Washington Post,* 12 February 1992; and Amy Borrus and Joyce Barnathan, "Stanching the flow of China's gulag exports," *Business Week,* 13 April 1992, pp. 51-52.

7 This application draws from the "Kew Gardens Principle"; see Simon, Powers and Gunnemann, 1993, p. 63. In one early example, foreign companies buying coffee beans from Uganda voluntarily ended their purchases when their sales were shown to be supporting rampant human rights abuses under the Government of Idi Amin (Gladwin and Walter, 1980, pp. 182-84).

8 One effort to assist TNC managers in making difficult decisions in this area is the use of an "ethical algorithm" (Donaldson, 1989, pp. 101-106). From another perspective, an innovative attempt to bridge the gap between empirical and normative research on business ethics suggests the concept of macrosocial and microsocial contracts. Using more specific microsocial contracts, firms can be responsive to the bounded cultural conditions in different societies. However, they are prevented from slipping into cultural relativism by a requirement that actions be consistent with their macrosocial contracts and with transcultural "hypernorms" defined similarly to human rights standards (Donaldson and Dunfee, 1994).

9 Debates in the United States over the extraterritorial extension of United States non-discrimination guarantees for employees have included discussions of the international basis for such principles (Quinn and Petrick, 1994, pp. 107-118).

10 For an interesting analysis of corporate social responsibility considerations related to employees when an asbestos manufacturing plant moves from the United States to Mexico, see De George, 1986, pp. 367-72. Related safety issues concerning the tragedy involving a Union Carbide plant in Bhopal, India are examined by Donaldson, 1989, ch. 7.

11 The amplified "Sullivan Principles" asked TNCs doing business in South Africa to "secure rights of black workers to freedom of association" while the subsequent United States State Department Principles called for "recognizing the right of all employees, regardless of racial or other distinctions, to self-organization and to form, join or assist labor organizations." With these initiatives, many TNCs did recognize black unions. While in one sense a "workplace" issue, black union organization also was an important stimulus for change in the apartheid system (Kline, 1991).

12 Donaldson and Dunfee (Donaldson and Dunfee, 1994), suggested that ethical rules for business practices are stipulated for the economic systems chosen by a society rather than being given by nature. This situation leads to potentially large variations in normative standards among countries that choose radically different economic models. Under this conception, the recent global convergence toward market economies and democratic institutions could make it easier to agree on a common set of social responsibility principles to guide TNC conduct.

Chapter IX

Trade union approaches to international production

Introduction

The rapidly changing landscape of employment and workplace relations in the context of the growing importance of transnational corporations (TNCs) and deep integration has been a central theme of this volume. An important feature of this more integrated world economy is the divergence in the mobility and organizational scope of some productive assets relative to others. A fundamental challenge facing decision makers is the need to address problems with an international dimension through structures and strategies that are still largely national in orientation and scope. Meeting this challenge applies as much to trade unions as it does to governments. But trade unions face an additional challenge. The liberalization of domestic and international economic policies has meant that trade unions have to rely more than ever on their own initiatives and resources to meet the traditional goals of their membership.

Chapter VI addressed industrial relations practices in a world economy in which production is increasingly organized internationally. Not only must trade unions deal more and more with TNCs, but the changes in the organization and management of these companies are beginning to alter established industrial relations practices in quite novel ways. In this context, trade unions have become increasingly concerned that corporate strategies leading to deeper economic

integration — and particularly the investment and disinvestment decisions of TNCs — should also bring their full benefits for labour. The basis for this concern is that the transnational organization of production has not been accompanied by a matching transnational organization of labour: although the organization of *production* by firms has become dependent upon cross-border linkages of greater complexity, the conditions and organization of *work* by firms and trade unions — and, broader, the patterns of industrial relations — have remained largely rooted in the national context, thereby affecting the ability of unions to pursue their traditional interests. Furthermore, because TNCs internalize different national labour market conditions within complex transnational structures, issues such as the availability of information and access to decision makers become important in the context of bargaining relations.

The purpose of this chapter is to review trade union strategies developed to meet these challenges. An analogy to the expansion of business may provide a helpful guide. The evolution of union organization from the local to the national level in response to the growth and widening scope of domestic firms considerably enhanced their bargaining power, reduced the gaps in organizational capacities between management and workers and reduced competition between labour in many countries. The spread of cross-border production activities reopens some of the gaps between management and workers and increases the potential competition among workers on geographically distinct labour markets. The next step, the transnationalization of labour organizations, may, therefore, appear as a logical step, matching the growth of business.

However, a consideration of trade union strategies needs to take into account the distinct objectives of organized labour, the social as opposed to simply economic orientation of unions, the resource constraints they face, as well as the considerable obstacles to internationalization that stem from diverging ideological and organizational approaches among trade unions, political barriers, legal and language differences, as well as disparate economic interests. In addition, cooperation among national unions must overcome management opposition to transnational bargaining prompted by fear of a collective power if unions are able to organize such bargaining successfully. Added to these divergent and conflicting interests, the difficulties confronting effective international trade union strategies reflect certain "organisational imperatives" facing all trade union activity (Olson, 1971, p. 77): trade unions must, to be successful, establish and defend the collective interest of a large group of employees. In this, trade unions face a simple dilemma: whilst the benefits of collective bargaining go to all employees regardless of whether they contribute to the solidarity of the group, achieving those benefits itself depends upon the widespread solidarity of the group. Consequently, trade-union solidarity exhibits the characteristics of a traditional public good exposed to the opportunities of free-riding behaviour. An effective response to this problem is likely to be all the more difficult at the international level.

In the light of these various difficulties, trade unions have evolved two broad approaches to the challenge of transnationalization. In the first place, they have sought to strengthen cross-border links and cooperation between national unions. The earliest accounts of this type of approach date back to the last century and have evolved into the present day international trade union structures (Windmuller and Pursey, 1993). On the other hand, and often acting through these international structures, trade unions have sought to influence the behaviour of TNCs through the creation and strengthening of international normative frameworks. This response also has a long history, but was pursued with particular vigour during the 1960s and 1970s (Windmuller and Pursey, 1993). The two approaches are by no means exclusive. In many respects, indeed, strong international trade union action has involved the simultaneous pursuit of both approaches — as witnessed, in particular, in Western Europe. More so than in chapter VI, therefore, the discussion here draws on the experience in the European Union, for the reasons given in the introduction to chapter VI.

Table IX.1. International trade secretariats, 1994

Name	Members (Millions)	Affiliated unions	Countries with affiliates	Headquarters	Regional offices			
					Africa	Asia, Australia, Pacific Islands	Europe	North America, Latin America, Caribbean
Education International (EI)	18	250	136	Brussels (Belgium)	Accra (Ghana)	Bangkok (Thailand) Kuala Lumpur (Malaysia)	-	Montevideo (Uruguay) San Jose (Costa Rica) Castries (Saint Lucia) Tegucigalpa (Honduras)
International Federation of Building and Woodworkers (IFBWW)	11	199	85	Geneva (Switzerland)	Lomé (Togo)	Kuala Lumpur (Malaysia)	-	Panama City (Panama)
International Federation of Chemical, Energy and General Workers' Unions (ICEF)	15	320	100	Brussels	-	-	-	-
International Federation of Commercial, Clerical, Professional and Technical Employees (FIET)	11	400	115	Geneva	-	Singapore (Singapore)	Brussels (Belgium)	San José (Costa Rica)
International Federation of Journalists (IFJ)	0.3	105	84	Brussels	-	Kuala Lumpur (Malaysia)	-	Caracas (Venezuela)
International Graphical Federation (IGF)	2.0	96	66	Brussels	-	-	Brussels (Belgium)	-
International Metal Workers Federation (IMF)	18	170	70	Geneva (Switzerland)	Johannesburg (South Africa)	New Delhi (India) Tokyo (Japan)	-	Caracas (Venezuela)
International Secretariat of Entertainment Trade Unions (ISETU)	0.3	68	26	Brussels (Belgium)	-	-	-	-
International Textile, Garment and Leather Workers' Federation (ITGLWF)	7.5	189	87	Brussels (Belgium)	-	Tokyo (Japan)	Brussels (Belgium)	Maracay (Venezuela)
International Transport Workers' Federation (ITF)	4.3	398	105	London (United Kingdom)	Nairobi (Kenya)	Tokyo (Japan)	London (United Kingdom)	Buenos Aires (Argentina)
International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations (IUF)	2.5	247	94	Geneva (Switzerland)	Nairobi (Kenya)	Sydney (Australia) Tokyo (Japan)	Brussels (Belgium)	Montevideo (Uruguay) Washington, D.C. (United States)
Miners' International Federation (MIF)	4	75	68	Brussels (Belgium)	-	-	-	-
Postal, Telegraph and Telephone International (PTTI)	4.5	250	113	Geneva (Switzerland)	Accra (Ghana) Abidjan (Côte d'Ivoire) Lagos (Nigeria) Ndola (Zambia)	Singapore (Singapore) Tokyo (Japan)	Geneva (Switzerland)	Buenos Aires (Argentina) Panama City (Panama) Santiago (Chile) Washington, D.C. (United States)
Public Services International (PSI)	16	399	116	Ferney Voltaire (France)	Nairobi (Kenya) Johannesburg (South Africa)	Brisbane (Australia) New Delhi (India) Tokyo (Japan)	Brussels (Belgium) Prague (Czech Republic) Bucarest (Romania) Riga (Estonia)	Miami (United States) San Juan (Puerto Rico) Santa Fe Kingston (Jamaica)
Universal Alliance of Diamond Workers (UADW)	..	10	8	Antwerpen (Belgium)	-	-	-	-

Source: information provided by the ITSs.

particular, paragraph 6 of the Guidelines goes some way towards recognizing the need for prior notification in the case of changes likely to have a significant impact on employees; the requirement is for "reasonable notice", but this is not defined.

- *Union recognition.* Both instruments recognize unequivocally the right of employees to be represented by trade unions.
- *Effectiveness of union action.* The Declaration defines threats of production switching or relocation as unfair bargaining tactics; the same applies to the possibility of cross-border transfers of strike-breaking labour. The Guidelines contain similar provisions.
- *Access to decision makers.* Both instruments assert the right of authorized representatives of workers to have access to representatives of management who are authorized to take decisions on matters under negotiation.
- *Information disclosure and consultations.* The Declaration urges the provision of information to employee representatives for bargaining purposes. The value of information on

- One of the strongest apprehensions is that TNCs could shape the course and outcome of collective bargaining and also restrict the exercise of workers' rights by transferring all or part of their operations to other locations. Paragraph 52 of the Declaration calls on them not to threaten to take such action and not to transfer workers from affiliates in foreign countries "... with a view to undermining bona fide negotiations with the workers' representatives or the workers' exercise of their right to organise".
- Another sensitive issue relates to the information disclosure practices of these establishments and the dependence of workers' representatives on management for information that may be considered vital for undertaking "meaningful negotiations with the entity involved". A paragraph (54), directed to TNCs, asks that they make such information available to the workers' representatives. Where national law and practice so provide, they should also supply information that would enable labour to "obtain a true and fair view of the performance of the entity or, where appropriate, of the enterprise as a whole".
- The other thorny question, which is again inseparable from the organizational and decision-making structures of TNCs, concerns access to company representatives who have the power to take decisions on matters under negotiation. In response, a paragraph (51) calls on TNCs to "... enable duly authorised representatives of the workers in their employment in each of the countries in which they operate to conduct negotiations with representatives of management who are authorised to take decisions on the matters under negotiation".

In order to get a picture of the extent to which the Declaration has made a difference in the policies and conduct of governments, labour and management, five triennial surveys have been carried out since the adoption of this instrument.

Finally, there is a procedure that enables aggrieved parties to submit requests for interpretation of the provisions of the Declaration on the application of which there may be disagreement. To date, 21 requests have been received, but only half sought specific action under the Declaration. Of these, only two have gone beyond the initial screening, then the procedural "scrutiny" and reached the interpretation stage. Neither of the two cases, however, dealt with the industrial relations provisions of the Declaration.

The procedure for the examination of disputes, coupled with the industrial relations provisions of the Declaration, particularly those relating to consultations (para. 56) and the examination and settlement of grievances (paras. 56-58), does, in fact, encourage the peaceful settlement of labour problems before they turn into open and damaging conflicts.

Source: information provided by the ILO.

Another main strand of the activities of international union structures is the provision of education and training to affiliated unions and their members, particularly to emerging unions in developing countries and the countries of Central and Eastern Europe. While important in strengthening the base and extending the scope of the international labour movement, these activities have an indirect and medium-term impact on industrial relations within TNCs. However, in particular areas, these activities do touch directly on TNC issues, e.g., training courses on bargaining with TNCs, or seminars bringing together workers from the various affiliates of a TNC.

Industrial relations practices are, however, addressed directly in a number of international trade union actions, each requiring ever higher degrees of international solidarity. Most notably, these involve the collection and exchange of information as well as the building up of networks; demonstrations of international solidarity; and, to a much lesser extent and limited to a few specific instances, the coordination of demands between foreign affiliates or transnational collective bargaining based on a common strategy and the coordinated termination of agreements. The subsequent discussion in this section elaborates on each of these activities.

1. Collection and exchange of information

The simplest and most common form of international union action is the collection and exchange of information among unions.[2] As suggested already in chapter VI, access to various types of information can be of considerable importance for a local union in a foreign affiliate, e.g., the international connections of the affiliate, the role and performance of the affiliate in the broader strategy of the group, future development plans and the industrial relations practices of the parent firm. Such information is often not immediately available to local unions, and international union structures can be important in providing it.

Given the often specific needs of local unions — such as an evaluation of the experience of a TNC in introducing new working arrangements, health standards and shifts in production schedules — information that is most useful to them is frequently most likely to be sourced from unions that have already had some experience in dealing with such an issue in a similar or related context. Advances in information and communication technology — the same that allow for the closer coordination of a TNC's geographically dispersed affiliates — are making it easier for unions to communicate directly with each other across national borders. Still, there are advantages from sourcing and collecting such information centrally, and the ITSs have become the centres of union information networks that can be immediately accessed even by a remote and small union. This means, of course, that an important everyday activity of ITSs is to maintain in-house information systems and to know where required information can be obtained.

Apart from being able to respond to ad hoc requests, the ITSs can also provide a forum for international consultations among national unions. These often extend beyond a simple exchange of information to a comparison of experiences within the same enterprise or with union representatives from other enterprises, to the coordination of solidarity actions and, occasionally, to consultations and exchange of information with central management. For this purpose, since the late 1970s, unions have organized world company councils in several large TNCs (table IX.2) in the automotive, chemical, food and drink, electrical and electronic, and mechanical engineering industries as well as in such services industries as finance, insurance and distributive trades. (For a brief description of the Volkswagen Group Works Council, see box VI.4.) Some ITSs, especially the International Metalworkers Federation and the International Federation of Commercial, Clerical, Professional and Technical Employees, have given priority to bringing together workers from the same TNC but employed in different countries. It appears that the councils have been important in creating a network of relationships among unions.

Table IX.2. World company councils, 1994

Company	*Home country*
Alfa Laval [a]	Sweden
Allianz [b]	Germany
Asea Brown Boveri [a]	Sweden/Switzerland
Caterpillar [a]	United States
Chrysler [a]	United States
Daimler Benz [a]	Germany
Electrolux [a]	Sweden
Fiat [a]	Italy
Ford [a]	United States
General Electric [a]	United States
General Motors/Saab [a]	United States
Honda [a]	Japan
IBM [a]	United States
Ikea [b]	Sweden
ISS [b]	Denmark
Matsushita [a]	Japan
Mazda [a]	Japan
METRO [b]	Germany
Mitsubishi [a]	Japan
Nestlé [d]	Switzerland
Nissan [a]	Japan
Northern Telecom [a]	Canada
Rank Xerox [b]	United States
Renault/Volvo [a]	France/Sweden
Siemens [a]	Germany
SKF [a]	Sweden
Spie Batignolles [c]	France
Tengelmann [b]	Germany
Toyota [a]	Japan
Unilever [d]	United Kingdom/Netherlands
Volkswagen [a]	Germany
Xerox [a]	United States

Source: information provided by the ITSs.

a Organized by the International Metal Workers Federation (IMF).

b Organized by the International Federation of Commercial, Clerical, Professional and Technical Employees (FIET).

c Organized by the International Federation of Building and Woodworkers (IFBWW).

d Organized by the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Federation (IUF).

However, world councils have been difficult to organize, among other reasons because the organization of meetings of the councils is very costly; the advent of information technology may, however, open new ways of coordination. Although informal talks between management and labour at the central level have taken place in a number of cases, particularly in Europe (Carley, 1993, p. 14), TNCs in general have resisted the recognition of the councils as negotiating partners, partly for fear that this may compromise managerial prerogatives, and partly on the ground that responsibility for social, personnel and industrial relations matters are typically decentralized to the level of affiliates or plants. It may, therefore, not be appropriate for top management to meet with union representatives at the world level to discuss concrete industrial relations matters in the absence of those (managers of the affiliates or representatives of local unions) directly involved. Overall, therefore, the experience with world company councils has been mixed and it has remained largely confined to a number of large TNCs in a few highly transnationalized industries.

In some cases, however, they have paved the way for more institutionalized voluntary agreements on exchange of information in some TNCs in Europe (section C below).

1. Demonstrating international solidarity

In disputes with TNCs — especially those involving collective bargaining and trade-union recognition rights — international union action extends to direct support for national unions. Here, international solidarity can take a variety of forms, staged according to the level of involvement of the international structures and the issue at stake: solidarity messages; provision of ad hoc assistance; pressures on headquarters; and corporate campaigning.

Solidarity messages. The most common and spontaneous form of international union solidarity involves the simple voicing of support for actions elsewhere in the corporate system — what can be termed "telex solidarity". The purpose is principally to make headquarters management aware of a dispute in a given affiliate and to alert it that unions throughout the corporation know about it too. Accordingly, the competent ITS informs unions from affiliates throughout the world who, in turn, send telexes or facsimiles to headquarters (and to the management of the affiliate involved in the dispute) to express their solidarity with the union involved in the particular dispute. Typically, this kind of activity remains entirely within the corporation, although it may happen that communications are also sent to the government in the host country of the affiliate. This activity — which accounts for a significant volume of the work of an ITS — can be quite effective in facilitating resolution of simple industrial relations disputes either because headquarters intervenes (e.g., where there is an impasse) or the local management does not find it worthwhile under these circumstances to pursue the matter.

Provision of ad hoc assistance. A complementary form of solidarity is the provision of ad hoc assistance, for instance, legal advice on specific matters (e.g., how to handle a dispute), small-scale financial support to a union, aid to the families of workers on strike and the like.

Pressures on headquarters. Where solidarity messages do not lead to the desired result, ITSs may try to put pressure on headquarters' management to intervene directly with the local management involved in a dispute. This is done mostly in the form of a "sunlighting strategy" that aims at warning the company that, if a dispute is not resolved, it is likely to receive widespread public attention, with consequences, among other things, for the corporate image. Such pressure, however, apparently is not applied too often, and typically only in the case of disputes involving fundamental issues such as union recognition, violence against strikers and interventions by police or armed forces in a labour dispute. It can take various forms. For instance, if a strong trade-union affiliate exists in the home country, its president may call on the president of the parent company to discuss the matter. Or the matter can be brought to the attention of the authorities, embassies, members of parliament and consumers' groups in both the host and home countries. In case of a strong union presence in other host countries of the company, local unions may raise the issue with their managerial counterparts or with the central management. For instance, the local management in a developing country affiliate of a TNC in the paper and printing industry was imposing more stringent controls and security checks than was agreed upon in other affiliates of the same TNC. Pressure on headquarters by unions in the various affiliates worldwide appears to have contributed to reaching agreement and ending the dispute.[3] Overall, while some of these forms of pressure may reach into the public realm, they are mostly confined to the company network.

Corporate campaigning. Full-scale campaigns are the most intensive form of international trade union action. They occur, however, quite seldom. Typically they are only undertaken when a fundamental issue is at stake and the chances for success are high (which,

among other things, requires a strong union in the country in which the dispute is being carried out). The organization of such campaigns requires careful preparatory research to identify points of leverage, the identification of clear objectives, the creation of strong solidarity, cooperation among various ITSs, a considerable organizational effort, and substantial financial resources. The decision to undertake a full-scale corporate campaign is therefore taken only after a careful evaluation of the situation; and, once taken, it requires very careful preparation. The international union structures may organize strong international pressure on the central management through campaigns in the media to raise public awareness of a dispute and embarrass a company, and calls for a consumer boycott of the company's products. In exceptional cases, sympathy strikes may take place, although legal and practical obstacles to them are high.[4] Given these difficulties, less costly avenues are pursued sometimes, such as restrictions on overtime in other plants to avoid that production is made up in this way (Rose, 1984). Such actions, when they take place, can be quite disruptive to the cross-border organization of production and distribution.

A widely-publicized example of a corporate campaign was the struggle between a franchise holder of a large TNC in Guatemala and the local enterprise union, which lasted for several years and concerned recognition of the union, reinstatement of dismissed workers and renewal of a collective agreement (ILO, 1991d, p. 32). The International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Associations (IUF) organized worldwide solidarity actions by means of short-term production stoppages and consumption boycotts at the company's plants. The ITS also held talks with the central management and lodged a complaint against the Government of Guatemala with the International Labour Organisation. In 1980, the dispute was settled by an agreement that marked the beginning of more positive relations between the TNC and the unions (Neuhaus, 1982, p. 62). Another example of a worldwide union campaign involved South Africa. After the 1972-1973 Durban strikes, ICFTU, its affiliates and ITSs, established a coordinating committee whose main purpose was to convince companies to recognize black trade unions in South Africa. The coordinating committee targeted TNCs investing in South Africa, documented cases where TNCs were paying wages falling well below poverty lines and, through their affiliates in other countries, put pressure on individual parent companies of foreign affiliates in South Africa to recognize black trade unions and, when appropriate, intervene in a dispute. Going beyond the individual company approach, unions worldwide pressured for the development of codes of conduct for companies operating in South Africa (which bore fruit in the Sullivan principles etc.) and engaged in "disinvestment" campaigns through demonstrations, threats of a product boycott and protests at shareholder meetings. As the latter example illustrates, international action may move beyond traditional forms of union action, such as stoppages of production, in accordance with the specific objectives of a given campaign. This was also exemplified in the recent case of a coal company, where the union exerted indirect pressure by contacting its counterparts in a country in which principal purchasers were located. These alerted their management that possible interruptions in supply could occur which, in turn, jeopardized the supplier contracts.

Demonstrating international solidarity among unions in bargaining situations is an important tool of international union action. However, the extent to which international union structures participate in a dispute, and escalate it, needs to be carefully evaluated on a case-by-case basis.

3. Transnational bargaining

Transnational collective bargaining attracted considerable attention in the literature on industrial relations in the 1970s (Northrup and Rowan, 1979), but has faded considerably in recent

years. Actual attempts by unions to coordinate demands internationally have only been made under particularly favourable conditions. An example is the 1967 Chrysler wage parity agreement for Canada and the United States (Blake, 1972). This case was characterized by a high degree of unionization, the integrated nature of the North American automobile industry, the fact that a single union had organized workers in the two countries, negligible productivity differences and a free trade agreement for the product concerned. Similarly, in the well publicized St. Gobain case, union solidarity was never actually tested (Northrup, et al., 1977).

Transnational collective bargaining based on common demands and a simultaneous termination of agreements has also been exceptional. The impediments to such action are considerable. To name a few, differences in labour legislation and practice obviously create problems. So does the growing diversity of international business forms: as TNCs increasingly opt for joint ventures, strategic alliances of finite duration, and the outsourcing of goods and services, the boundaries of a firm blur, and organizational difficulties become forbidding. To that, one has to add the problem of identifying mutual interests when diverse labour markets are involved (e.g., the United States and Japan) or where subcontracting is firmly entrenched (e.g., Republic of Korea) (Sengenberger, 1992).

Where transnational collective bargaining has taken place, unions have targeted the most promising candidates. Within the United States, they were among the largest TNCs, and those with the most centralized labour relations (Hershfield, 1975). The most successful cases have occurred within the services sector (especially in shipping and entertainment) and appear to share a number of characteristics: high sensitivity to disruptions, the international demand for the industry's output, high unionization (e.g., among dockers or film crews), the mobility of labour and the low probability of factor and location substitutability (Miscimara, 1981; Northrup, et al., 1977). All in all, however, transnational collective bargaining plays only a marginal role in trade union approaches to international production.

* * *

Industrial relations at the national level are not only a bilateral issue between employers and employees; rather, they take place within an established regulatory framework. Trade unions seek to replicate, to a certain extent, this approach at the international level. The strategies described so far involve bilateral relations between unions and TNCs at the international level. The normative side of this approach is discussed next.

B. International normative frameworks

The most common form of international norms are labour standards set by the ILO to create a floor for the promulgation of national labour laws. Although not designed to tackle specific issues raised by TNCs, such standards apply to both indigenous firms and foreign affiliates; this topic will be further pursued in subsection 2 below. A more focused type of international instrument dealing with industrial relations, and prompted by the ascendancy of TNCs, consists of international guidelines for TNC behaviour. The next subsection discusses two of these instruments, namely, the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy and the chapter on employment and industrial relations of the OECD Guidelines on Multinational Enterprises. In both cases, the focus is on the industrial relations aspect of the two instruments and, particularly, those issues discussed in chapter VI as representing central issues in the relations between TNCs and trade unions.

1. International guidelines for transnational corporations in the area of industrial relations

Beginning in the 1960s, the perception that the transnationalization of capital could adversely affect the position of organized labour generated pressures to regulate the activities of TNCs through stronger national legislation. Eventually, however, these pressures were superseded by a broad-based trend of international economic integration (chapter III). In fact, as discussed in chapter VII, recent years have seen a significant liberalization of restrictions on inward investment in most countries and regions, and there is little evidence to suggest that trade unions see restricting capital mobility as an appropriate or particularly viable strategy in today's open world economy. From a longer-term perspective, the emergence of deeper integration of the world economy and the adoption of complex integration strategies by TNCs have added to the uncertain effects of proscriptive strategies and increased the desirability of more creative responses.

Recognizing the limitations of national approaches, trade unions became the driving force behind various regional and international efforts to establish normative frameworks that would affect the conduct of TNCs, particularly in the area of industrial relations and conditions of work. As early as 1969, the ICFTU adopted a resolution on "Multinational corporations and conglomerates" (ICFTU, 1971),[5] and, in 1975, "The Charter of Trade Unions Demands for the Legislative Control of Multinational Enterprises" (ICFTU, 1976), taking the position that the interests of trade unions would be best served by the adoption of a legally-binding international framework negotiated in a global setting. Various initiatives were pursued, including at the United Nations, to negotiate such a framework. But it soon became clear that a legally binding instrument would not be feasible at that level. While negotiations on a comprehensive voluntary code proceeded at the United Nations, two other simultaneous efforts to elaborate voluntary guidelines were successfully concluded, one at the ILO and the other at the OECD. These remain the main international instruments of importance to organized labour.

The ILO Declaration, adopted by the Governing Body of the International Labour Office in 1977, is a non-binding, universally applicable code. The aim of the Declaration is to "encourage the positive contribution which multinational enterprises can make to economic and social progress and to minimise and resolve the difficulties to which their various operations may give rise..." (paragraph 2). The principles and recommendations are intended to promote good social practice on the part of Governments as well as employers' and workers' organizations in both home and host countries, and *all* enterprises, irrespective of their ownership, size, sector of activity or location. In recognition of the decision-making power, financial resources and technological capabilities of TNCs, there are certain provisions of the Declaration that urge TNCs in particular either to assume a leading role in certain spheres or to cooperate in special ways with Governments and labour. The provisions of the Declaration cover key areas in which the policies and practices of TNCs have either had or are likely to have repercussion on labour and society, focusing in particular on employment, training, conditions of work and life and industrial relations (box IX.1).

The OECD Guidelines, adopted in 1976, while narrower in geographical scope than the ILO Declaration — they apply only to TNCs from the OECD countries (and Hungary),[6] but their impact extends to other countries as well — are broader in coverage. The Guidelines are part of a declaration that also includes recommendations addressed to Governments on national treatment, conflicting requirements and incentives and disincentives; binding decisions provide mechanisms for follow-up (OECD, 1992b). This instrument is intended to guide the process of cooperation in the area of FDI and, therefore, deals with a whole range of issues — such as disclosure of information, competition, taxation and science and technology — arising from TNC operations. Many of these subjects bear only indirectly on industrial relations. However, the

Guidelines also contain a chapter referring directly to employment and industrial relations (box IX.2).

As regards the principal issues that arise in the relations between TNCs and trade union as discussed in chapter VI, the ILO Declaration and the OECD Guidelines, and their follow-up, provide guidance and clarification on the following:

Locational flexibility. On the consequences of increased capital mobility, the Declaration urges TNCs, through active human resources planning, to endeavour to ensure stable employment opportunities. This expectation is particularly important when the discontinuation of operations would accentuate structural unemployment. In cooperation with TNCs, there is an expectation that Governments will provide some forms of support as well as appropriate information and retraining to those displaced. In the event of changes in operations, perhaps resulting from acquisition or a transfer of production, TNCs are expected to give both Government and employee representatives reasonable notice to facilitate orderly adjustment. Similar provisions are contained in the Guidelines. In

Box IX.1. The ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy: issues in industrial relations

Labour-management relations in TNCs have long been a major concern for the ILO. In the years preceding the adoption of the Declaration, they received special mention at regional conferences, were the subject of a resolution at the 1968 International Labour Conference and the focus of a symposium organized by the International Institute for Labour Studies in 1969.

The 19 paragraphs (40-58) of the Declaration that provide guidelines in the field of industrial relations reflect the broad range of concerns that were articulated by Governments and representatives of the social partners over the years. They are designed to promote the observance of international standards, by both national and transnational enterprises, in the following areas: freedom of association and the right to organize; collective bargaining; and labour-management consultations and the settlement of labour disputes through, *inter alia*, the use of voluntary arbitration and conciliation machinery. As it is in the case of other paragraphs of the Declaration, those relating to industrial relations are reinforced by references to relevant ILO Conventions and Recommendations.

According to the provisions of the instrument, TNCs "should observe standards of industrial relations not less favourable than those observed by comparable employers..." in the host country. The shared responsibility and roles expected of all the parties are explicitly identified in some paragraphs. While most of the provisions are directed at Governments and employers, it is, of course, implicit that the cooperation of workers and their representatives is indispensable for realizing the aims of those provisions.

There is a clear recognition of the importance of national legislation and practice. For example, Governments and employers are often recommended to act in particular ways, and workers are expected to enjoy certain rights "in keeping with national law and practice". Here, the standard-setting responsibility and role of Governments are critical. Those that have not ratified the relevant ILO Conventions are urged to do so and, in the absence of ratification, they, together with employers in national enterprises and TNCs, are none the less advised to use those instruments and the corresponding recommendations as guidelines. This is particularly emphasized with respect to the Convention (No. 87) concerning the Freedom of Association and Protection of the Right to Organise and the Convention (No. 98) concerning the Application of the Principles of the Right to Organise and Bargain Collectively — both of which are basic human rights Conventions.

Even though management in local, mixed and wholly foreign-owned enterprises are expected to have the same standards of conduct in all aspects of labour-management relations, there are three paragraphs that are addressed to TNCs only. They reflect certain concerns that have prevailed over the years and cannot be divorced from the organizational structures of TNCs as well as the international scope of their operations:

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particular, paragraph 6 of the Guidelines goes some way towards recognizing the need for prior notification in the case of changes likely to have a significant impact on employees; the requirement is for "reasonable notice", but this is not defined.

- *Union recognition.* Both instruments recognize unequivocally the right of employees to be represented by trade unions.
- *Effectiveness of union action.* The Declaration defines threats of production switching or relocation as unfair bargaining tactics; the same applies to the possibility of cross-border transfers of strike-breaking labour. The Guidelines contain similar provisions.
- *Access to decision makers.* Both instruments assert the right of authorized representatives of workers to have access to representatives of management who are authorized to take decisions on matters under negotiation.
- *Information disclosure and consultations.* The Declaration urges the provision of information to employee representatives for bargaining purposes. The value of information on

- One of the strongest apprehensions is that TNCs could shape the course and outcome of collective bargaining and also restrict the exercise of workers' rights by transferring all or part of their operations to other locations. Paragraph 52 of the Declaration calls on them not to threaten to take such action and not to transfer workers from affiliates in foreign countries "... with a view to undermining bona fide negotiations with the workers' representatives or the workers' exercise of their right to organise".
- Another sensitive issue relates to the information disclosure practices of these establishments and the dependence of workers' representatives on management for information that may be considered vital for undertaking "meaningful negotiations with the entity involved". A paragraph (54), directed to TNCs, asks that they make such information available to the workers' representatives. Where national law and practice so provide, they should also supply information that would enable labour to "obtain a true and fair view of the performance of the entity or, where appropriate, of the enterprise as a whole".
- The other thorny question, which is again inseparable from the organizational and decision-making structures of TNCs, concerns access to company representatives who have the power to take decisions on matters under negotiation. In response, a paragraph (51) calls on TNCs to "... enable duly authorised representatives of the workers in their employment in each of the countries in which they operate to conduct negotiations with representatives of management who are authorised to take decisions on the matters under negotiation".

In order to get a picture of the extent to which the Declaration has made a difference in the policies and conduct of governments, labour and management, five triennial surveys have been carried out since the adoption of this instrument.

Finally, there is a procedure that enables aggrieved parties to submit requests for interpretation of the provisions of the Declaration on the application of which there may be disagreement. To date, 21 requests have been received, but only half sought specific action under the Declaration. Of these, only two have gone beyond the initial screening, then the procedural "scrutiny" and reached the interpretation stage. Neither of the two cases, however, dealt with the industrial relations provisions of the Declaration.

The procedure for the examination of disputes, coupled with the industrial relations provisions of the Declaration, particularly those relating to consultations (para. 56) and the examination and settlement of grievances (paras. 56-58), does, in fact, encourage the peaceful settlement of labour problems before they turn into open and damaging conflicts.

Source: information provided by the ILO.

Box IX.2. The OECD Guidelines' chapter on employment and industrial relations

"Enterprises should, within the framework of law, regulations and prevailing labour relations and employment practices, in each of the countries in which they operate:

1. Respect the right of their employees to be represented by trade unions and other bona fide organizations of employees, and engage in constructive negotiations, either individually or through employers' associations, with such employee organizations with a view to reaching agreements on employment conditions, which should include provisions for dealing with disputes arising over the interpretation of such agreements, and for ensuring mutually-respected rights and responsibilities;
2. (a) Provide such facilities to representatives of the employees as may be necessary to assist in the development of effective collective agreements;

   (b) Provide to representatives of employees information which is needed for meaningful negotiations on conditions of employment;
3. Provide to representatives of employees where this accords with local law and practice, information which enables them to obtain a true and fair view of the performance of the entity or, where appropriate, the enterprise as a whole;
4. Observe standards of employment and industrial relations not less favourable than those observed by comparable employers in the host country;
5. In their operations, to the greatest extent practicable, utilize, train and prepare for upgrading members of the local labour force in co-operation with representatives of their employees and, where appropriate, the relevant governmental authorities;
6. In considering changes in their operations which would have major effects upon the livelihood of their employees, in particular in the case of the closure of an entity involving collective lay-offs or dismissals, provide reasonable notice of such changes to representatives of their employees, and where appropriate to the relevant governmental authorities and co-operate with the employee representatives and appropriate governmental authorities so as to mitigate to the maximum extent practicable adverse effects;
7. Implement their employment policies including hiring, discharge, pay, promotion and training without discrimination unless selectivity in respect of employee characteristics is in furtherance of established governmental policies which specifically promote greater equality of employment opportunity;
8. In the context of bona fide negotiations[6] with representatives of employees on conditions of employment, or while employees are exercising a right to organize, not threaten to utilize a capacity to transfer the whole or part of an operating unit from the country concerned nor transfer employees from the enterprises' component entities in other countries in order to influence unfairly those negotiations or to hinder the exercise of a right to organize;[7]
9. Enable authorized representatives of their employees to conduct negotiations on collective bargaining or labour management relations issues with representatives of management who are authorized to take decisions on the matters under negotiations.

[6] Bona fide negotiations may include labour disputes as part of the process of negotiation. Whether or not labour disputes are so included will be determined by the law and prevailing employment practices of particular countries. *

[7] This paragraph includes the additional provision, concerning transfer of employees, adopted by OECD Governments at the meeting of the OECD Council at Ministerial level on 13 and 14 June 1979.*

* These texts are integral parts of the negotiated instruments."

Source: excerpt from OECD, 1992b, pp. 13-14, 18.

TNC activities beyond the affiliate level is also recognized, and the articles encourage the provision of information on the performance of the enterprise as a whole when this is relevant. This principle has important implications for the disclosure of economic information on cross-border TNC operations and the timing of the disclosure of information. Similar provisions are contained in the Guidelines. The Declaration also provides that TNCs and employees should devise, by mutual agreement, systems for regular consultations on matters of mutual concern.

- *Innovatory practices*. The Declaration stresses the need to consider local practices and to take into account established policy objectives of the countries in which TNCs operate. Furthermore, TNCs are expected to observe industrial relations standards no less favourable than those of national employers. Within the framework of law and practice, the Guidelines do not prevent TNCs from seeking to introduce innovatory practices.

In sum, the two instruments, between themselves, go a long way in covering the principal issues arising in the relations between TNCs and labour.

While the Declaration and the Guidelines do not carry direct legislative force in the countries that have adopted them, they do reflect a political and moral commitment from governments, employers and labour organizations to observe the standards and principles embodied therein. At a minimum, the existence of such commitments raises the expectation that legislation or practices inconsistent with the tenets of these instruments will not be pursued.[7] Although the Declaration and the Guidelines lack statutory bite, they have been furnished with a mechanism for follow-up by way of periodic reviews on the extent to which the instruments have been given effect. In the case of the Declaration, governments, labour and business are requested to report periodically on how the Declaration has been observed. In addition, the Declaration and the Guidelines provide for the possibility that governments, employers or labour organizations can request a clarification of the instruments on issues arising from their application. These procedures have, however, proven to be complicated and time consuming.[8] Overall, therefore, the main contribution of these two instruments is to define agreed-upon international standards concerning industrial relations in TNCs, covering a wide range of issues.

2. International labour standards

Trade-union efforts to establish international agreements on TNC activities had culminated in the late 1970s in the adoption of a number of voluntary instruments. Experience with working with these instruments has lessened their interest in this approach. Many of the perceived difficulties were seen to stem from their non-mandatory nature (although this very status may have assured their durability) and the weakness of their implementation and follow-up mechanisms. More recently, however, pressures for policy convergence under conditions of deeper integration — because it is increasingly giving rise to "system frictions" (Ostry, 1992) in areas previously sheltered from international pressures — have renewed interest in an international normative approach, albeit with stronger enforcement mechanisms. This is particularly true for frictions emerging in labour markets. The reasons are not difficult to find. The expected benefits from international integration derive from the freeing up and relocation of resources — including across borders — for more productive uses. But an additional condition for these benefits to be realized is that any resources so released should not remain unemployed. Consequently, welfare improvements resulting from international integration will depend, in considerable part, on decisions taken in the labour markets of developed and developing countries (Lawrence, 1994). These labour markets are not directly integrated, but rather are indirectly linked through trade flows and FDI. In recent years, the growing concern over high unemployment in high wage developed countries has been further increased by the decline of manufacturing jobs through the migration of some labour-intensive production to developing countries and the corresponding

rise in the export share of some of these countries (Wood, 1994). Because these jobs have traditionally been associated with high rates of unionization, trade unions have responded to the problem of job displacement through FDI and trade by renewing international efforts, focusing on the broader (i.e., not TNC-specific) approach to seek better enforcement of global labour standards, such as those developed by ILO.

The issue, however, is not to establish a global minimum wage nor — broader — to reduce the competitive advantages of developing countries based on lower wages *per se*. Rather, the proponents of this approach focus on the acceptance of certain standards relating to, in particular, freedom of association (including especially the right to organize and the right to bargain collectively), forced labour, discrimination and child labour (box IX.3). The underlying rationale behind common labour standards is to remove any international competitive advantage arising from the violation of basic workers' rights, an action which could be considered an extreme form of "social dumping".[9] In particular, labour should be in a position to organize itself and bargain freely within its national environment and to raise standards over time. The proper enforcement of these labour standards is being sought through the inclusion of a "social clause" in international trade and investment agreements (ICFTU, 1978, 1993; International Metal Workers Federation, 1988; TUAC, 1994). For many trade unions in both developed and developing countries — and some governments — the acceptance of "social clauses" has become the main normative effort regarding industrial relations in a globalizing economy.

The revival of the labour-standards debate is set in a context of increasing trade linkages and, hence, shallow integration. Deeper integration of the world economy, through TNCs and FDI, adds significantly to the complexity of this debate. Transnational corporations have not only become significant agents of trade expansion, but through intra-firm trade have altered the nature of those trade relations; perhaps as much as one-third of world trade takes place within TNCs (chapter III). But more central to the recent discussion is the belief that the mobility of TNCs enables them to escape the burden of labour standards by locating in countries with lower standards, a fear exacerbated by the worldwide competition for FDI. But the links between deep integration and labour-market conditions do not stop there. Unlike trade, the connections established through FDI do not end with the initial contact, but involve a continuous flow of resources across borders. Moreover, the nature of FDI is such that these resource flows include not only capital and technology, but also managerial practices and other intangible elements relating to workplace relations (see Part Two). Consequently, TNC networks can become important channels through which, at least potentially, better labour standards can be disseminated in a number of ways:

As a result of requirements imposed by home countries on the affiliates abroad of the TNCs headquartered in their territories. This would represent an extraterritorial application of laws.[10]

As a consequence of the adoption of global standards in such areas as safety and technology transfer. This reflects pressures resulting from the need to organize the entire coporate network as one integrated value chain.

In the exercise of corporate social responsibility. This would involve voluntary actions by TNCs, precedents for which were mentioned in chapter VIII.

As a consequence of the influence of trade unions. An example is the agreement between BSN and the International Union of Food and Allied Workers' Association (IUF) to "monitor proper compliance throughout all BSN subsidiaries" (box IX.4) of certain ILO Conventions. Other examples are Reebok (box VIII.12) and Levi Strauss; the latter's "Terms of engagement", while not referring directly to ILO Conventions, cover explicitly a number of the issues addressed by them (box VIII.6).

Box IX.3. The social clause

At the ministerial meeting in Uruguay in 1986, which launched the Uruguay Round of Multilateral Trade Negotiations, the United States representative proposed that workers' rights be included as a subject of negotiation. Although no consensus was reached, the Chairperson of the Ministerial Meeting named workers' rights as a subject to be taken up at a later stage in the negotiations. In 1987 and again in 1990, the United States proposed in the GATT Council that GATT should establish a working group to consider "the relationship between international trade and respect for internationally-recognized workers' rights." In April 1994, the Uruguay Round meeting in Marrakesh agreed to refer the issue of workers' rights and trade to the preparatory committee of the agreed new World Trade Organization (WTO).

The primary mechanism to link workers' rights and trade has been the idea to include a "social clause" in trade agreements. Not surprisingly, this idea — which has been very controversial — has had its strongest advocates among trade unions who made specific proposals in this respect. Trade unions are not calling for a social clause which would reduce the competitive advantages that developing countries have based on lower wages; nor are they calling for an international minimum wage; nor for an artificial equalization of labour standards between developed and developing countries. Rather, the International Confederation of Free Trade Unions (ICFTU) believes that a social clause is necessary in order to achieve the objectives set forth in the preamble to GATT — which states that members recognize "that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods".

The ICFTU believes that a social clause should contain two key elements. First, it should be based on already agreed and widely ratified international standards contained in ILO Conventions (see accompanying table). Second, the social clause should establish an implementation procedure involving the ILO as the competent world organization to examine the implementation of labour standards with established procedures for reporting and investigation.

Acceptance of seven main ILO Conventions, 1994

	Freedom of association		*Forced labour*		*Discrimination*		
Item	*Right to organize (No. 87)*	*Collective bargaining (No. 98)*	*Forced labour (No. 29)*	*Abolition (No. 105)*	*Equal remuneration (No. 100)*	*Employment and occupation (No. 111)*	*Child labour - minimum age (No. 138)*
Countries that ratified the Convention	110	124	135	113	120	118	46
Per cent of ILO membership	64	73	79	66	70	69	27

Source: information provided by the ILO.

The ICFTU does not believe that implementation of a social clause would pose great problems or that it would lead to an uncontrollable wave of unjustified import controls. Under the proposal, if a country was found to be falling short of its obligations, a joint Advisory Body, consisting of representatives of both the new WTO and of the ILO, would recommend measures to be undertaken by the government within a specified time to improve performance. Such measures could include better enforcement of laws and regulations through a strengthened labour inspectorate. At the end of the period, a further report would be prepared on the effect given to the earlier recommendations. The second report would state that the country was now fulfilling its obligations, or that progress was being made and further time was needed, or that the government had failed to make adequate efforts to implement the recommendations. In the latter case, the government concerned would be warned that, if no progress was made within one year, the matter would be referred to the WTO Council for consideration of appropriate trade sanctions.

Naturally, various combinations of these approaches are also conceivable, as can be seen from some aspects of the anti-apartheid movement preceding the elections in the Republic of South Africa in April 1994. There, a number of governments (at the regional, national and subnational levels) established and requested the observance of codes that required TNCs under their jurisdiction to take actions that contradicted certain aspects of the apartheid regime in their foreign affiliates in the Republic of South Africa (UNCTC, 1986, pp. 89-98). In fact, a number of TNCs did so out of their own volition. And the trade-union movement (as well as other groups) pursued the same objective vigorously through its own means (including through monitoring and ratings of corporate implementations), also using TNC affiliate networks as conduits to obtain the desired outcome.

Recent regional integration agreements — including the North American Free Trade Agreement (NAFTA) and European integration efforts — have indeed included provisions concerning labour standards or resulted in their inclusion in other related agreements. They differ from the labour standards of the ILO in a number of ways. For example, although the North American Agreement on Labor Cooperation (NAALC) does not attempt to establish common standards, it does require monitoring of existing legislation and applies fully to FDI; in fact, the (few) cases that have been brought up under it all deal with FDI matters (box IX.5). In Europe, the concern over "social dumping" contributed — in the framework of efforts to strengthen the social dimension of the integrating Europe — to the initiative to establish European Works Councils in TNCs for the purposes of informing and consulting employees. Although a regional focus may provide greater potential for enforcement, its obvious limitation is that it does not provide coverage to non-members. For this reason, the proposal to incorporate "social clauses" within international trade agreements — a long-standing demand of many national trade unions — is once again returning to the international agenda.[11] In this form, labour standards can be seen as providing stronger support for an open trading and FDI system by ensuring that the gains from greater openness are more evenly distributed. But, tying labour standards to trade and investment agreements would involve an international mandatory mechanism of adjudication and enforcement. Already, the debate over the formation of the World Trade Organization (box IX.3) suggests that this issue will receive considerable attention from trade unions and others, both as far as trade and FDI are concerned (Goodhart, 1994, p. 14). A particular important challenge in this respect is to ensure that the objective of better labour standards is not being misused for protectionist purposes (Steil, 1994).

C. Industrial relations in Western Europe

The period leading up to the creation of the Single European Market has been accompanied by the expansion of many TNCs, both from the European Union and abroad, seeking economic advantages from participation in the more unified market. The increase in competition among all firms has led to corporate consolidation through European-wide structures. This process has involved the rationalization of production and distribution activities, organizational restructuring (including new inter-firm arrangements) and the introduction of new management practices. All these changes have, inevitably, affected traditional collective bargaining relations and given rise to new challenges for industrial relations frameworks.

The industrial relations landscape associated with a more integrated European Union exhibits a number of innovatory practices. On the one hand, management and trade unions in a number of TNCs have established voluntary works councils in response to these changes. In some respects, these resemble the world councils mentioned above. But, most crucially, they are joint undertakings between management and trade unions and they appear to hold out the possibility of a more structured exchange of information and views; this is discussed in subsection 1. Efforts to enhance employee participation have also been pursued at the legislative level within the

framework of the European Union. They have led to a draft Directive dealing with the creation of European Works Councils; this is discussed in subsection 2. If this Directive is, indeed, finalized, it would merge the practical and legislative strands of industrial relations in Western Europe and create a new form of international industrial relations mechanisms with, perhaps, implications beyond the European Union.

1. Voluntary information and consultation arrangements in transnational corporations in Europe

The benefits to employees of mechanisms for exchanging information at the international level with the management of a TNC were discussed earlier, highlighted further by the experience

Box IX.4. Labour-management cooperation: the experience of BSN

BSN is France's leading packaged food and beverage group and the world's largest producer of fresh dairy products. It has a long history of company-level dialogue with trade unions. The company's positive experience of working with unions during the 1970s was instrumental in the decision to establish a "group committee" comprised of national members. This decision was taken prior to the 1982 French legislation (the "Auroux laws") which obliged companies with their headquarters in France to establish joint committees of management-employee representatives.

Paralleling this development, BSN's senior management was invited in 1985 to a meeting with representatives of the International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Association (IUF) from a number of European countries. This meeting provided the basis for annual informal meetings designed to encourage a sharing of views. These meetings involved three categories of union participants: officials of the IUF secretariat; representatives of the national trade unions affiliated to IUF of the European countries in which BSN has affiliates (Austria, Belgium, the Czech Republic, France, Germany, Ireland, Italy, Netherlands, Spain and the United Kingdom); and trade-union representatives working in BSN affiliates. Following new acquisitions by BSN in Europe, representatives from further countries may join the meetings. In recent years, participants from a number of non-European countries, including Japan and the United States, have attended as observers. Typically, the meetings are attended by four or five representatives of central management and 25-30 labour representatives. Discussions are not confined to past experience; workers may also be informed of the company's broad strategic plans.

These meetings are of an informative nature. Communication is two ways: from senior management to union representatives and from union representatives to senior management. Negotiations and collective bargaining processes are grounded at the national and local levels. In France, for example, BSN businesses are covered by 22 different collective agreements. National industrial relations systems are not always compatible with enterprise-level consultation processes. In Germany, for instance, legislation provides for information to be given at the local level, through works councils and not through trade unions.

In 1988, BSN and the IUF signed a "common viewpoint" in which they agreed to work together in preparing framework agreements on four specific problem areas: a policy of skills training to facilitate the introduction of new technology and adjustment to industrial restructuring; a policy to achieve equality of information provision within all BSN affiliates; equality of the sexes at the workplace; and the implementation of trade union rights as defined in ILO Conventions Nos. 87, 98 and 135. Agreements have been reached in these three areas, and, on 26 May 1994, a "déclaration commune" on trade union rights was signed between BSN and the IUF. The English translation of the text is reproduced below.

"IUF/BSN Joint Declaration on Trade Union Rights

BSN and the IUF:

- recalling the fundamental right of each employee to be represented and defended by the trade union organization of her/his choice;

/...

of world company councils. However, it was also suggested in the discussion of these mechanisms that their effectiveness has been compromised by a number of obstacles. One response from the trade union movement has been to refocus efforts at the regional level. This has developed in a quite distinctive way in Europe.

The focal point for this effort was the European Trade Union Confederation which, since its formation in 1973, has pursued a strategy of European-level employee-management relations calling for greater regional coordination among trade unions. In part in response to such calls, and in parallel with legislative initiatives, a number of TNCs have established arrangements for the regular exchange of information between managers and employee representatives at the European level. At the beginning of the 1990s, some 30 to 40 such arrangements existed (table IX.3), with

Box IX.4. (cont'd)

- affirming that the counterweight represented by the trade union organizations contributes to the respect of the needs and aspirations of the workforce by company executives;
- mutually recognizing the legitimacy of each party and their right to participate in the social as well as economic spheres, each mindful of their respective responsibilities as far as these conform with laws, collective agreements or other contractual agreement in effect;
- are convinced that reinforcing democratic forms of cooperation in the enterprise is the responsibility of both parties, and that this implies the recognition of divergent approaches and differences in judgment on means and methods in the search for negotiated solutions;
- note that achieving this objective requires efforts to provide economic and social education and information to the entire workforce as well as their representatives to better understand the problems, the limitations faced by the company, and what it has at stake.

In this spirit, BSN and the IUF undertake to:

1. Monitor proper compliance throughout all BSN subsidiaries with ILO Conventions 87, 98 and 135, which concern respectively:

- the right of all employees to join the trade union organization of their choice;
- the right of all workers to be free from any act of discrimination leading to the restriction of trade union rights;
- the protection of all workers' representatives from all prejudicial measures, including firing, resulting from their status or activity as representatives of the workforce in accordance with the law, collective agreements, or other forms of contractual agreement in effect.

2. Encourage management and trade unions to negotiate agreements [concerning trade union rights], where possible for fixed durations, and to seek to publicize these agreements among the workforce to the widest possible extent;

3. Encourage management and employee representatives to negotiate and conclude agreements seeking to ensure that trade union and employee representatives benefit, with comparable ability, from the same opportunities of access to training, salary progression and promotion as other employees, and that the remainder of their professional development is taken care of when they decide to stand down from office.

Within the continuity of the BSN/IUF framework agreements (equality of men and women, economic and social information, vocational training), BSN and the IUF confirm that the process of informing and educating trade union and worker representatives should develop within each BSN subsidiary with the goal of ensuring effective implementation.

A first review of the implementation of this declaration will be undertaken in a concerted way during the plenary meeting in 1995."

Sources: ILO, 1991d; IUF, 1994.

Box IX.5. The North American Agreement on Labor Cooperation

The two main components of the North American Agreement on Labor Cooperation (NAALC) consist of (1) the labour standards that the signatories have agreed to adhere to; and (2) the dispute-settlement procedures established to resolve labour related disputes between the parties to the agreement.

With respect to labour standards, the NAALC stipulates that the signatories will be judged in terms of whether or not they adhere to their own domestic labour laws and regulations. Furthermore, the NAALC does not explicitly prohibit the signatories from adopting new legislation that would constitute a regression in terms of the rights of workers. The NAALC is much weaker than the NAFTA in this regard since the latter prohibits the signatories from adopting legislation that would erode previous commitments under the agreement (for a detailed analysis of the NAFTA's treatment of discriminatory measures, see Gestrin and Rugman, 1993). Enforcement of the laws, not the content of the laws, is the primary standard against which compliance or non-compliance with the NAALC is to be judged.

With respect to the NAALC's dispute-settlement process, the Agreement establishes strict conditions under which the process can be used and penalties for non-compliance imposed. Two criteria must be met for a labour issue to qualify for consideration by an Evaluation Committee of Experts, the first stage of the dispute-settlement process; the issue must be related, and it must be covered by "mutually recognized labor laws". Furthermore, only labour issues related to occupational safety and health, child labour, or minimum wage standards can lead to the formation of Arbitral Panels after the work of the Evaluation Committee of Experts is complete and the parties have had a chance to discuss the Committee's findings. As well as being limited in its mandate, the dispute-settlement process is also unwieldy. More than three years can elapse from the time an issue has been identified as objectionable to the time the complaining parties can take retaliatory trade action if all of the committees and groups involved in the process take the maximum time allotted to fulfil their responsibilities.

NAALC also reflects the growing concern of policy makers with issues related to FDI. The focus of much of the debate over the NAALC and the NAFTA itself has been the significance of Mexico's low wages and less stringent labour standards for FDI patterns (for an analysis of the response of TNCs to NAFTA, see Gestrin and Rugman, 1994a). Indeed, six months after NAALC had come into effect, the two complaints that had been brought to the United States National Administrative Office (no complaints had been brought to either the Canadian or Mexican National Administrative Offices) both involved activities of TNCs in Mexico. Therefore, one of the primary objectives of the NAALC was to limit the scope for the signatory governments to attempt to attract FDI by means of regressive labour policies.

Unlike the NAFTA investment provisions, however, which establish common standards in areas such as intellectual property rights, use of performance requirements, dispute settlement etc., the NAALC standards are much more loosely defined (for detailed discussions of the NAFTA investment provisions, see Gestrin and Rugman, 1994b). The underlying reason for this weakness relates to the problems inherent in trying to establish a workable distinction between differences in labour standards that reflect the "natural" economic gaps between economies at different levels of development and differences in labour standards that have been policy induced by governments seeking to attract FDI.

varying degrees of formalized structure (table IX.4). A number of TNCs (including Bull, Elf Aquitaine, St. Gobain, Thomson Consumer Electronics and Volkswagen) have formal written agreements with trade union representatives; others (including BSN, Nestlé and Péchiney) have made such arrangements "agreed practice" in their relations with the workforce. Other arrangements are based on more informal contacts, initiated by either management or employee representatives, with the cooperation of the other party. Meetings between management representatives (numbering from 2 to 20) and worker representatives (averaging 30 people, sometimes also including representatives from affiliates located outside Europe) are held at regular intervals, typically on an annual basis. In some agreements, ad hoc meetings are envisaged to address specific issues. In other cases, the arrangement simply provides for joint exchange visits between European plants, as in the case of Ford and IBC (a joint venture between General Motors and Isuzu, see Gold and Hall, 1992, p. 14). In a number of TNCs (including Allianz,

Table IX.3. Firms with information and consultation arrangements in Europe, 1993

		Management representation		
Company	*Name of body*	*Number*	*Comment*	*Employee representation*
Airbus Industries	Staff Council	..	..	..
Allianz	Allianz Company Councils	..	Senior management, such as the Personnel Director, attends at its own discretion	20-25
Asea Brown Boveri	Asea Brown Boveri Company Council	..	Senior management, such as the Chief Executive Officer, attendsat its own discretion	..
Bayer	Europa Forum	..	Management participation	..
BSN	European Consultation	5-10	General Manager, divisional managers & assistants	30
BSN	European Information Committee (Glass Division)	..	Chairperson/Managing Director of the division and Human Resources Directors from each country	12
Bull Group	Bull European Information Committee	5-6	Chairperson, Managing Director, senior executives	9
Continental	European Information Exchange	..	..	..
Elf Aquitaine	European Information and Concertation Body	8	Chairperson and Chief Executive Officer, 3 Senior Vice Presidents and Chief Operating Officer from each of the three group divisions	75
Eurocopter	European Information and Consultation Committee	..	Chairperson, general managers and Human Resources Manager	..
Hoechst	European Information Meeting	..	..	..
Nestlé	IUF/Nestlé Meeting	about 20	President of Nestlé Europe, heads of European operations, Director of Human Resources and Personnel Directors from each country	50
Péchiney	European Information Committee	5	Chairperson and Managing Director Péchiney, General Manager and Assistant General Manager, Social Affairs Manager	28
Rhône-Poulenc	Joint meeting	9	Chairperson, Managing Director and Director of Social Affairs for the Group, 3 Personnel Directors, 3 General Managers	35
Schmalbach-Lubeca (Continental Can)	European Information Meeting	..	Group management	14
St. Gobain	Joint meeting	4-5	Chairperson, General Manager, Assistant Directors of Social Affairs and of Human Resources	70
Thomson Consumer Electronics	European Branch Committee	..	Senior management	20
Volkswagen	European Volkswagen Group Works Council	..	Management attends at its own discretion	17

Sources: Gold and Hall, 1992; and Carley, 1993.

Note: According to the European Trade Union Institute, information and consultation bodies also exist in the following companies: Assurance Générales de France (AGF), Borealis, Europipe, Groupe Générale des Eaux, Grundig, Merloni Elettrodomestici, Nokia, Renault, Schneider, Usinor Sacilor and Volvo, but no further information is available. Discussions are also under way in a number of other firms to establish such bodies. Arrangements to inform and consult employee representatives on a cross-border basis within the Nordic area have been developed in a number of TNCs in these countries, including Fundia, ELKEM, ISS, Nivis Tyre AB, Norsk Hydro, Outokumpo, PLM, Protan and SAS (Ågotnes, 1993).

Asea Brown Boveri and GEC-Alsthom), trade union organizations are seeking to turn more informal contacts into regular arrangements (Carley, 1993, p. 16).

These arrangements are generally concerned with an exchange of information and views (see also box VI.4) and complement, rather than substitute for, national industrial relations practices which include a number of voluntary initiatives for information and consultation (Multinational Business Forum, 1993). There are no formal consultation rights allowing for labour's concerns to be reflected to any significant extent in final decisions. Topics on the agenda of the meetings tend to include the company's general economic situation, rationalization plans and changes in organization, investment and production strategies, training and retraining policies. More narrow industrial relations issues, such as wages and working time, are unlikely to be discussed (Streeck and Vitols, 1993, p. 26).[12]

A number of agreements (including those by BSN, Thomson and Volkswagen) make explicit reference to the provision of information on planned structural or industrial change, including job displacement, transfers of production, new investment, acquisitions and investment in new technology where such decisions have a group-level basis. Even where the scope of the arrangement is limited simply to information provision, this has been of some value to labour. One useful effect of these agreements has been to increase international union contacts. In many cases, the unions involved hold preliminary discussions in order to develop a common strategy for the meeting. In some companies, employee representatives felt that, through such committees, they had been able to influence management plans.

In some cases (e.g., those within Bull, Elf Aquitaine, Péchiney and Thomson), the company councils are designed to encourage consultation and a social dialogue between labour and management and, in at least two cases, the scope of the arrangement goes beyond the establishment of committees for the exchange of information. According to the procedures for consultation contained in the Volkswagen agreement, employee representatives have formal consultation rights, albeit limited to planned cross-border transfers of production (Streeck and Vitols, 1993, p. 25). A more ambitious agreement is the case of BSN (box IX.4), where the parties have agreed to

Table IX.4. Degrees of formality in European-level information and consultation arrangements

		Informal arrangement	
Formal written agreement	*Agreed practice*	*Initiated by management*	*Initiated by employee representatives*
Bull	BSN (food and drink)	Rhône-Poulenc	Allianz
Elf Aquitaine	BSN (Glass)	St. Gobain (until May 1992)	Mercedes Benz
Thomson Consumer Electronics	Nestlé		Volkswagen (until February 1992)
Volkswagen (from February 1992)	Péchiney		
St. Gobain (from May 1992)			

Source: Gold and Hall, 1993.

work jointly on a defined group of industrial relations issues: skills training, promoting gender equality and trade union rights. The agreement, signed in May 1994, represents an interesting development in labour-TNCs relations since, as mentioned earlier, it commits both parties to monitor the observance of basic trade union rights as defined in certain ILO Conventions (box IX.3). It further urges management and trade union organizations to negotiate and publicize collective bargaining agreements that do not discriminate against trade-union members.

A number of factors explain the emergence of these voluntary agreements in Europe. Union pressure has been only one of the factors underlying their establishment. In the absence of management acceptance (e.g., Gillette and Unilever) (Gold and Hall, 1992, p. 38), unions have not been successful. Such initiatives have thus depended upon finding convergent interests. Corporate interest stems, very much, from easing the implementation of European-wide restructuring plans.[13] But there is also a feeling that these structures can help establish a company-wide workforce identity. In this context, an examination of the TNCs that are already operating councils at the European level reveals a number of shared characteristics (Gold and Hall, 1993; Marginson and Sisson, 1993).[14] In particular, they seem to follow European production strategies, supported by unified management structures at that level, and a number of them are firms that have responded positively to the completion of the European Single Market and have experienced rapid rates of industrial restructuring. Familiarity with an industrial relations framework that attaches some importance to the need to inform and consult with employees is another factor underlying the establishments of voluntary arrangements. To date, these characteristics appear to be most pronounced in TNCs based in France, Germany and Sweden. Overall, it is noteworthy that in almost all of the cases where such voluntary arrangements were created, the experience of both management and trade unions appears to have been positive, as witnessed, for example, by the fact that the life of such agreements has, typically, been extended (Gold and Hall, 1992).

Political factors have also accounted for the spread of these initiatives. A number of the TNCs are (or were) State-owned enterprises, include senior management sympathetic to the objectives of these arrangements and originate in countries that have legislation on group or work-level committees. For example, legislation introduced in France in 1982 on group-enterprise committees may have been instrumental in developing a positive attitude towards employee involvement within French companies; so far they account for many of the voluntary work councils that have been established. Similarly, actions of Volkswagen reflect the experience of operating under the German codetermination system. Finally, legislative developments in the European Union, including the expectation that a mandatory Directive could be enacted, also encouraged the social partners to experiment with information and consultation mechanisms on a voluntary basis. It is to these developments — which have to be seen in the broader context of Western European integration, including the desire to balance economic and social integration — that the discussion now turns.

The European Union's approach to the industrial relations issues raised by the transnationalization of business has been to focus on specific issues, notably regarding information and consultation rights. The success in enacting such measures has been mixed. Most successful were measures extending information and consultation rights and allowing participation regarding specific issues (e.g., collective redundancies) in Union enterprises.[15] Employer opposition, however, has meant the failure of initiatives seeking to institutionalize employee participation in those areas seen to compromise managerial authority. Such was the case of the proposals for a European Company Statute, the Fifth Company Law Directive and the "Vredeling Proposal".[16] Efforts in this direction, however, received renewed impetus from the Protocol on Social Policy (the "Social Chapter") of the 1992 Maastricht Treaty. It provided authority for a proposal (in the

form of a draft Directive) on "The establishment of European Works Councils or procedures in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees".[17] After a number of attempts to reach consensus on the text of the draft Directive, the Commission decided, in April 1994, to set in motion the procedures provided by the European Social Protocol for its adoption by the Council of Ministers (CEC, 1994, p. 3), which it did in a first reading on 22 June 1994 (Council of the European Union, 1994).

Building, in part, upon the experience of existing voluntary work councils and, in part, on the European Union's own initiatives over the past twenty years to strengthen employee participation, the proposed Directive has the following principal features (see also box IX.6):

- It prescribes the establishment of European Works Councils or employee information and consultation procedures in "community-scale" undertakings. Central management is responsible for creating the Councils at its own initiative or at the request of at least 100 employees or their representatives in at least two undertakings in at least two Community member States. In contrast to the important coordinating role played by national or European trade unions in the establishment of voluntary councils, the proposed Directive does not explicitly prescribe a formal role for trade union organizations. Instead, employee representation is determined in accordance with national legislation and practice. This provision recognizes the considerable diversity of industrial relations structures and practices in the Union. While representatives may be drawn from individual works councils in France, Germany or the Netherlands, this would not be possible in countries where such councils do not exist. On the other hand, the proposed Directive does not rule out the possibility of including external trade union officials as members of the Council.
- A "community-scale" undertaking is one with at least 1,000 employees in the Community and at least 150 in each of at least two member countries. (The former number has been subject to continuous negotiations.) These would include "European-scale" undertakings that have their headquarters outside the territory of the European Union or in the United Kingdom (even though the United Kingdom has not signed the Social Protocol). In the latter cases, the responsibility for the implementation of the Directive lies with the company's representative agent or with the management of the establishment that employs the highest number of employees within the European Union.
- In principle, the nature, functions, powers and operating procedures of a European Works Council are left to be decided by agreement between the management of the group and a special negotiating body of employee representatives. If agreement is not reached within three years from the starting of negotiations between the employee's negotiating body and management (or if management refuses to initiate negotiations within six months of the request being made), a Council has to be established on the basis of the provisions set out in the annex of the proposed Directive. On the other hand, in order to respect the bargaining autonomy of the parties, the proposed Directive would accept an agreement by the two sides not to set up a Council at all. If the requirements set out in the annex of the draft Directive apply, the European Works Councils would meet at least annually with central management and obtain information, in particular as regards "to its structure, economic and financial situation, the probable development of the business and of production and sales, the employment situation and probable trend, investments, and substantial changes concerning the organization, the introduction of new working methods or production processes, transfers of production, mergers, cut-backs or closures of undertakings, establishments or important parts thereof, or collective redundancies" (Council of the European Union, 1994, p. 20). In addition, they would give employees the right to timely consultation over management proposals likely to have a considerable effect for employees (particularly relocations, the closure of establishments, collective redundancies). In this respect, the draft Directive goes beyond the voluntary councils which focus

Box IX.6. How to establish a European Works Council

Section II of the draft Directive on the "Establishment of a European Works Council or an employee information and consultation procedure" provides, among other things, for the following:

Article 4

Responsibility for the establishment of a European Works Council or an employee information and consultation procedure

1. The central management shall be responsible for creating the conditions and means necessary for the setting up of a European Works Council or an information and consultation procedure, as provided for in Article 1(2), in respect of a Community-scale undertaking or a Community-scale group of undertakings.
2. Where the central management is not situated in a Member State, the central management's representative agent in a Member State, to be designated if necessary, shall take on the responsibility referred to in paragraph 1.

   In the absence of such an agent, the management of the establishment or the central management of the group undertaking employing the greatest number of employees in any one Member State shall take on the responsibility referred to in paragraph 1.
3. For the purposes of this Directive, the representative agent or agents or, in the absence of any such agents, the management or the central management, shall be regarded as the central management.

Article 5

Special negotiating body

1. In order to achieve the objective in Article 1(1), the central management shall initiate negotiations for the establishment of a European Works Council or an information and consultation procedure on its own initiative or at the written request of at least 100 employees or their representatives in at least two undertakings or establishments in at least two different Member States.
2. For this purpose, a special negotiating body shall be established in accordance with the following guidelines:

   (a) The Member States shall determine the method to be used for the election or appointment of the members of the special negotiating body who are to be elected or appointed in their territories. Member States shall provide that employees in undertakings and/or establishments in which there are no employees' representatives through no fault of their own, have the right to elect or appoint members of the special negotiating body.

   (b) The second subparagraph shall be without prejudice to national legislation and/or practice laying down thresholds for the establishment of employee representation bodies. The special negotiating body shall have a minimum of three and a maximum of 17 members.

   (c) In these elections or appointments, it must be ensured:

   - firstly, that each Member State in which the Community-scale undertaking has one or more establishments or in which the Community-scale group of undertakings has the controlling undertaking or one or more controlled undertakings is represented by one member;
   - secondly, that there are supplementary members in proportion to the number of employees working in the establishments, the controlling undertaking or the controlled undertakings as laid down by the legislation of the Member State within the territory of which the central management is situated.

   (d) The central management shall be informed of the composition of the special negotiating body.
3. The special negotiating body shall have the task of determining, with the central management, by written agreement, the scope, composition, powers and term of office of the European Works

/...

Box IX.6. (cont'd)

Council(s) or the arrangements for implementing a procedure for the information and consultation of employees.

4. With a view to the conclusion of an agreement in accordance with Article 6, the central management shall convene a meeting with the special negotiating body. It shall inform the local managements accordingly.

   For the purpose of the negotiations, the special negotiating body may be assisted by experts of its choice.

5. The special negotiating body may decide, by at least two-thirds of the votes, not to open negotiations in accordance with paragraph 4, or to terminate the negotiations already opened.

   Such a decision shall stop the procedure to conclude the agreement referred to in Article 6. Where such a decision has been taken, the provisions in the Annex shall not apply.

   A new request to convene the special negotiating body may be made at the earliest two years after the abovementioned decision unless the parties concerned lay down shorter periods.

6. Any expenses relating to the negotiations referred to in paragraphs 3 and 4 shall be borne by the central management so as to enable the special negotiating body to carry out its task in an appropriate manner.

In compliance with this principle, Member States may lay down budgetary rules regarding the operation of the special negotiating body. They may in particular limit the funding to cover one expert only.

Article 6

Content of the agreement

1. The central management and the special negotiating body must negotiate in a spirit of cooperation with a view to reaching an agreement on the detailed arrangements for implementing the information and consultation of employees provided for in Article 1(1).

2. Without prejudice to the autonomy of the parties, the agreement referred to in paragraph 1 between the central management and the special negotiating body shall determine:

   (a) the member undertakings of the Community-scale group of undertakings or the establishments of the Communit-scale undertaking which are covered by the agreement;

   (b) the composition of the European Works Council(s), the number of members, the allocation of seats and the term of office;

   (c) the functions and powers and the procedure for information and consultation of the European Works Council;

   (d) the venue, frequency and duration of meetings of the European Works Council;

   (e) the financial and material resources to be allocated to the European Works Council;

   (f) the duration of the agreement and the procedure for its renegotiation.

3. The central management and the special negotiating body may decide, in writing, to establish one or more information and consultation procedures instead of a European Works Council. The agreement must stipulate by what method the employees' representatives shall have the right to meet to discuss the information conveyed to them.

4. This information shall relate in particular to transnational questions which significantly affect workers' interests. The agreements referred to in paragraphs 2 and 3 shall not, unless provision is made otherwise therein, be subject to the subsidiary requirements of the Annex.

5. For the purposes of concluding the agreements referred to in paragraphs 2 and 3, the special negotiating body shall act by a majority of its members."

Source: Council of the European Union, 1994, pp. 10-14.

on the provision of information. At the same time, managerial prerogatives prevail, with the final decision being exclusively the responsibility of central management. The draft Directive makes explicit provision for the diffusion of information: members of the Councils are obliged to inform employee representatives (or the body of employees) at the entity or group level, of the outcome of Council meetings.

The draft Directive also spells out detailed procedures for the appointment and operations of a special body to negotiate a European Works Council agreement; its terms of reference, negotiating procedures and the issues to be covered (box IX.6).

By preparing a Directive as opposed to a regulation, there is considerable scope to adapt European Works Councils to national systems and institutions. Moreover, these Councils would not usurp the functions of existing information and consultation bodies established nationally. The European Union has also avoided the tendency towards upward harmonization, forcing uniformity across member nations to the highest common denominator.

The elaboration of the proposed Directive has involved a long process of consultations with representatives of trade unions and employers at the European level. The ETUC was the main influence behind the basic tenets of the draft Directive (ETUC, 1991), and, while advocating a number of improvements in the present text, its principal objective was to obtain formal backing for the recognition of information and consultation rights. Employer groups (especially the Union of Industrial and Employers Confederation of Europe, UNICE), on the other hand, while accepting the right to information and consultation for labour, saw this Directive as potentially limiting managerial prerogatives, especially if the Councils should seek to assume bargaining powers as opposed to simply information and consultation rights. Furthermore, they considered a single legislative approach as insufficiently flexible. They were also concerned that this approach could compromise other voluntary initiatives that can be carefully tailored to meet precise needs and particular circumstances. In addition, UNICE held that consultation is more appropriately undertaken at the local level, with those directly affected by proposed actions. Thus, UNICE preferred a European Union document placing the responsibility on local management to provide information on the company as a whole (UNICE, 1991a, b, 1994).

After its adoption by the Council of Ministers in a first reading on 22 June 1994, the Directive went before the European Parliament for a second reading. Given the experience with the voluntary works councils, the sort of subsidiarity legislative approach of the Directive that seeks to accommodate national and individual company bargaining preferences, and the procedural avenue (Directive as opposed to regulation) taken by the Commission, there is reason to expect that the proposed Directive would be adopted in its final version in the near future. In that event, it is likely to be translated into law in most member countries in 1996 and 1997, thus affecting perhaps as many as 1,000 TNCs in Europe (box IX.7). Since the United Kingdom had opted out of the Social Chapter, it would not be bound by the Directive.

However, it may well be that the Directive, if and when adopted, would have a number of important repercussions for TNCs based outside the 11 European Union members that signed the Social Chapter. Those with operations in the 11 member countries meeting the criteria would be required to establish European Works Councils in respect of these operations. This would immediately raise the question whether TNCs so affected — e.g., from the United Kingdom, the United States or Japan — would maintain two sets of industrial relations: one characterized by information and consultation procedures; the other possibly without such procedures. Management of these TNCs may well decide under those circumstances to extend the information and consultation rights enjoyed by most European Union employees to those in other parts of Europe and beyond. This applies also to TNCs headquartered in the 11 countries. For instance, these rights could be extended voluntarily to foreign affiliates in Central and Eastern Europe, be it in anticipation of European Union membership of some of these countries, be it to mitigate social

dumping charges or, more broadly, to facilitate the transition to a market economy. In any event, if TNCs do not extend these rights to those elsewhere, they are likely to face trade unions pressure to do so.[18] In short, the influence of the Directive may well extend beyond the ambit of formal

Box IX.7. One thousand European Works Councils?

The Directive, as adopted in the first reading by the Council of Ministers on 22 June 1994, applies to companies operating in the European Union that employ a minimum of 1,000 employees, with at least 150 employees in each of two member States of the Union. A 1992 survey (Sisson, et al., 1992), found that, in 1991, out of 13.5 million enterprises in Europe, the first criterion would have been met by 8,447 companies (with a total of 46 million employees worldwide). Out of these, some 880 European-based companies and an estimated 282 non-European-based companies would have satisfied the second criterion, namely employing more than 150 employees in each of two member States of the Union (in fact, the 1,160 companies employ more than 1,000 employees in at least two member States — the 1,000-threshold being set by the available data) (table 1). In total, then, at least 1,000 European Works Councils could be established if and when the Directive becomes law in the member States.

Table 1. Transnational corporations in the European Union with 1,000 or more employees and affiliates in at least two member States

(Number of companies and percentage)

Country	*Companies with 1,000+ employees*	*of which, European-based companies with affiliates in at least 2 member States of the European Union*	*of which, non-European-based companies with affiliates in at least 2 member States of the European Union*	*Total*	*Per cent*
Belgium	187	16	16	32	2.8
Denmark	100	15	2	17	1.5
France	873	117	26	143	12.3
Germany	2 449	257	50	307	26.4
Greece	46	2	-	2	0.2
Ireland	67	10	2	12	1.0
Italy	479	32	19	51	4.4
Luxembourg	9	2	-	2	0.2
Netherlands	700	83	21	104	9.0
Portugal	162	1	3	4	0.3
Spain	351	13	10	23	2.0
United Kingdom	3 024	332	133	465	40.0
Total	8 447	880	282	1 162	100.0

Source: based on Sisson, et al., 1992.

Of the non-European-Union-based companies, the following 43 had more than 1,000 employees in at least two European Union member States: Alcan, Asea Brown Boveri, Caterpillar, Citibank, Colgate Palmolive, Digital, Du Pont, Eaton, Ericksson, Electrolux, Esso, Exxon, Firestone, Ford, Fujitsu, General Motors, Goodyear, Hertz, Hewlett Packard, Honeywell, IBM, ITT, John Deere, Johnson & Johnson, Kodak, Levi Strauss, Mars, Massey Ferguson, McDonald's, Mobil, Monotype, Motorola, NCR, Nestlé, Nissan, Norsk Hydro, Otis, Philip Morris, Procter & Gamble, Rank Xerox, Sony, Unisys and Volvo.

application to other parts of the world. It may become a model for a broader conception of relationships between trade unions and TNC management.

Conclusions

The ability of trade unions to pursue the interests of their members is built largely on national foundations. However, historically, national trade unions have responded to the growing internationalization of the world economy by strengthening cross-border solidarity. The extent of such action has ebbed and flowed under shifting economic, political and ideological influences, but over the past two decades, the changing nature of the world economy and, particularly, the expanding role of TNCs, have added new urgency to international responses. In particular, deep integration at the level of production is making it more difficult to isolate nationally traditional industrial relations issues from the transnational organization of production.

The view that unions need to match the organizational scope of TNCs by transnationalizing their own *structures* is a simplistic one. Other alternatives exist, including the internationalization of union *action*. In this latter respect, international trade unions have followed two broad approaches: strengthening cross-border cooperation through international trade union bodies able to provide training, information and research capacities and to organize varying degrees of cross-border solidarity in support of particular demands; and campaigning for establishing or reinforcing international normative frameworks aimed at influencing TNC behaviour in areas of direct concern to them. The aim of both approaches is to improve trade union leverage in collective bargaining without compromising national trade union advantages. Still, cooperation among trade unions has had to overcome national barriers to cross-border solidarity, including financial and logistical obstacles and legislative, political and language differences.

Over the past decade, trade unions have begun to take a more realistic view of both these approaches. Greater realism has involved a more focused effort in terms of access to information and decision makers, lesser insistence on global instruments dealing specifically with TNCs and a more strategic approach to the pursuit of objectives, including a greater willingness to enter voluntary agreements with management. The benefits of this greater realism are, perhaps, most clearly apparent in regionally-based initiatives, particularly within the European Union.

But even as trade unions have adopted a more pragmatic position in their dealings with TNCs, new corporate strategies are beginning to influence industrial relations. Integrated international production not only reinforces the trend towards diminished autonomy of national industrial relations practices and the need to accommodate particular business requirements, but also complicates the options and potential outcomes of collective bargaining arrangements. The pressures of integrated international production also mean closer collaboration between employers and unions to enhance flexibility at the plant level and to ensure production quality across the entire value chain. Under these conditions, more decentralized decision-making and negotiating may be better suited to workplace flexibility, reinforcing a trend towards enterprise and plant negotiations for the setting of wages and working conditions. However, there is a tension within integrated international production between the benefits of decentralization and the need to coordinate activities across geographically and functionally dispersed affiliates.

Consequently, the impact of integrated international production on the relative strength of labour is likely to be complex. As TNCs rationalize and integrate regional and global production systems and adopt leaner production techniques, they also become more sensitive to disruptions and stoppages. It is for these reasons that TNCs have attempted to minimize the dangers from confrontational labour relations in the workplace by investing in the personnel function and implementing management approaches based on employee empowerment and participation.

Under these conditions, trade unions will need to continue their search for broadly encompassing but flexible structures that ensure the full participation of their members in a global environment marked by rapid technological, organizational and structural changes.

Notes

1. The WCL and the WFTU also have international trade secretariats of various industries.

2 One estimate for the 1970s (Blake, 1973) is that about 60 per cent of international union action took the form of information exchange and consultation. A similar percentage is likely to apply nowadays, although there are no precise estimates.

3 Information provided by the International Graphical Federation.

4 One practical obstacle could be that employees in foreign affiliates of a given TNC may not be supportive of such action; data for the late 1960s suggest that, when respondents in the Canadian subsidiary were canvassed on their willingness to undertake sympathy strikes in support of fellow Chrysler employees in the United States, the United Kingdom and Mexico, solidarity (in the form of undertaking such strikes) was 52, 13 and 12 per cent for the respective countries (Blake, 1972).

5 In 1972, calls for international regulation of TNCs prompted the International Chamber of Commerce to prepare its own guidelines which also covered labour practices (International Chamber of Commerce, 1972).

6 While not a member of the OECD, Hungary has adopted the Guidelines.

7 On the broader question of "soft law", see Baade, 1980.

8 The OECD has recently published an annotated text of the Guidelines which reflects the clarifications provided since 1976 and most of these clarifications deal with the employment and industrial relations chapter; see OECD, 1994d.

9 Enhancing competitiveness through lowering labour standards was challenged as early as 1906 when an international labour conference in Berne adopted a treaty, later ratified by 12 European countries, prohibiting the manufacture and export of matches containing hazardous materials. Concern over the proliferation of such practices was clearly reflected in the formation of the ILO after the First World War and by the United Nations Conference on Trade and Employment after the Second World War (Wilkinson and Sengenberger, 1994). The unratified Havana Charter of 1948 which was to underpin the International Trade Organisation stated:

> *"The Members recognise that...all countries have a common interest in the achievement and maintenance of fair labour standards related to productivity, and thus in the improvement of wages and working conditions as productivity may permit. The Members recognise that unfair labour conditions, particularly in production for export, create difficulties in international trade and, accordingly, each Member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory."* (Article 7.1; UN, 1948).

10 As was done, for example, by the United States in the context of trading-with-the-enemy provisions.

11 As early as 1953, the United States proposed adding a labour-standards article to GATT and made similar efforts in the Tokyo and Uruguay Rounds; furthermore, the United States (particularly during the 1980s) passed a series of laws linking preferential trade and investment benefits to worker rights (Lawrence, 1994, p. 16, and Collingsworth, et al., 1994).

12 Streeck and Vitols, 1993, undertook a survey on the experience with voluntary arrangements in eighteen large manufacturing TNCs in Europe.

13 A side effect is that, through these information mechanisms, local management becomes better informed as well as to the status of their own plants.

14 Gold and Hall, 1993, examined in detail arrangements in the following TNCs: Allianz, BSN, Bull, Elf Aquitaine, Mercedes Benz, Nestlé, Péchiney, Rhône-Poulenc, St. Gobain, Thomson Consumer Electronics and Volkswagen.

15 For example, Council Directive 75/129/EEC of 17 February 1975 on "The approximation of the laws of the Member States relating to collective redundancies", *Official Journal of the European Communities*, No. L48 (22 February 1975), pp. 29-30.

16 The 1989 proposal for a European Company Statute included measures to enable employees to participate in the supervision and strategy development of the "Societas Europea". The 1983 Fifth Directive provided for employee participation in undertakings employing at least 1,000 people (but not groups of undertakings) on a management board. The proposal for a Council Directive (known as the "Vredeling" proposal) relates to procedures for informing and consulting employees of undertakings with complex structures. For a summary, see the introduction to the proposed Council Directive, CEC, 1994.

17 The Protocol on Social Policy of the Maastricht Treaty contains a provision whereby the *twelve* Member States of the European Union allow *eleven* Member States to adopt themselves the measures provided for in the "Agreement on Social Policy" which is annexed to the Protocol. The latter provides the legal basis for the Directive.

18 It has been reported that British trade unions have already set up steering committees in preparation for the Committees with their colleagues in the 11 countries in 12 United Kingdom-owned enterprises (Taylor, 1994).

In an increasingly liberal policy environment, human resource development remains one area in which the role of government is more important than ever. Indeed, as competitiveness is increasingly determined by created assets, it is important that governments effectively coordinate their policies for human resource development with measures to attract foreign direct investment (FDI). In that context, this chapter seeks to answer three major questions arising from the discussion in Part Two and, especially, chapter V:

> Since it is important to have available a skilled workforce *in situ* to attract FDI, what can governments do about creating such a workforce? In other words, how can governments achieve a competitive edge with respect to FDI through human resource development policies?
>
> Since it is also important to attract transnational corporations (TNCs) *because* they do contribute to human resource development, what can governments do to attract TNCs that particularly do so?

- Since it is an important public goal to encourage TNCs to participate in human resource development, what can governments do to encourage TNCs to contribute to an extent beyond just their own minimum requirements?

In discussing these issues, this chapter suggests that governments should adopt policies that facilitate human resource development as a means to enhance a country's attractiveness to FDI without resorting to monetary incentives that are too costly for governments and without imposing unduly heavy burdens on TNCs in the form of mandatory requirements.

In that context, the Government of a host country needs to focus on the national long-term objectives for human resource development, but needs also to be aware of short-term realities. In particular, it is important for governments to keep in mind that the extent to which individual host countries can benefit from TNC contributions in this area depends to a large extent on how TNCs are able to balance their own competing requirements of global-scale efficiency of their operations with locally responsive strategies. Therefore, promoting human resource development requires policies that strike a right balance between ensuring that local goals are supported, while taking account of TNCs' needs to be competitive in a global market. Furthermore, in order to maximize the contribution of TNCs to human resource development, the formulation of FDI policies should also take account of three factors (see chapter V). First, greater attention should be focussed on TNCs that would provide training and skills development that would not be forthcoming in their absence. Second, labour turnover and forward and backward linkages are required for newly acquired skills to be passed on or otherwise diffused in the local economy. Third, human resource development costs should actually be a contribution by TNCs and not be borne by employees in the form of lower wages.

The discussion in this chapter is divided into three sections. Section A points out that all national policies that are directly or indirectly related to human resource development have some impact on how attractive a country is to foreign investors; it also points out that matching training programmes to the special needs of TNCs can provide a competitive edge for attracting increased flows of FDI. Section B explores ways and means of formulating special policies to channel FDI into areas that most enhance skills through training, both within foreign affiliates and through forward and backward linkages. Section C examines policies that encourage or mandate investments in human resource development by TNCs, including policies extending beyond their normal requirements. Its message is that the aim of policy makers should not only be to attract FDI that involves the highest possible levels of skills development, but also to induce TNCs to undertake the maximum possible amount of training.

A. Achieving a competitive edge for foreign direct investment through human resource development policies

The effectiveness of FDI policies depends, among other factors, on the existing human resources pool of a country. Whenever necessary, TNCs contribute through training or other programmes to the development of specific skills that they require for their operations. But the extent to which a TNC would be able to impart such skills to a workforce in a host country largely depends on national absorptive capacity in terms of the basic quality of the human capital. Other things being equal, the more the focus of national education programmes is placed on creating a workforce that is generally literate and skilled, the higher the probability of attracting FDI. Ultimately, therefore, all general policies that are directly or indirectly related to human resource creation have some impact on the role that can be played by TNCs in the human resource development of a given country.

Providing an initial base for the development of a skilled workforce is often accomplished through policies that emphasize the quantitative expansion of vocational education in technical fields. The vocational training programmes could be either public training programmes or in-house programmes by industry. In many countries, major emphasis has also been put on changing attitudes to the technical professions. For example, the Korea Advanced Institute of Science was established to provide an example and stimulus to reorient graduate education and research at all universities throughout the country. Traditionally, the individuals skilled in fields of technology had not been highly regarded in the Republic of Korea. A technical qualification system was designed to change this tradition and to assign a qualification status and recognition equivalent to that of other professionals.

For countries trying to attract TNCs into more advanced manufacturing, the demand for university graduate-level technical manpower often increases considerably, both in quantitative and qualitative terms. As the strengthening of science and engineering college education becomes essential, many governments have therefore found it imperative to expand university and graduate education greatly, with special emphasis on science and technical fields such as engineering.

Achieving a competitive edge for participating in international production, however, goes beyond having a literate and skilled human resources pool. Matching national education programmes with the needs of the private sector, and particularly the special requirements of TNCs, is becoming an important goal of many policy makers. In today's globalized economy it is necessary that governments implement educational programmes leading to the development

Box X.1. Investing in human resource development to strengthen locational advantages: South Carolina's training programme

South Carolina has been highly successful in obtaining new investment, attracting 45 foreign manufacturers between 1990 and 1992. One in four manufacturing workers in the State of Carolina is employed by a foreign affiliate. South Carolina has developed a distinctive brand of industrial policy directed at expanding high-technology industry in the State. Major infrastructure investment, such as Atlanta's Hartsfield International Airport and a state-of-the-art telephone network have been important contributory factors. However, South Carolina's competitive edge may well have derived from its commitment to training workers.

In 1961, the State started its Special Schools Programme. While the original intention was to stem the flow of young workers leaving the State, the Programme has now evolved into a state-financed custom-training scheme. The Programme's curriculum unit works with the employer to create appropriate training courses and work manuals. The training is provided within one of the State's 16 technical colleges or at the plant site, often utilizing instructors drawn from the company's own managerial and technical staff. Training is provided in the areas of mathematics, reading, conflict resolution, effective communication and statistical process management. In 1992, the Programme provided training for 6,500 workers from 120 companies at a cost to the State of $6.4 million.

An example of how this approach paid off was BMW's decision, in 1992, to locate a $400 million plant, with 2,000 jobs and a $66.5 million annual payroll in the State. BMW spent three years assessing 250 alternative locations in ten countries in its search for a lower-cost overseas site for production of its 3-series model of automobiles. One of the final two locations considered was a 1,000 acre area in South Carolina. Within a four-month period, the State and local governments spent $36.6 million to acquire all 140 properties of the families that lived in that area. For a company such as BMW, the Special Schools Programme undertakes everything from placing vacancy advertisements to screening potential employees on the basis of such factors as eye-hand coordination and compatibility with team-working. The programme has guaranteed BMW five qualified applicants for each job vacancy.

Source: "The boom belt", *Business Week*, 27 September 1993.

of a workforce that is flexible and well-adjusted to the constantly evolving world of international business. Yet, often one of the challenges faced by both developed and developing countries is the existence of inconsistencies between the education offered by the State and the skills required by the private sector in general and by TNCs in particular. As a result, policy makers in a number of countries have often striven to formulate policies that constantly evolve to be more entrepreneurial and responsive to the needs of business (and TNCs), while they relate to the specific development goals of each individual country. This can involve custom-made State training schemes tailored to the specific requirements of individual foreign investors (box X.1).

In pursuing such schemes, due attention needs to be given to sectoral changes. The pace at which jobs are growing in the services sector is outstripping that of employment in manufacturing in industrialized countries and in an increasing number of developing countries, and promising forecasts of further growth call for a special focus on services in formulating policies for achieving a competitive edge for increased FDI through human resources development. Although many countries have vocational training programmes to expand a skilled workforce attractive to TNCs, most programmes are still designed primarily to meet the needs of manufacturing and extractive industries. Policy makers need to catch up with the increasing importance, sophistication and skill intensity of TNCs in the services sector. What is necessary is the introduction of training programmes that are targeted to meet the basic requirements of a wide ranging variety of TNCs in this sector.

For countries trying to attract TNCs into service industries with a potential for human resource development, government-sponsored training schemes can, again, be critical. The enhancement of human capital through such schemes, when coupled with other factor endowments, often induces service TNCs to upgrade their existing operations and encourages new investors to locate in regions where there is an available supply of skilled labour. For instance, the raising of educational standards and skills in the south of the United States has been identified as being vital for attracting service enterprises to invest in this region.[1] Another example pertaining to Singapore, where the National Productivity Board (a governmental agency) and Singapore Airlines have set up the Service Quality Centre, a training institute for service workers. Between the end of 1990 and November 1991, the Centre is reported to have trained more than 6,000 persons of all occupational categories from foreign affiliates of such TNCs as Citibank, Kentucky Fried Chicken and Shangri-La Hotels.[2]

While the coordination between the needs of TNCs and programmes of vocational training institutions is becoming more common, the needs of international business have generally not been reflected in curricula for general education in secondary schools and universities. In fact, many school administrators continue to maintain a certain degree of defensiveness against what they see as their responsibility, arguing that TNCs and business in general have special expertise and interest in vocational training, and that is where their main concern should remain. In one country, the law actually prohibited TNC staff, national or expatriate, from taking part in local teaching or research activities.[3] Not surprisingly, corporations in countries with even the most developed education systems criticize public learning institutions for the "lack of connections of school curricula with the world of work, the schools' preoccupation with academic study and credentials, inadequacy of basic skills training, and the consequent unpreparedness of school-leavers for work" (Noah and Eckstein, 1988, p. 66).

The absence of serious attention to the skills needs of TNCs in general education has, however, been modified somewhat in recent years, as schools have recognized that they need to improve collaboration with the world of work. It is increasingly acknowledged that educators need to become better informed about various aspects of TNCs and their activities; that, as education becomes more costly, it can profit from the material and other support that TNCs can provide; and that schools need access to the workplace in order to bring a greater degree of realism

and sense of immediacy to their curricula. As the role of TNCs in the world economy has grown, steps have been taken to adapt national educational curricula to take account of a workplace now increasingly dominated by global considerations. In recognition of the importance of international business, the American Assembly of Collegiate Schools of Business (AACSB) has, since 1980, required evidence of an international dimension in the curricula of accredited schools. The more recently established Association of Collegiate Business Schools and Programs (ACBSP) has a similar requirement (Fleming et al., 1993). Although the majority of European business schools

Box X.2. Curriculum on transnational corporations: a United Nations programme for institutions of higher learning

More than 40 universities and institutes in Africa, Asia and Latin America have worked with UNCTAD's Division on Transnational Corporations and Investment to develop interregional curricula on matters related to TNCs, and many are now including elements from them in their degree programmes. The Division also trains educators to develop and use such curricula. They are meant for three courses:

- **The first**, for students with a background in economics or business, explores the principles and strategies that govern TNCs and their contribution to the development process, mainly from the host country's perspective. Four of the institutions now offering this course are the African Institute of Development and Economic Planning in Senegal, the East and Southern African Management Institute in Tanzania, the University of Malaysia and the University of the South Pacific.
- **The second** course, for graduate students of business administration and commerce, focuses on thetheory of international business and TNCs. Using eleven case studies, it introduces students to specific subjects like cost/benefit analysis, technology-transfer agreements, country-risk management and the establishment of joint ventures. Some of the institutions offering this course include the East and Southern African Management Institute, the University of Sri Lanka, the University of Lagos and the University of Chihuahua in Mexico. The Universidad Catolica in Chile and the Universities of Botswana and Zimbabwe have also shown interest in this course.
- **The third** course covers the legal aspects of TNCs. It gives an overview of the nature and impact of these firms in the world economy and examines a variety of legal, contractual, financial and fiscal issues in detail. Selected institutions offering this course include the East and Southern African Management Institute in Arusha, United Republic of Tanzania, the University of Singapore, the University of the Philippines, and the University of Nigeria-Awolowo.

Teaching courses of this nature are, of course, predicated on the availability of teaching material. For this purpose, the Division on Transnational Corporations and Investment has published the *United Nations Library on Transnational Corporations (UNLTNC)* which, in twenty volumes, brings together writings on subjects that, together, cover the most important aspects of TNC activity. [a]

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a The *UNLTNC* is published by Routledge for the United Nations. The volumes are: Dunning, 1993a; Jones, 1993; Lall, 1993b; Lecraw and Morrison, 1993; Stonehill and Moffet, 1993; Hedlund, 1993b; Moran, 1993; Gray, 1993; Robson, 1993; McKern, 1993; Chudnovsky, 1993; Sauvant and Mallampally, 1993; Buckley, 1994; Plasschaert, 1994; Frischtak and Newfarmer, 1994; Enderwick, 1994; Cantwell, 1994; Chen, 1994; Rubin and Wallace, 1994; and Fatouros, 1994.

has traditionally incorporated a significant international component in their programmes, these are becoming more widespread (Loustarinen and Pulkkinen, 1991). The internationalization of business education is occurring at both the undergraduate and graduate levels (Arpan et al., 1993). A number of universities in developing countries have also adapted their curricula to provide for more specific courses on TNCs (box X.2).

Reforms in general policies to make education and training more TNC-oriented must, however, take account of national interests for labour turnover and mobility. Attempts to take account of TNC needs may influence governments to make changes in educational policy and programmes that may not necessarily be consistent with educational needs for the broader development of the national economy. For example, the substitution of curricula normally associated with vocational education or in-house training by TNCs for the usual general secondary schooling may yield, in the short term, a larger pool of ready employees for TNCs, but excessive emphasis on such training could limit labour-market flexibility and the absorptive capacity of workers for more advanced knowledge.

B. Channelling foreign direct investment into areas with potential for human resource development

The main impact by TNCs on human resource development occurs through two principal channels: the hiring of local staff and training of that staff in the skills required; and the transfer of technology and know-how to personnel in domestic enterprises linked to foreign affiliates through forward and backward linkages (chapter V). The nature of the contribution by a TNC to human resources development through these channels depends on the type of activity in which a particular TNC is engaged. Some activities require a higher skills base and therefore involve more training, while others may only require unskilled or minimally skilled labour.

1. Attracting transnational corporations with maximum potential for imparting skills

In order to derive the greatest human resource development benefits from the activities of TNCs, governments of host countries strive to encourage FDI in such form and in those industries that are not only likely to create the maximum employment, but are also most likely to transfer the greatest amount and/or highest levels of technology and skills. The essential role of the policies of the Government of a host country in this respect is thus one of encouraging activities of TNCs in areas that result in enhanced levels of human resource development.

This has particular implications for developing countries. Given the tendency of TNCs to invest in sophisticated industries only in countries perceived to have a prevailing stock of highly qualified human resources, countries with lower levels of skilled manpower are likely to be able to induce FDI primarily into low-technology activities with limited scope for the development of human resource capabilities. Thus, policies aimed at attracting TNCs into activities that most enhance human resource development must, in the first place, be intertwined with the broader policies mentioned in section A, that is, those aimed at raising the overall level of national absorptive capacity for skills and knowledge and those geared towards providing specialized training necessary to attract targeted TNCs.

Channelling FDI into activities that provide the maximum contribution to training can be accomplished through the FDI incentives schemes or promotion programmes operating in a country. In other words, special fiscal or other types of incentives can be provided to FDI in industries that the government considers most important in terms of contribution to potential skills development. Government policy may also concentrate on promoting FDI in those industries that a government believes impart the kind of skills that are considered important, by targeting investors through information and facilitating their entry.

Host countries aiming at maximizing training provided by TNCs need not necessarily aim at high-technology industries only. Many lower-technology industries involve a number of

corporate functions that are actually quite skill-intensive (table V.2). In fact, since, under complex corporate strategies, virtually all corporate functions are potentially subject to FDI, governments need to focus more and more not on industrial activities *per se*, but on specific corporate functions (e.g., accounting, research and development, billing, advertising) when trying to attract FDI. Furthermore, governments also need to recognize the benefits that can result from supporting the creation of a dynamic industry cluster. This is illustrated in the case of the Malaysian electronics industry (Henderson, 1993). In 1985, the thirteen United States semiconductor manufacturers in Malaysia spent more than $100 million on local training. This investment allowed an upgrading of their value-added activities with, for example, the addition of semiconductor testing to routine assembly. At the same time, the Government of Malaysia targeted complementary investments that led to the manufacture of megachips, disk drives and wafer fabrication. Malaysia now produces and exports a broad range of electrical and electronic products, including colour televisions, computer peripherals and air conditioners. This has created a considerable pool of appropriately skilled labour able to meet the needs of a rapidly developing industry cluster.

Another way of channelling FDI into activities that promote human resource development is by formulating policies that encourage the most beneficial forms of collaboration between TNCs and domestic firms. There are numerous forms of possible collaboration between TNCs and domestic firms. One major area involves subcontracting (backward linkages). Another area involves TNCs using the services of local agents in various capacities, e.g., distributing, dealing, retailing and servicing (forward linkages). Both types of linkages are typically associated with considerable training, in particular where foreign affiliates operate with certain quality requirements.

Government policies need not only to encourage such collaboration but also to focus on TNCs in those industries and activities that are likely to provide significant technical assistance through training and other forms of human resource development for enterprises linked through backward or forward linkages. For example, in Mexico quality control and technical assistance provided by foreign affiliates to their subcontractors was more frequent in the technologically advanced industries (automobiles, engines, computers and electric and electronic equipment). It was also high in food and beverages, which are characterized by high requirements for standardized products in the industry segments dominated by TNC affiliates (UNCTC, 1992c, pp. 44-45). If subcontracting forms an important part of the strategy of firms in some industries (as was the case in Mexico), policies to encourage FDI in those industries would indirectly foster the transfer of skills and human resource development.

Apart from the contributions that are made as a result of standard operating procedures, TNCs can also contribute to human resource development in a manner that goes beyond their normal minimum requirements (see chapter V). Transnational corporations make such investments for a number of reasons. In some cases, it is to enhance their public image in the country of operations. In others, it is to make an investment that will enhance operations in the future. But in many cases, it is the result of host-government policies aimed at encouraging foreign affiliates established in the country to maximize the human resource development contribution that they can make. Many countries have, in fact, established legal or administrative requirements for the

provision of training to employees by foreign affiliates in the framework of policies aiming at an overall skill improvement of the country's workforce. Often, these involve a mandatory financial contribution by TNCs. In other cases, the focus is on staff localization programmes. Governments of host countries also offer TNCs certain incentives, in return for increased investment in education and training, and they may also initiate collaborative schemes with TNCs to implement training programmes.

1. Financial contributions by transnational corporations

With regard to financial contributions, payroll levies are one of the most widely used methods of fund raising for training, particularly in developing countries. Through this taxation scheme, governments levy a charge on corporations which typically ranges between 1 per cent and 2.5 per cent of the corporation's total payroll (Middleton, Ziderman and Adams, 1993). These finances are then funnelled into a fund that the government uses for the training and education of the country's workforce. A payroll-levy programme can be a useful tool for providing governments, particularly of poorer countries, with a reliable source of financing for their training programmes. Since many of these programmes only apply to corporations with a certain minimum number of employees, TNCs are normally included because they are often the large employers -- especially in developing countries. They have, indeed, been quite successful in some countries in encouraging TNCs in particular to contribute to training (box X.3).

However, the payroll levy is a method of financing training that has received considerable criticism from both TNCs and employees. One of the greatest concerns voiced is that, in some cases, the funds were not used solely to finance training, as originally intended, but in part were diverted to service other unrelated projects. In other cases, the funds were underutilized and accumulated as unused revenue surplus (Middleton, Ziderman and Adams, 1993, p. 125). This lack of consistency in fund distribution has adverse effects on the credibility of the programme as a whole, which can lead to negative attitudes by TNCs towards payroll tax contributions. A second

Box X.3. Payroll levies and training subsidies in Singapore

With a low rate of population growth and rapid industrial expansion, Singapore developed a scheme to improve productivity by raising the level of technology in production, reducing the number of low-paid unskilled jobs and upgrading the skills of the workforce. Administered by the Economic Development Board, the scheme rests on improved public-private sector cooperation. A Government programme to reimburse company training expenses is a major component of the strategy.

A levy on the wages of unskilled workers goes into a Skills Development Fund, which is used to upgrade the workforce through training grants to enterprises. By most measures, these training grants have been successful. By 1985, the Fund had awarded grants to 23,000 enterprises. Training reached 240,000 workers, or 21 per cent of the labour force. Transnational corporations and other larger firms were the initial beneficiaries of the programme, but determined efforts to make small firms aware of external training courses and to provide support for industry associations increased the number of smaller firms participating in the programme.

The steady growth in the use of the Fund can in part be attributed to an incremental strategy of implementation. In the first two years, efforts were focused on creating awareness of the Fund among employers, with ad hoc reimbursements of approved courses. In the second stage, priority was given to in-plant training, and reimbursements increased to 90 per cent of costs as an additional incentive. The third stage encouraged the development of corporate training plans by paying grants in advance of expenses, thereby reducing interest costs to firms. In the fourth stage, the focus was on reaching smaller enterprises and improving training quality.

Sources: Pang and Salome (1986); Skills Development Fund (1989).

type of criticism emanates from those it is meant to benefit. It is that the tax burden often becomes the responsibility of individual workers. Although payroll taxes are intended to make employers contribute to training, payment of the tax is at times passed on to the worker indirectly, via reduced wages (Brittain, 1972).

In their application to TNCs, payroll levies are also often criticized on account of their uniform application across industries. Different TNC activities require different levels of training, which are, in turn, accompanied by varying levels of expenditure on the part of TNCs. Transnational corporations requiring a more technologically advanced workforce, for instance, require more intensive training and specialized expertise than do, for example, TNCs in most assembly operations. In response to this, a number of countries have attempted to relate training-levy payments to the benefits gained by individuals from the actual training experience. This concept of "benefit-related taxation" suggests that levies be adjusted across industries in accordance with the costs associated with each industry's training needs. By adopting an adjustable levy system, governments may be in a better position to encourage human resource development programmes by TNCs in industries that they particularly seek to promote.

2. Localization programmes

Experience suggests that, other things being equal, TNCs prefer to use as many local managers and skilled workers as possible (chapter V). The assignment of expatriates to overseas affiliates is often very expensive. In addition, foreign investors may need to employ national managers who have a better grasp of local conditions than expatriates. The employment of nationals of the host country in visible positions is also likely to improve a TNC's image in the host country. However, in many cases, the transfer of skills is incomplete in the critical high-level management and engineering functions, due either to the paucity of suitably qualified local personnel or to deliberate decisions by the parent firm to retain expatriates in key positions. The desire of TNCs to protect privileged infomation or technical knowledge may also be a factor. A consequence in such cases may be a high concentration of expatriates in top management, engineering and technical posts. Yet, the transfer of skills is most complete from the point of view of many developing countries when the dependence on foreign manpower is not only phased out, but full localization at all levels of staff has occurred. Thus, once qualified local staff are available, there can be a strong role for a programme of localization of staff in specific positions.

Localization policies can take many forms. For instance, a firm that employs a foreigner may be required in some countries to pay a certain percentage of the foreigner's payroll in tax as a training levy to support localization programmes (Eze, 1977). This is intended both to discourage the employment of foreigners and to provide funds for the training of local workers to replace them. Similarly, the control of work permits for foreign workers is often used to encourage the hiring of nationals. Localization requirements are also often incorporated into contractual arrangements with TNCs, especially in the natural resources sector and certain service industries. The petroleum industry offers some good examples.

The older generation of petroleum contracts first embodied localization concepts in general invocations, requiring TNCs to employ local citizens "where available", "if qualified" or "so far as reasonably practicable", leaving the matter ostensibly to the sole judgement of the TNCs themselves. This is the approach adopted, for example, in the EGP/Esso (Exxon) contract of 1974 in Egypt and in the Petroleum (Production) Regulations of 1969 in Malta. But since the availability of qualified and experienced nationals is often limited (if not, at times, non-existent), the more recent agreements have gone one step further by making it incumbent upon the foreign operators to offer training programmes, and even scholarships, to rectify that situation. To ensure faithful implementation and bar future evasion or delay, some petroleum contracts have included a timetable for training, often in conformity with the applicable legislation. For instance, the

Nigerian Petroleum Decree of 1969 provided that foreign petroleum operators must guarantee that, within ten years, they would employ Nigerians in 75 per cent of the management, professional and supervisory positions, and in 100 per cent of all other jobs. The Decree also required foreign operators to prepare and submit a detailed programme for the recruitment and training of Nigerians within the first year of operation. Subsequent petroleum exploration contracts in Nigeria, such as the Oil Prospecting License No. 90 granted to Occidental, gave effect to that requirement by stipulating that Occidental was to make an annual contribution of 15,000 pounds sterling per "block" of the contract area in support of educational programmes related to petroleum technology. The first of such payments was to be made within 30 days after the granting of the licence. Occidental was also obligated to sponsor certain additional training and academic activities for Nigerians both in Nigeria and abroad. Similarly, in Peru, the Decree Law No. 22774 "Guidelines for oil contracts" provided in Article 5.10 that a national personnel-training policy should be established at the expense of the petroleum contractor. In a contract concluded between Petroperu and Shell, the latter was obligated to conduct a training programme for Peruvian personnel during the term of the contract in order to enable it to replace foreign personnel. The first such programme was to be prepared and submitted to Petroperu for approval within six months following the signing of the contract. Shell alone would bear its cost, which was supposed to be no less than $100,000 each year, as long as the volume of production did not exceed 90,000 barrels a day. Should the volume increase, then the minimum obligation would increase concomitantly.

In a number of cases, localization programmes have been quite effective. For example, as a consequence of both company policy and government regulations, a number of Pfizer's plants in India and Pakistan were converted to 100 per cent local labour and management. However, at times, governments, keeping their economic goals in mind, seem to require such a quick pace of localization of management that other efforts of human resource development are actually frustrated. In particular, the prohibition against hiring foreign experts at the management level may hinder a TNC's own goal of training lower-level managers and workers on the site (ILO, 1980).

3. Provision of incentives by governments

Instead of imposing levies on TNCs to ensure their active participation in human resource development, governments can choose to facilitate TNC participation in training through financial incentives. For example, they can minimize TNCs' training costs through special deductions from taxes on profits. Such profit-tax deductions are often granted in addition to, not as a substitute for, the usual exemptions for which TNCs would in any case be entitled to offset some of their training costs. Argentina, Brazil, Chile, Fiji, Pakistan and the Philippines are examples of countries that apply tax-exemption schemes (Middleton, Ziderman and Adams, 1993).

In addition to tax exemptions, wage subsidies are another incentive that can be used to encourage TNCs to become more involved in employee training. Where wage-subsidy schemes apply, governments subsidize a percentage of total trainee salaries. The advantage of a wage-subsidy scheme is that it can be differentiated to favour TNC activities that most enhance human resource development. Examples of countries that have used the wage-subsidy mechanism include Australia, Fiji, India, Malawi, Nepal, New Zealand, Nigeria, Sri Lanka and Taiwan Province of China. The effectiveness of wage subsidies in those countries has differed. In Taiwan Province of China, for instance, a subsidy and technical assistance programme, implemented in the 1970s, boosted training volumes by 400 per cent within two years. After the termination of the subsidy, volumes dropped to double the original amount but continued to rise thereafter, reflecting long-term benefits derived from the plan (San and Chen, 1988). In contrast, results

pertaining to wage subsidies in Australia show that the effects were somewhat positive, but not significant (San and Chen, 1988).

Governments can also provide for long-term manpower development through collaborative schemes with TNCs. In particular, they can provide incentives to TNCs to set up joint training centres that cater to training needs beyond the immediate requirements of a particular foreign affiliate. For example, in 1972, Tata (India) assisted in establishing a training centre in Singapore in collaboration with the Government's Economic Development Board, in return for the Government's assistance in the securing of industrial land at reasonable rents, the sanctioning of tax-free remittances of technical fees, as well as an effective tax holiday. The Government of Singapore provided the land and building for the training centre and an estimated $1.5 million for the purchase of equipment required by it, as well as 70 per cent of its total operating costs. Tata provided the instructors for the centre. The centre was actually crucial to Tata's proposal to establish, through its Singapore affiliate, Tata Precision Industries Pte Ltd, a series of high precision engineering projects, because these required the skilled tool-makers produced by the training centre. However, insofar as long-term manpower development is concerned, the major innovation of the agreement was the requirement for Tata to train twice the number of skilled workers required for Tata's precision engineering complex. The excess workers trained by Tata could be released to industry through a Government institution (Soon, 1993).

A second agreement was made between Rollei (Germany) and the Government of Singapore to establish a Training Centre very similar to that set up in collaboration with Tata. The Government provided land and buildings for the centre and shared in the operating costs. The training centre trained skilled workers in excess of Rollei's needs who could be released to other firms and industries through a Government institution. To establish the joint training centre, substantial concessions were also made to Rollei, in particular, the right of first refusal for a 10-year period, from 1 January 1972, for the manufacture of optical lenses and photographic equipment in Singapore. During this 10-year period, the manufacture of a wide range of optical lenses and photographic equipment was placed under the Control of Manufacture Ordinance, which required all manufacturers intending to manufacture these products to obtain a licence. A licence would only be granted if Rollei and its associated companies declined the option to manufacture such products in Singapore on a comparable scale and at a comparable technological level and price range. Rollei argued that this concession was necessary to prevent its Japanese competitors from acquiring the know-how transferred by Rollei to Singapore. Rollei was also granted a five-year tax holiday to be followed by export concessions for a further period for 10 years, during which it would be liable to a concessionary rate of the corporate income tax (Soon, 1993).

Several other training projects have been established by the Economic Development Board of Singapore in collaboration with TNCs, with the intention of facilitating rapid response to changing industry trends. Apart from the incentives mentioned above, the partner TNCs in these collaborative training programmes implemented in Singapore were assured the secure supply of the skilled workers they required through a bonding scheme; it required all trainees to serve the partner TNCs for a period of three years after the completion of their training. To induce school-leavers to join the training centres, stipends were paid to trainees while they were undergoing training; these were eventually recovered from the partner TNCs or the firm to which they were released by the Government. A further inducement to trainees at the time was the deferment from full-time national service for a further six years after completion of their training and apprenticeships (Soon, 1993).

Conclusions

Unprecedented levels of global competition have caused a fundamental re-examination of the sources of competitive advantages. Undoubtedly, the quality of human resources is at the centre of most competitive advantages, as created assets -- rather than natural assets -- increasingly play a key role in advancing economic development. The distinctive capabilities of TNCs derive, to a considerable extent, from investments in created assets, based on their ability to recruit, train and motivate creative individuals. Investment in, and the effective use and management of, human resources are, therefore, of critical -- perhaps of *the* most critical -- importance for both governments and TNCs in today's world.

It follows that the upgrading of human resources should occupy a central place in the policies of governments intent on promoting economic development. Any policies in this direction automatically make a country also more attractive, at least in principle, to foreign investors. In addition, education and training curricula need to be responsive to the needs of business and -- in today's global economy -- especially the needs of international business. There clearly is some room for paying more attention to market signals, particularly in the applied areas of technology, engineering and management education. Government policies need to encourage that focus. If a government wishes TNCs to bring with them sophisticated processes and technology, and train employees in-house and through forward and backward linkages in their use, it is essential that the local economy possesses labour not only in suitable quantities but also of appropriate skill -- in brief, has an adequate absorptive capacity.

Apart from general human resource development policies, governments have a range of instruments that can be implemented to attract FDI that is particularly knowledge and training intensive. Efforts in this direction need to focus increasingly on individual corporate functions (as opposed to investment projects in general), to take into account complex corporate strategies in the framework of which each part of the value-added chain -- and hence each corporate function -- has become subject to FDI.

Beyond that, governments may wish to make special efforts to ensure that the human resource development potential of foreign affiliates is, indeed, being realized. This involves a balancing of costs and benefits that may accrue from training. Thus, training taxes or levies should not be unrealistic or indiscriminate in their application to different types of TNC activities. Localization programmes should not be implemented at the expense of losing the opportunity to receive training from skilled expatriates. Incentives should not be too costly for governments. Perhaps the greatest potential for human resource development lies in closer cooperative relationships between TNCs, trade unions and governments in the identification of skill shortages, training priorities and appropriate policy initiatives. As liberalization is redefining the relationships of the principal actors in the market in a globalizing world economy, the scope -- and need -- for new and imaginative cooperative relationships is greater than ever.

Notes

1 See "American South puts emphasis in new skills", *Financial Times*, 13 January 1993, p.4.

2 See "Singapore camp tries to polish service sector", *The Asian Wall Street Journal*, 8-9 November 1991, pp. 1 and 5.

3 Argentinian Law No. 20654/1974; see Dagnino Pastore, 1977.

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Annex table 1. Foreign-direct-investment inflows, by host region and economy, 1982-1992
(Millions of dollars)

Host region/economy	*1982-1987 (Annual average)*	*1988*	*1989*	*1990*	*1991*	*1992*
All countries	67526	159101	196132	207912	162124	158413
Developed regions/economies	52757	131313	168488	176346	120616	102401
Western Europe	21298	60313	87981	109108	80707	82412
European Union	19032	57162	81063	99701	72014	78802
Belgium and Luxembourg	1215	5212	7057	8056	9377	11073
Denmark	95	503	1090	1132	1553	1017
France	2783	8487	10313	13183	15149	21843
Germany	1502	870	10760	8950	7390	6800
Greece	494	907	752	1005	1135	1144
Ireland	124	92	85	99	97	102
Italy	1371	6789	2191	6441	2403	3072
Netherlands	2012	4945	8097	11948	5801	5638
Portugal	244	922	1737	2610	2448	1873
Spain	2528	7021	8428	13841	10503	8058
United Kingdom	6665	21414	30553	32436	16158	18182
Other Western Europe	2266	3151	6918	9407	8693	3610
Austria	218	436	587	653	360	947
Finland	158	532	490	812	-233	387
Iceland	10	-15	-27	6	35	17
Norway	228	279	1519	1003	-398	897
Sweden	464	1514	1522	1972	5751	329
Switzerland	1188	405	2827	4961	3178	1033
North America	27905	62366	71636	56060	32038	11145
Canada	979	3795	2626	7638	6592	7757
United States	26927	58571	69010	48422	25446	3388
Other countries	3554	8634	8871	11178	7871	8844
Australia	2532	8013	7770	6884	4763	4980
Israel	110	230	125	101	253	235
Japan	480	-520	-1060	1760	1370	2720
New Zealand	296	441	1365	1754	682	70
South Africa	44	116	8	-5	-7	-5
Turkey	92	354	663	684	810	844
Developing regions/economies	14752	27772	27376	31266	39060	51485
Africa	1878	2776	4891	2160	2713	3042
Oil-exporting countries	1551	2079	3521	1239	1840	2161
Algeria	-7	13	12	..	12	10
Angola	153	131	200	-335	665	288
Cameroon	115	67	..	-62	-21	10
Congo	34	9	3	7	6	4
Egypt	809	1190	1250	734	253	459
Gabon	78	133	-31	74	-101	-36
Libyan Arab Jamahiriya	-152	98	125	159	190	150
Nigeria	371	377	1882	588	712	897
Tunisia	150	61	79	75	125	379
Other countries	327	697	1370	921	873	881
Benin	-	..	1	1	13	1
Botswana	58	40	42	38	40	61
Burkina Faso	1	1	1	1	1	-
Burundi	1	1	1	1	1	1
Central African Republic	7	-4	1	1	-5	-3
Chad	17	1	19	..	-2	13
Côte d'Ivoire	49	52	19	21	20	22

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(Annex table 1, cont'd.)

Host region/economy	1982-1987 (Annual average)	1988	1989	1990	1991	1992
Comoros	1	4	3	-	3	1
Cape Verde	1	-	-1	-	1	-1
Djibouti	-	..	-	-	-	-
Ethiopia	-	2	..	4	1	-
Ghana	6	5	15	15	20	23
Guinea	2	7	4	-	1	6
Gambia	-	1	15	..	10	6
Guinea-Bissau	1	1	1	2	2	6
Equatorial Guinea	2	1	-	10	42	20
Kenya	24	-	62	57	19	6
Lesotho	4	21	13	17	8	3
Liberia	21	290	656	225	8	-1
Madagascar, Republic of	5	3	13	22	14	21
Malawi	10	17	9	23	19	-3
Mali	1	1	15	-7	4	-8
Mauritania	6	2	4	7	2	-
Mauritius	7	24	36	41	19	15
Morocco	42	85	167	165	320	424
Mozambique	2	5	3	9	23	25
Namibia	3	-2	-1	37	105	56
Niger	14	-1	-	-1	1	-
Rwanda	16	21	16	8	5	2
Senegal	-1	14	10	-3	22	9
Seychelles	12	23	23	27	22	21
Sierra Leone	-20	-23	22	32	30	37
Somalia	7	-43	-41	6	-	-
Sudan	6	2	9	-31	-1	-
Swaziland	14	54	75	27	47	44
Togo	6	13	7	-1	7	-2
United Republic of Tanzania	3	4	6	-3	3	2
Uganda	-	5	-2	-6	1	3
Zaire	-35	-4	-6	-15	12	-2
Zambia	40	93	164	203	34	50
Zimbabwe	-4	-18	-10	-12	3	23
Latin America and the Caribbean	6042	9040	6248	8647	15032	17711
Oil-exporting countries	1523	2816	3455	3302	6984	6346
Bolivia	17	-10	-24	27	52	93
Ecuador	58	80	80	82	85	80
Mexico	1294	2594	3037	2632	4762	5366
Trinidad and Tobago	76	63	149	109	169	178
Venezuela	78	89	213	451	1916	629
Other countries/economies	4519	6224	2793	5345	8048	11365
Antigua and Barbuda	18	31	41	59	52	20
Argentina	359	1147	1028	1836	2439	4179
Aruba	..	..	..	131	185	-37
Bahamas	-7	37	25	-16	-	7
Barbados	5	12	8	11	7	14
Belize	2	14	19	17	13	18
Bermuda	1410	1022	-1007	819	2489	3256
Brazil	1494	2969	1267	901	972	1454
Cayman Islands	213	22	80	49	-9	61
Chile	179	141	184	249	563	737
Colombia	597	203	576	500	457	790
Costa Rica	60	122	101	163	178	220
Cuba	..	..	..	1	10	5
Dominican Republic	48	106	110	133	145	179
Dominica	3	7	8	7	11	14
El Salvador	16	17	13	2	25	12
Grenada	5	15	11	13	15	23

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(Annex table 1, cont'd.)

Host region/economy	*1982-1987 (Annual average)*	*1988*	*1989*	*1990*	*1991*	*1992*
Guatemala	74	330	76	48	91	94
Guyana	2	2	-2	8	12	-
Haiti	6	10	9	8	14	8
Honduras	25	48	51	44	45	60
Jamaica	3	-12	57	138	127	87
Netherlands Antilles	-68	7	17	8	33	6
Nicaragua	-	-	-7	1	1	25
Panama	23	-52	37	-18	-40	-1
Paraguay	9	8	13	76	83	40
Peru	9	26	59	41	-7	127
Saint Kitts and Nevis	9	13	41	49	21	14
Saint Lucia	16	16	27	45	58	46
Saint Vincent and the Grenadines	3	10	11	8	9	19
Surinam	-16	-96	-168	-43	10	-30
Uruguay	18	47	38	42	32	13
Virgin Islands	6	2	71	18	5	-93
Developing Europe	33	93	128	149	184	79
Gibraltar	11	30	67	36	37	7
Malta	22	41	52	46	29	9
Former Yugoslavia	1	22	9	67	119	64
Western Asia	398	691	455	471	505	749
Oil-exporting countries	265	477	297	213	359	553
Bahrain	45	222	181	-4	-7	-9
Iran, Islamic Republic of	-105	61	-19	-362	23	18
Iraq	3	-	3	-	-3	8
Kuwait	-3	16	4	-6	1	-35
Oman	139	92	112	141	149	59
Qatar	-2	-21	-2	5	43	5
Saudi Arabia	149	-83	-20	554	128	385
United Arab Emirates	41	189	39	-116	26	122
Other countries	133	215	158	258	145	197
Cyprus	58	62	70	130	82	107
Jordan	43	24	-1	38	-12	41
Lebanon	4	-	2	7	2	19
Syrian Arab Republic	18	121	74	72	62	18
Yemen	10	8	14	13	11	12
East, South and South-East Asia	6273	14980	15416	19426	20245	29402
Oil-exporting counties	1127	1296	2350	3424	5479	6239
Brunei Darussalam	1	1	..	-1	-1	-4
Indonesia	282	576	682	1093	1482	1774
Malaysia	844	719	1668	2332	3998	4469
Other countries/economies	5146	13685	13066	16002	14766	23163
Afghanistan	-	..	..	..	-	-
Bangladesh	1	2	-	3	1	4
China	1362	3194	3393	3487	4366	11156
Hong Kong	1014	2627	1077	1728	538	1918
India	89	91	252	236	145	140
Korea, Democratic People's Republic of	1	1	629	-61	-	43
Korea, Republic of	253	871	758	715	1116	550
Lao People's Democratic Republic	-	2	4	6	8	9
Macao	1	-	-1	1	11	-18
Maldives	2	1	4	6	7	7
Mongolia	..	..	..	..	11	6
Myanmar	-	..	..	5	1	17
Nepal	1	1	-	6	2	1
Pakistan	86	186	210	244	257	349

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(Annex table 1, cont'd.)

Host region/economy	1982-1987 (Annual average)	1988	1989	1990	1991	1992
Philippines	96	936	563	530	544	228
Singapore	1605	3655	2773	5263	4395	5635
Sri Lanka	42	46	20	43	48	123
Taiwan Province of China	306	959	1604	1330	1271	879
Thailand	287	1105	1775	2444	2014	2116
Viet Nam	2	8	4	16	32	-
Pacific islands	128	192	240	414	381	502
Fiji	19	24	13	50	13	58
Kiribati	-	..	..	..	..	..
New Caledonia	..	1	8	31	3	17
Papua New Guinea	101	154	203	300	325	400
Solomon Islands	2	3	6	13	19	12
Tonga	-	-	-	-	-	1
Vanuatu	7	11	9	13	18	12
Western Samoa	..	..	..	7	3	2
Central and Eastern Europe	17	15	268	300	2448	4526
Albania	..	..	..	..	-1	1
Belarus	..	..	..	..	..	7
Bulgaria	..	..	..	4	56	42
Former Czechoslovakia	..	..	257	207	600	1103
Estonia	..	..	..	..	..	58
Hungary	..	..	..	..	1462	1479
Kazakhstan	..	..	..	..	..	100
Latvia	..	..	..	..	..	14
Lithuania	..	..	..	..	..	10
Moldova	..	..	..	..	..	17
Poland	17	15	11	89	291	678
Romania	..	..	..	..	40	77
Russian Federation	..	..	..	..	..	700
Ukraine	..	..	..	..	..	200
Uzbekistan	..	..	..	..	..	40
Memorandum:						
Least developed countries	197	494	1008	603	346	303

Sources: UNCTAD, Division on Transnational Corporations and Investment database on foreign direct investment, based on the International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development and official national sources.

Annex table 2. Foreign-direct-investment outflows, by home region and economy, 1982-1992
(Millions of dollars)

Home region/economy	*1982-1987 (Annual average)*	*1988*	*1989*	*1990*	*1991*	*1992*
All countries	67876	168073	222395	231509	191889	171129
Developed regions/economies	66547	162073	212009	221879	185017	161951
Western Europe	37558	102469	123700	143503	111910	105558
European Union	32177	82628	100812	116606	94224	96546
Belgium and Luxembourg	897	3784	6812	6262	6165	11175
Denmark	320	720	2066	1482	1852	2236
France	3923	14496	19426	34822	23932	30993
Germany	6300	12700	18310	28600	22330	15780
Italy	2013	5576	2141	7637	7321	6016
Netherlands	4610	6750	15016	15284	12633	12269
Portugal	7	80	84	163	463	688
Spain	396	1235	1473	2937	3584	1300
United Kingdom	13713	37287	35484	19419	15944	16089
Other Western Europe	5382	19841	22888	26897	17686	9012
Austria	184	310	867	1701	1293	1872
Finland	504	2624	3111	3313	1071	407
Iceland	1	1	8	9	11	27
Norway	840	978	1358	1470	1782	404
Sweden	2364	7233	9694	14034	6988	1405
Switzerland	1490	8695	7850	6370	6541	4897
North America	17394	20090	39003	28248	39926	38831
Canada	3967	5766	5177	4316	6826	5742
United States	13428	14324	33826	23932	33100	33089
Other countries	11594	39514	49306	50128	33181	17562
Australia	2158	5072	3319	931	2044	-296
Israel	84	62	38	165	414	575
Japan	9093	34210	44160	48050	30740	17240
New Zealand	175	152	1791	998	-44	-22
South Africa	83	18	-2	..	..	..
Turkey	2	..	..	-16	27	65
Developing regions/economies	1321	5978	10367	9592	6862	9151
Africa	79	142	122	190	170	93
Oil-exporting countries	59	110	79	166	131	35
Algeria	9	5	8	5	50	..
Angola	..	..	..	1	..	..
Cameroon	10	29	-	15	1	..
Egypt	12	12	23	12	62	4
Gabon	6	10	8	29	15	26
Libyan Arab Jamahiriya	24	56	35	105	-	..
Tunisia	-1	-2	5	-1	3	5
Other countries	20	32	43	24	39	58
Benin	-	..	..	..	..	..
Botswana	..	..	..	..	..	..
Burundi	..	..	-	-	..	..
Cape Verde	..	-	1	-	..	..
Central African Republic	1	5	4	4	4	6
Chad	1	14	13	..	..	..
Comoros	..	..	..	1	..	..
Equatorial Guinea	..	..	-	-	-	..
Kenya	7	2	1	..	..	..
Lesotho	..	-	..	..	..	..
Mauritania	-	1	..	..	..	..
Mauritius	..	-	1	1	11	43

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(Annex table 2, cont'd.)

Home region/economy	*1982-1987 (Annual average)*	*1988*	*1989*	*1990*	*1991*	*1992*
Namibia	..	..	..	2	6	2
Niger	-	..	..	..	..	..
Sao Tome	..	-	..	..	..	..
Senegal	2	14	..	..	..	..
Seychelles	6	6	8	8	5	5
Swaziland	2	12	15	8	13	2
Zimbabwe	..	-22	..	..	..	..
Latin America and the Caribbean	294	296	703	1042	1196	286
Oil-exporting countries	93	70	137	356	149	86
Bolivia	-	2	1	1	2	2
Trinidad and Tobago	3	..	..	..	..	..
Venezuela	89	68	136	355	147	84
Other countries/economies	202	226	566	686	1047	200
Antigua and Barbuda	..	..	..	..	..	-2
Argentina	-5	..	..	..	..	..
Barbados	2	1	3	1	1	1
Brazil	161	175	523	665	1014	146
Colombia	37	44	29	16	24	50
Costa Rica	4	1	6	2	6	3
Grenada	..	..	..	..	1	..
Netherlands Antilles	-	3	5	2	1	2
Uruguay	2	2	..	..	..	..
Developing Europe	..	..	..	..	..	..
Western Asia	150	254	575	-19	36	543
Oil-exporting countries	146	254	558	10	7	532
Kuwait	146	254	558	10	7	532
Other countries	4	-	17	-29	29	11
Cyprus	..	..	..	3	15	14
Jordan	3	-	17	-32	14	-3
Yemen	1	..	..	..	..	..
East, South and South-East Asia	812	5277	9013	8388	5452	8221
Oil-exporting countries	..	..	..	..	..	..
Other countries/territories	812	5277	9013	8388	5452	8221
China	333	850	780	830	913	4000
Korea, Republic of	106	151	305	820	1357	1047
Pakistan	4	13	43	2	-4	-12
Singapore	178	117	882	1352	1160	1347
Sri Lanka	1	2	2	1	5	2
Taiwan Province of China	162	4120	6951	5243	1854	1701
Thailand	29	24	50	140	167	136
Pacific islands	-14	9	-46	-10	8	8
Fiji	-10	-25	-28	-10	8	8
Papua New Guinea	-4	34	-18	..	..	..
Central and Eastern Europe	8	22	19	38	10	27
Albania	..	..	..	..	..	-20
Former Czechoslovakia	..	..	1	20	14	30
Hungary	..	..	..	..	..	-
Poland	8	22	18	..	-7	13
Romania	..	..	..	18	3	4

Sources: UNCTAD,Division on Transnational Corporations and Investment database on foreign direct investment, based on the International Moneraty Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; and official national sources.

Annex table 3. Foreign-direct-investment inward stock, by host region and economy, 1980, 1985, 1990 and 1992.
(Millions of dollars)

Host region/economy	*1980*		*1985*		*1990*		*1992*	
All countries	502688		745760		1704642		1948104	
Developed regions/countries	394146		555503		1373975		1520144	
Western Europe	195180		235920		744546		838316	
European Union	175810		212068		678678		767429	
Belgium and Luxembourg	7306		8840		36644	a/	57094	a/
Denmark	4193		3613		9192		11762	b/
France	22617		33392		86513		119198	a/
Germany	36630		36926		119619		129606	
Greece	4524		8309		14016	a/	16295	a/
Ireland	3749		4649		4974	c/	5173	c/
Italy	8892		18977		57985		62740	d/
Netherlands	19167		25071		73188		83733	d/
Portugal	576		791		6366	e/	10687	e/
Spain	5141		8939		66276		97888	d/
United Kingdom	63014		62561		203905		173254	
Other Western Europe	19370		23852		65868		70886	
Austria	3163		3472		9884		11726	
Finland	1102		1339		5132		3672	
Iceland	123	f/	226	f/	201	f/	253	f/
Norway	3144	f/	3980	f/	7985	f/	8484	f/
Sweden	3332		4777		11759		14199	
Switzerland	8506		10058		30907		32554	
North America	134697		247031		504010		541191	
Canada	51651		62416		109099		121665	d/
United States	83046		184615		394911		419526	
Other countries	64270		72553		125418		140637	
Australia	13173		25049		71461		79709	d/
Israel	727	f/	1131	f/	1959	f/	2447	f/
Japan	31380		33050		34630		38720	c/
New Zealand	2364		2043		4997	a/	5749	a/
South Africa	16519		10920		11051	e/	11039	e/
Turkey	107		360		1320		2974	b/
Developing regions/economies	108455		190077		329877		420194	
Africa	21107		24989		39939		45660	
Oil-exporting countries	8031		15860		27291		30952	
Algeria	1320	f/	1281	f/	1315	f/	1337	f/
Angola	61	f/	675	f/	1024	f/	1977	f/
Cameroon	330	f/	1125	f/	1161	f/	1150	f/
Congo	309	f/	479	f/	564	f/	573	f/
Egypt	2256	f/	5700	f/	11039	f/	11751	f/
Gabon	803		774		1458		1320	b/
Nigeria	2404	f/	4405	f/	8022	f/	9631	f/
Tunisia	548		1422		2708	e/	3212	e/
Other countries	13076		9129		12648		14709	
Benin	32	f/	34	f/	36	f/	50	f/
Botswana	266	f/	515	f/	819	f/	920	f/
Burkina Faso	18	f/	25	f/	31	f/	31	f/
Burundi	7	f/	24	f/	29	f/	31	f/
Chad	123	f/	186	f/	243	f/	254	f/
Central African Republic	50	f/	77	f/	96	f/	88	f/
Côte d'Ivoire	650		550		1060	a/	1102	a/
Comoros	..		-	g/	15	g/	19	g/

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(Annex table 3, cont'd.)

Host region/economy	1980	1985	1990	1992
Cape Verde	..	..	3 h/	3 h/
Djibouti	3 f/	3 f/	5 f/	5 f/
Ethiopia	110 f/	114 f/	116 f/	117 f/
Guinea	2 f/	3 f/	24 f/	30 f/
Guinea-Bissau	- f/	4 f/	8 f/	16 f/
Equatorial Guinea	..	5 f/	23 f/	85 f/
Gambia	21 f/	23 f/	41 f/	57 f/
Ghana	288	312	375	418 b/
Kenya	666	368	393	668 b/
Lesotho	9	15	69	79 b/
Liberia	1230	1334	2527 i/	2535 i/
Madagascar, Republic of	36 f/	47 f/	103 f/	138 f/
Malawi	100 f/	138 f/	210 f/	227 f/
Mali	13 f/	35 f/	29 f/	25 f/
Mauritania	..	33 f/	51 f/	53 f/
Mauritius	20 f/	37 f/	162 f/	196 f/
Morocco	305 f/	557 f/	1035 f/	1779 f/
Mozambique	15 f/	17 f/	42 f/	90 f/
Namibia	..	16 j/	51 j/	212 j/
Niger	188 f/	203 f/	260 f/	262 f/
Rwanda	54 f/	133 f/	213 f/	219 f/
Senegal	360	194	304 i/	336 i/
Seychelles	37	87	194 a/	237 a/
Sierra Leone	77 f/	66 f/	- f/	64 f/
Somalia	29 f/	4 f/	28 f/	28 f/
Sudan	- f/	28 f/	12 f/	11 f/
Swaziland	149 f/	184 f/	427 f/	517 f/
Tanzania	154	72	11	16 b/
Togo	182 f/	216 f/	249 f/	254 f/
Uganda	9 f/	7 f/	4 f/	8 f/
Zaire	440 f/	351 f/	277 f/	287 f/
Zambia	414	99	593 i/	677 i/
Zimbabwe	7023 k/	3013	2483 a/	2567 a/
Latin America and the Caribbean	48030	71934	116415	149003
Oil-exporting countries	12711	19664	35989	49320
Bolivia	420	592	806	951 b/
Ecuador	719	982	1370	1535 b/
Mexico	8992 f/	14824 f/	27856 f/	37984 f/
Trinidad and Tobago	976	1719	2093	2440 b/
Venezuela	1604	1548	3865	6410 b/
Other countries/economies	35318	52270	80426	99683
Antigua and Barbuda	23 f/	94 f/	286 f/	358 f/
Argentina	5344	6563	8778 a/	15396 a/
Bahamas	298 f/	294 f/	337 f/	344 f/
Barbados	102 f/	123 f/	169 f/	191 f/
Belize	12 f/	10 f/	72 f/	103 f/
Bermuda	5132 f/	8053 f/	13850 f/	19595 f/
Brazil	17480	25665	37143	39569 b/
Cayman Islands	223 f/	1480 f/	1749 f/	1802 f/
Chile	886	2321	6175	7475 b/
Colombia	1061	2231	3500	4747 b/
Costa Rica	672	957	1447	1846 b/
Dominican Republic	239	265	572	896 b/
Dominica	..	6 g/	41 g/	65 g/
El Salvador	154	181	212	249 b/
Grenada	1 f/	13 f/	70 f/	108 f/
Guatemala	44 f/	71 f/	743 f/	928 f/
Haiti	79 f/	112 f/	149 f/	171 f/
Honduras	93 f/	172 f/	383 f/	488 f/
Jamaica	501 f/	459 f/	691 f/	904 f/
Netherlands Antilles	569 f/	57 f/	207 f/	246 f/
Nicaragua	109 f/	109 f/	105 f/	130 f/

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(Annex table 3, cont'd.)

Host region/economy	*1980*		*1985*		*1990*		*1992*	
Panama	387		533		474	a/	433	a/
Paraguay	218	f/	298	f/	401	f/	524	f/
Peru	898		1152		1254	b/	1374	b/
Saint Kitts and Nevis	1	f/	32	f/	160	f/	195	f/
Saint Lucia	94	f/	197	f/	315	f/	419	f/
Saint Vincent and the Grenadine	1	f/	9	f/	46	f/	74	f/
Surinam	-	f/	21	f/	-	f/	-	f/
Uruguay	700	f/	767	f/	980	f/	1026	f/
Virgin Islands	..	f/	31	f/	118	f/	30	f/
Developing Europe	297		498		919		1183	
Gibraltar	..		32	g/	197	g/	241	g/
Malta	156	f/	286	f/	465	f/	503	f/
Former Yugoslavia	141	f/	179	f/	257	f/	439	f/
Western Asia	5607		27101		27631		28884	
Oil-exporting countries	5073		25995		25752		26663	
Bahrain	..		281	g/	815	g/	800	g/
Iran, Islamic Republic of	1214		857		284	e/	324	e/
Iraq	153		149		167	a/	172	a/
Kuwait	348		342		343	a/	309	a/
Oman	266		985		1407		1615	b/
Qatar	174		167		157		204	b/
Saudi Arabia	2200	k/	22422		21519	a/	22032	a/
United Arab Emirates	719		792		1060	e/	1208	e/
Other countries	533		1106		1879		2221	
Cyprus	310		520		1046	e/	1235	e/
Jordan	155		455		344	a/	372	a/
Lebanon	12		11		7		27	b/
Syrian Arab Republic	-	f/	37	f/	374	f/	455	f/
Yemen	56		83		108	i/	132	i/
East, South and South-East Asia	32248		64384		142781		192411	
Oil-exporting countries	16370		33513		53026		64744	
Brunei Darussalam	19	f/	33	f/	26	f/	21	f/
Indonesia	10274		24971		38883		42139	b/
Malaysia	6078		8510		14117	e/	22584	e/
Other countries/economies	15877		30872		89755		127667	
Afghanistan	11	f/	12	f/	12	f/	12	f/
Bangladesh	63		112		147	e/	153	e/
China	..		3444		14135	a/	29657	a/
Hong Kong	1729		3520		13413	a/	15869	a/
India	1177		1075		1667	e/	1951	e/
Korea, Democratic People's Republic of	..		..		572	h/	615	h/
Korea, Republic of	1140		1806		5429	e/	7095	e/
Lao People's Democratic Republic	2	f/	1	f/	13	f/	30	f/
Macao	2	f/	10	f/	10	f/	3	f/
Maldives	5	f/	3	f/	25	f/	38	f/
Myanmar	5	f/	6	f/	9	f/	27	f/
Nepal	1	f/	2	f/	12	f/	15	f/
Pakistan	690		1079		1708	e/	2314	e/
Philippines	1225		1302		2098	a/	2870	a/
Singapore	6203		13016		32043	e/	42073	e/
Sri Lanka	231		517		681	e/	852	e/
Taiwan Province of China	2405		2930		9735	e/	11885	e/
Thailand	981		1999		7980	a/	12110	a/
Viet Nam	7	f/	38	f/	66	f/	99	f/
Pacific islands	1167		1171		2192		3054	
Fiji	358		393		360	a/	430	a/
Papua New Guinea	748		683		1653	a/	2378	a/
Solomon Islands	28	f/	32	f/	61	f/	92	f/

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(Annex table 3, cont'd.)

Host region/economy	*1980*		*1985*		*1990*		*1992*	
Vanuatu	33	f/	62	f/	110	f/	140	f/
Western Samoa	1	f/	1	f/	8	f/	13	f/
Central and Eastern Europe	87		180		791		7766	
Albania							-	l/
Belarus	..		..		..		7	m/
Bulgaria	..		..		4	n/	102	n/
Former Czechoslovakia	..		..		464	n/	2167	n/
Estonia	..		..		..		58	m/
Hungary	1		3		3		2944	h/
Kazkhastan	..		..		..		100	m/
Latvia	..		..		..		14	m/
Lithuania	..		..		..		10	m/
Moldova	..		..		..		17	m/
Poland	86	f/	177	f/	320	f/	1289	f/
Romania	..		..		..		117	l/
Russian Federation	..		..		..		700	m/
Ukraine	..		..		..		200	m/
Uzbekistan	..		..		..		40	m/

Source: UNCTAD, Division on Transnational Corporations and Investment database on foreign direct investment.

a/ Estimated by adding flows to the stock of 1989.
b/ Estimated by adding flows to the stock of 1990.
c/ Estimated by adding flows to the stock of 1986.
d/ Estimated by adding flows to the stock of 1991.
e/ Estimated by adding flows to the stock of 1988.
f/ Estimated by accumulating flows since 1970.
g/ Estimated by accumulating flows since 1982.
h/ Estimated by accumulating flows since 1987.
i/ Estimated by adding flows to the stock of 1987.
j/ Estimated by accumulating flows since 1985.
k/ Estimated by subtracting FDI inflow for 1981 from the stock of 1981.
l/ Estimated by accumulating flows since 1991.
m/ Represents FDI inflow for 1992.
n/ Estimated by accumulating flows since 1990.

Annex table 4. Foreign-direct-investment outward stock, by home region and economy, 1980, 1985, 1990 and 1992
(Millions of dollars)

Home region/economy	*1980*		*1985*		*1990*		*1992*	
All countries	506604		674370		1649242		1932300	
Developed regions/countries	503087		657857		1603140		1869616	
Western Europe	235494		311589		849405		999852	
European Union	206003		271056		707316		843894	
Belgium and Luxembourg	6037		4688		28913	a/	46253	a/
Denmark	2065		1801		7342		11430	b/
France	23604		37077		110126		160897	c/
Germany	43127		59909		151581		178682	
Italy	6970		16301		56105		68718	c/
Netherlands	42116		47810		108438		131730	c/
Portugal	130	d/	200	d/	517	d/	1668	d/
Spain	1226		2076		14987		23322	c/
United Kingdom	80729		101195		229308		221197	
Other Western Europe	29491		40533		142089		155958	
Austria	530		1079		4274		7461	c/
Finland	743		1842		12089		11756	
Iceland	..		..		21	d/	59	d/
Norway	1115	d/	3854	d/	10133	d/	12319	d/
Sweden	5611		12408		49842		50547	
Switzerland	21491		21350		65731		73817	
North America	242750		289762		507434		576229	
Canada	22572		38728		75745		87462	c/
United States	220178		251034		431689		488767	
Other countries	24843		56506		246301		293534	
Australia	2260		6653		30920		29250	c/
Israel	28	d/	510	d/	912	d/	1901	d/
Japan	16570	d/	42030	d/	202450	d/	250430	d/
New Zealand	263		809		4389	a/	4323	a/
South Africa	5722		6504		7631	e/	7630	e/
Turkey	161	d/	161	d/	154	d/	246	d/
Developing regions/economies	3438		16413		45893		62418	
Africa	452		779		1481		1736	
Oil-exporting countries	389		594		1151		1317	
Algeria	99	d/	157	d/	185	d/	235	d/
Cameroon	7	d/	36	d/	108	d/	109	d/
Egypt	39	d/	91	d/	163	d/	229	d/
Gabon	76	d/	102	d/	164	d/	205	d/
Libyan Arab Jamahiriya	162	d/	206	d/	526	d/	526	d/
Tunisia	6	d/	2	d/	6	d/	14	d/
Other countries	63		185		329		418	
Benin	-	d/	2	d/	2	d/	2	d/
Botswana	3	d/	3	d/	3	d/	3	d/
Central African Republic	2	d/	3	d/	20	d/	30	d/
Chad	1	d/	1	d/	36	d/	36	d/
Kenya	18	d/	60	d/	66	d/	66	d/
Mauritius	..		..		..		46	d/
Namibia	..		-	f/	2	f/	10	f/
Senegal	8	d/	45	d/	52	d/	52	d/
Seychelles	14	d/	44	d/	77	d/	87	d/
Swaziland	18	d/	28	d/	72	d/	87	d/

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(Annex table 4, cont'd.)

Home region/economy	1980		1985		1990		1992	
Latin America and the Caribbean	855		1916		4263		6281	
Oil-exporting countries	1		53		1120		1355	
Bolivia	1	d/	1	d/	7	d/	11	d/
Trinidad and Tobago	..		16	f/	21	f/	21	f/
Venezuela	..		36	g/	1092	g/	1323	g/
Other countries/economies	854		1863		3143		4926	
Barbados	5	d/	12	d/	23	d/	25	d/
Brazil	652		1361		2397		3557	b/
Chile	42		102		178		713	
Colombia	137		301		402		476	b/
Costa Rica	6	d/	26	d/	44	d/	53	d/
Netherlands Antilles	10	d/	10	d/	21	d/	24	d/
Peru	3		38		63		63	b/
Uruguay	..		13	g/	15	g/	15	g/
Developing Europe	..		..		..		..	
Western Asia	591		956		2134		2713	
Oil-exporting countries	568		930		2115		2654	
Kuwait	568	d/	930	d/	2115	d/	2654	d/
Other countries	23		26		19		59	
Cyprus	..		..		3	h/	32	h/
Jordan	23	d/	26	d/	16	d/	27	d/
East, South and South-East Asia	1520		12740		38008		51681	
Oil-exporting countries	414		750		1477		1484	
Malaysia	414		749		1469	d/	1469	d/
Sri Lanka	..		1	i/	8	i/	15	i/
Other countries/economies	1106		11990		36531		50198	
China	..		131		2489	a/	7401	a/
Hong Kong	..		9441		14015	j/	14015	j/
India	..		95		76	k/	76	k/
Korea, Republic of	142		487		2172	a/	4576	a/
Pakistan	31		127		282	d/	266	d/
Philippines	171		171		154	d/	154	d/
Singapore	652	d/	1320	d/	4058	d/	6565	d/
Taiwan Province of China	97		204		12888	d/	16443	d/
Thailand	13		14		398	a/	701	a/
Pacific islands	21		22		7		7	
Papua New Guinea	11		22		7	l/	7	l/
Fiji	10	d/	..		..		..	
Central and Eastern Europe	79		100		209		266	
Former Czechoslovakia	..		..		21	m/	65	m/
Poland	79	d/	100	d/	170	d/	176	d/
Romania	..		..		18	h/	25	h/

Source: UNCTAD, Division on Transnational Corporations and Investment database on foreign direct investment.

a/ Estimated by adding flows to the stock of 1989.
b/ Estimated by adding flows to the stock of 1990.
c/ Estimated by adding flows to the stock of 1991.
d/ Estimated by accumulating flows since 1970.
e/ Estimated by adding flows to the stock of 1988.
f/ Estimated by accumulating flows since 1983.
g/ Estimated by accumulating flows since 1982.
h/ Estimated by accumulating flows since 1991.
i/ Estimated by accumulating flows since 1985.
j/ Estimated by adding flows to the stock of 1987.
k/ Represents 1988 stock data.
l/ Represents 1989 stock data.
m/ Estimated by accumulating flows since 1989.

Annex table 5. The ratio of foreign-direct-investment inflows to gross fixed capital formation and the ratio of gross fixed capital formation to gross domestic product, 1981-1992
(Percentage)

Host region/economy	*1981-1985*	*1986-1990*	*1991*	*1992*
All countries	1.9	3.2	3.5	3.7
	(23.6)	(22.9)	(24.6)	(20.5)
Developed regions/countries	2.3	4.4	3.3	2.9
	(19.2)	(18.6)	(20.4)	(19.5)
Western Europe	2.7	5.3	5.1	5.6
	(20.1)	(18.3)	(21.6)	(20.2)
European Union	2.8	5.6	5.2	6.1
	(19.7)	(17.9)	(21.3)	(20.1)
Belgium and Luxembourg	7.3	14.8	18.6	17.0
	(18.5)	(15.3)	(19.8)	(22.0)
Denmark	0.9	2.7	6.5	4.9
	(16.4)	(17.9)	(18.9)	(16.7)
France	2.0	3.7	5.6	8.6
	(20.9)	(18.7)	(22.6)	(20.5)
Germany	1.1	1.6	2.0	1.8
	(21.3)	(18.2)	(21.4)	(20.8)
Greece	7.2	7.9	8.5	8.2
	(20.1)	(15.9)	(18.5)	(16.9)
Ireland	4.1	1.1	1.3	1.3
	(24.6)	(15.2)	(18.2)	(15.3)
Italy	1.2	2.1	1.0	1.6
	(21.4)	(18.0)	(20.5)	(20.0)
Netherlands	6.1	11.6	8.8	8.8
	(19.0)	(19.4)	(22.3)	(20.6)
Portugal	3.6	9.6	13.7	8.5
	(22.3)	(20.7)	(24.1)	(22.4)
Spain	5.5	9.0	8.3	6.3
	(20.0)	(17.5)	(22.9)	(22.1)
United Kingdom	5.6	13.6	9.0	13.1
	(16.3)	(16.4)	(20.3)	(17.2)
Other Western Europe	1.6	3.4	4.5	1.9
	(22.2)	(21.0)	(23.7)	(21.6)
Austria	1.3	1.5	0.9	2.1
	(23.7)	(20.3)	(23.7)	(22.7)
Finland	0.7	1.8	-0.9	2.0
	(23.4)	(21.0)	(29.2)	(24.8)
Iceland	3.2	-0.4	2.8	1.5
	(19.4)	(16.8)	(17.7)	(18.6)
Norway	1.2	3.7	-2.0	4.2
	(24.4)	(24.6)	(18.7)	(17.4)
Sweden	1.6	3.5	12.6	0.8
	(18.2)	(17.1)	(20.9)	(18.6)
Switzerland	2.4	5.3	5.4	1.8
	(23.7)	(24.6)	(26.2)	(24.6)
North America	2.9	6.7	3.8	1.2
	(15.1)	(15.4)	(14.8)	(13.2)
Canada	-0.6	3.7	5.7	7.2
	(20.6)	(19.2)	(20.9)	(20.7)
United States	3.4	7.1	3.5	0.4
	(14.5)	(15.0)	(14.1)	(12.5)
Other countries	0.7	0.8	0.7	0.7
	(27.2)	(24.7)	(27.1)	(27.6)
Australia	5.1	10.2	7.9	8.8
	(22.5)	(20.9)	(22.3)	(20.6)
Israel	2.4	2.3	1.8	1.5
	(12.8)	(13.9)	(15.8)	(20.5)
Japan	0.1	..	0.1	0.2
	(29.0)	(25.8)	(28.2)	(28.9)

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(Annex table 5, cont'd.)

Host region/economy	*1981-1985*	*1986-1990*	*1991*	*1992*
New Zealand	5.4	9.8	9.6	1.0
	(22.3)	(19.0)	(20.6)	(17.6)
South Africa	0.4	..	..	..
	(26.2)	(17.8)	(19.0)	(17.0)
Turkey	0.9	2.0	3.3	..
	(15.5)	(20.1)	(22.8)	(21.7)
Developing regions/economies	2.4	2.7	4.0	7.8
	(22.1)	(22.6)	(26.5)	(26.5)
Africa	2.5	3.7	4.7	10.5
	(22.3)	(24.3)	(24.7)	(19.6)
Oil-exporting countries	2.8	3.7	4.8	13.2
	(24.2)	(30.3)	(27.7)	(21.6)
Algeria	-0.1	..	0.1	..
	(30.8)	(28.5)	(29.6)	(19.3)
Angola	28.5	13.1	..	..
	..	..	..	..
Cameroon	8.7	0.3	-1.1	..
	(18.8)	(26.8)	(29.7)	(18.7)
Congo	4.6	4.2	1.8	..
	(35.9)	(22.1)	(16.7)	(11.1)
Egypt	7.7	5.4	3.0	5.3
	(27.6)	(58.0)	(40.4)	(23.5)
Gabon	5.1	6.8	-9.4	..
	(34.4)	(30.3)	(20.6)	(18.2)
Libyan Arab Jamahiriya	-3.1	0.1	1.7	..
	(28.8)	(37.5)	(44.6)	(52.0)
Nigeria	4.5	27.5	19.3	23.3
	(17.2)	(9.9)	(11.3)	(12.1)
Tunisia	8.3	3.4	4.2	9.6
	(29.6)	(21.0)	(21.7)	(18.7)
Other countries	1.7	3.6	4.3	7.1
	(18.2)	(15.4)	(20.6)	(16.6)
Benin	0.2	0.2	5.1	..
	(16.5)	(13.6)	(13.0)	(11.8)
Botswana	16.3	19.7	..	..
	(30.6)	(15.5)	(14.5)	..
Burkina Faso	0.3	0.2	0.1	..
	(35.1)	(27.5)	(28.4)	(33.8)
Burundi	2.1	0.7	0.4	0.3
	(15.5)	(15.2)	(17.5)	(19.2)
Central African Republic	9.8	2.4	-2.8	..
	(8.2)	(12.0)	(13.2)	(13.1)
Côte d'Ivoire	2.7	4.3	1.5	..
	(21.0)	(11.1)	(14.4)	(13.4)
Comoros	..	6.4	5.4	..
	(33.0)	(21.7)	(23.5)	(17.6)
Cape Verde	..	0.5	1.0	..
	(56.6)	(45.3)	(41.2)	(35.9)
Djibouti	0.1	0.3	..	..
	(33.4) a/	(29.9)	(29.7)	..
Ethiopia	0.1	0.1	0.1	..
	(11.7)	(14.3)	(11.2)	(10.2)
Ghana	1.1	1.3	2.3	2.5
	(18.8)	(10.4)	(10.8)	(12.9)
Guinea	..	1.1	..	..
	..	(16.8)	(12.6)	..
Gambia	..	9.0	20.0	..
	(28.0)	(13.9)	(15.5)	(14.3)
Guinea-Bissau	1.9 a/	1.6	3.0	..
	(35.5)	(41.1)	(21.4)	(31.8)
Equatorial Guinea	9.5	15.8	79.8	..
	(16.3) b/	(16.3)	(19.9)	(33.3)

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(Annex table 5, cont'd.)

Host region/economy	*1981-1985*	*1986-1990*	*1991*	*1992*
Kenya	1.4 (19.4)	2.4 (18.1)	1.2 (22.0)	0.5 (19.4)
Lesotho	3.4 (36.4)	4.5 (41.5)	1.7 (74.7)	.. (65.9)
Madagascar, Republic of	0.7 (14.2)	3.3 (11.2)	8.0 (13.8)	.. (5.8)
Malawi	4.5 (24.2)	5.6 (15.3)	4.4 (16.2)	-0.9 (23.7)
Mali	2.4 (17.5)	-0.3 (18.0)	0.6 (22.7)	.. (19.5)
Mauritania	4.7 (27.0)	1.9 (19.9)	0.9 (18.2)	.. (20.4)
Morocco	1.5 (24.7)	1.9 (18.9)	5.2 (22.4)	6.3 (21.6)
Mozambique	0.2 (9.2)	3.9 (7.9)	15.8 (10.5)	.. (13.5)
Niger	0.6 (22.1)	3.6 (12.2)	0.2 (12.6)	.. (15.8)
Rwanda	6.8 (14.7)	4.8 (14.8)	2.0 (19.1)	0.9 (15.0)
Senegal	2.3 (14.7)	0.2 (11.4)	.. (14.4)	.. ..
Seychelles	25.8 (28.2)	33.6 (19.6)	.. (22.6)	.. ..
Sierra Leone	-5.0 (11.7)	-115.4 (6.5)	58.3 (9.8)	.. (7.7)
Somalia	-1.7 (41.1)	-1.7 (34.0)	.. ..	.. ..
Sudan	0.7 (16.1)	.. (8.7)	.. (29.3)	.. (29.6)
Swaziland	6.0 (27.2)	39.5 (17.3)	.. (17.2)	.. ..
Togo	2.4 (25.7)	2.1 (22.5)	2.0 (25.0)	.. (21.2)
Tanzania	0.7 (15.9)	.. (33.1)	0.3 (40.6)	0.2 (41.5)
Uganda	-0.1 (15.4)	-0.2 (14.8)	0.3 (14.8)	.. (10.1)
Zaire	-10.2 (7.3)	-1.4 ..	3.2 ..	.. ..
Zambia	10.7 (16.5)	35.6 (7.4)	.. (13.8)	.. ..
Zimbabwe	.. (17.5)	-1.1 (15.6)	 (17.3)	.. ..
Latin America and the Caribbean	5.6 (15.5)	3.6 (15.6)	7.5 (18.5)	11.6 (16.5)
Oil-exporting countries	2.9 (18.8)	6.2 (17.6)	10.1 (15.3)	42.6 (16.7)
Bolivia	6.3 (15.0)	1.6 (11.3)	7.2 (12.1)	.. (13.7)
Ecuador	2.5 (20.8)	3.7 (20.1)	3.8 (16.9)	3.3 (17.7)
Mexico	3.6 (18.4)	8.1 (16.6)	8.6 (15.8)	.. (16.9)
Trinidad and Tobago	6.9 (26.4)	10.7 (17.5)	23.6 (13.1)	.. (13.3)
Venezuela	0.8 (19.2)	2.1 (21.4)	19.7 (12.9)	5.0 (15.9)
Other countries/economies	7.7 (13.9)	3.0 (14.8)	6.1 (20.0)	8.2 (16.4)
Argentina	6.8 (14.2)	4.2 (16.1)	8.8 (10.4)	10.9 (12.1)
Bahamas	0.6 (16.5)	1.4 (20.2)	.. (20.8)	.. ..

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(Annex table 5, cont'd.)

Host region/economy	*1981-1985*	*1986-1990*	*1991*	*1992*
Barbados	1.9	3.4	2.6	..
	(20.7)	(15.6)	(18.4)	(16.3)
Belize	-1.6	15.1	10.4	13.0
	(19.9)	(20.2)	(24.8)	(26.9)
Brazil	6.8	3.9	1.3	2.1
	(14.3)	(14.1)	(25.5)	(19.4)
Chile	7.0	4.7	9.6	8.0
	(15.2)	(13.6)	(16.6)	(14.3)
Colombia	10.2	7.7	8.7	12.5
	(15.5)	(15.5)	(14.2)	(10.9)
Costa Rica	10.7	11.3	17.8	16.3
	(21.3)	(17.0)	(20.1)	(15.4)
Dominican Republic	2.9	7.7	10.0	9.7
	(29.9)	(21.5)	(16.1)	(18.7)
Dominica	3.9	16.5	14.1	..
	(31.1)	(26.2)	(38.0)	(40.0)
El Salvador	1.7	2.4	3.2	1.3
	(13.1)	(14.3)	(10.2)	(12.4)
Grenada	6.6	18.0	16.6	..
	(35.3)	(32.0)	(40.2)	(43.0)
Guatemala	5.7	14.7	8.0	6.9
	(13.1)	(12.3)	(9.4)	(10.8)
Guyana	2.5	0.6	11.0	0.2
	(27.8)	(26.9)	(42.2)	(30.0)
Haiti	2.5	2.3	4.1	..
	(15.6)	(13.9)	(13.6)	..
Honduras	2.7	5.6	7.8	8.6
	(18.0)	(19.2)	(42.2)	(17.5)
Jamaica	-1.5	5.0	23.0	..
	(18.4)	(19.8)	(29.8)	(16.7)
Nicaragua	..	..	..	..
	(19.4)	(56.8)	(94.3)	..
Panama	3.5	-1.2	-4.4	-0.1
	(21.9)	(13.4)	(8.6)	(15.4)
Paraguay	1.1	1.8	6.1	..
	(26.9)	(27.5)	(18.5)	(21.2)
Peru	0.1	0.6	-0.1	1.9
	(20.2)	(23.1)	(25.3)	(28.5)
Saint Kitts and Nevis	..	40.9	..	..
	..	(38.5) c/	(53.3)	..
Saint Vincent	5.3	16.4	..	..
	(28.3)	(24.7)	(27.8)	..
Surinam	2.4	-30.0	..	..
	(22.0)	(18.3)	(18.4)	..
Uruguay	1.4	5.2	2.9	1.0
	(12.2)	(9.3)	(9.2)	(9.7)
Developing Europe	0.2	0.3	0.8	10.4
	(42.0)	(34.3)	..	..
Malta	9.3	7.1	3.9	1.1
	(25.6)	(23.2)	(29.8)	..
Former Yugoslavia	..	0.1	0.5	..
	(42.3)	(34.6)	..	..
Western Asia	0.5	0.5	0.2	0.3
	(24.3)	(24.5)	(34.2)	(50.4)
Oil-exporting countries	0.3	0.3	0.2	0.2
	(24.2)	(24.5)	(36.3)	(52.0)
Bahrain	5.6 d/	6.9	..	..
	(34.6)	(30.8)	(26.7)	..
Iran, Islamic Republic of	-0.1	-0.3	..	..
	(17.6)	(30.2)	(70.7)	..
Iraq	..	..	..	..
	(38.4)	(22.1)	..	..

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(Annex table 5, cont'd.)

Host region/economy	*1981-1985*	*1986-1990*	*1991*	*1992*
Kuwait	.. (19.5)	.. (18.5)	.. (85.5)	-0.5 (26.2)
Oman	6.3 (23.5)	7.0 (22.7)	8.7 (13.4)	3.0 (14.9)
Qatar	-0.1 e/ (22.7)	-0.5 (16.2)	.. (17.8)	.. ..
Saudi Arabia	0.4 (28.2)	0.9 (22.0)	0.6 (18.1)	1.4 (18.8)
United Arab Emirates	0.1 (28.8)	1.0 (23.9)	0.4 (19.1)	1.5 (20.0)
Other countries	2.1 (25.7)	2.7 (25.5)	2.0 (16.0)	1.8 (27.3)
Cyprus	39.8 (7.1)	6.6 (18.7)	5.8 (23.7)	6.2 (23.0)
Jordan	4.4 (37.9)	2.0 (24.1)	-1.3 (25.5)	2.8 (18.7)
Lebanon	0.5 ..	1.4 f/ (5.5) g/	.. ..	.. ..
Syrian Arab Republic	0.1 (24.7)	2.1 (37.2)	1.2 (22.9)	0.2 ..
Yemen	1.6 (17.6)	1.2 h/ (9.8)	.. ..	.. ..
East, South and South-East Asia	2.0 (25.2)	3.5 (25.8)	4.1 (29.2)	15.4 (27.6)
Oil-exporting countries	3.9 (26.9)	4.1 (28.2)	9.6 (32.0)	14.3 (32.6)
Indonesia	1.0 (25.0)	2.0 (29.5)	3.7 (33.1)	4.1 (32.1)
Malaysia	10.8 (32.9)	10.6 (24.9)	23.9 (29.1)	.. (33.6)
Other countries/economies	1.7 (25.0)	3.4 (25.5)	3.4 (28.9)	15.8 (27.0)
Bangladesh	.. (14.8)	0.1 (12.5)	.. ..	.. ..
China	0.9 (30.9)	2.1 (38.1)	3.3 (35.8)	.. (30.4)
Hong Kong	6.5 (29.1)	13.6 (22.0)	2.3 (24.7)	.. (24.4)
India	0.2 (18.4)	0.3 (20.6)	0.2 (28.2)	.. (24.8)
Korea, Republic of	0.5 (26.1)	1.3 (24.4)	1.0 (31.5)	0.5 (36.3)
Myanmar	.. (18.2)	.. (10.1)	.. (11.7)	.. ..
Nepal	.. (15.0)	0.4 (16.7)	0.5 (15.3)	0.3 (15.6)
Pakistan	1.7 (14.9)	2.9 (15.2)	3.6 (14.7)	4.3 (14.5)
Philippines	0.7 (26.5)	6.8 (16.1)	5.8 (20.4)	1.9 (17.9)
Singapore	18.1 (42.3)	33.9 (33.7)	26.2 (33.3)	30.6 (36.4)
Sri Lanka	3.1 (24.9)	2.6 (20.4)	2.4 (19.3)	5.7 (20.2)
Taiwan Province of China	1.5 (24.1)	3.5 (18.0)	3.0 (20.6)	.. (20.3)
Thailand	3.2 (22.7)	5.9 (21.4)	5.6 (29.3)	.. (32.9)
Pacific islands	15.7 (24.9)	19.9 (19.3)	35.9 (20.9)	50.4 (17.8)
Fiji	12.3 (22.6)	8.5 (13.8)	.. (17.5)	.. ..

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(Annex table 5, cont'd.)

Host region/economy	*1981-1985*	*1986-1990*	*1991*	*1992*
Papua New Guinea	16.4	21.5	30.7	40.1
	(27.1)	(21.2)	(21.4)	(25.1)
Vanuatu	..	20.3	..	..
	..	(29.1) i/	(37.9)	..
Memorandum:				
Least developed countries	1.4	3.2	3.5	10.4
	(16.1)	(13.4)	(18.9)	(7.9)

Sources: UNCTAD, Division on Transnational Corporations and Investment database on foreign direct investment; and the International Monetary Fund, 1994a and 1994b.

a/ Average from 1984 to 1985.
b/ Represents 1985.
c/ Average from 1987 to 1990.
d/ Average from 1982 to 1985.
e/ Average from 1983 to 1985.
f/ Average from 1986 to 1988.
g/ Average from 1988 to 1990.
h/ Average from 1986 to 1989.
i/ Average from 1987 to 1990.

Annex table 6. New bilateral treaties for the promotion and protection of foreign direct investment signed or entered into force as of May 1994

Economy	Date of signature	Date of entry into force
Albania		
Switzerland	22 September 1992	30 April 1993
Poland	5 March 1993	9 August 1993
Austria	18 March 1993	..
United Kingdom	30 March 1994	..
Algeria		
France	13 February 1993	..
Argentina		
Italy	22 May 1990	14 October 1993
Germany	9 April 1991	8 November 1993
France	3 July 1991	..
Poland	31 July 1991	1 September 1992
Spain	2 October 1991	28 March 1994
Canada	5 November 1991	29 April 1993
Egypt	11 May 1992	3 December 1993
Tunisia	17 June 1992	..
Chile	2 August 1992	..
China	5 November 1992	..
Hungary	5 February 1993	..
Senegal	6 April 1993	..
Armenia	16 April 1993	..
Bulgaria	21 September 1993	..
Finland	5 November 1993	..
Venezuela	16 November 1993	..
Jamaica	8 February 1994	..
Ecuador	20 February 1994	..
Bolivia	17 March 1994	..
Armenia		
Argentina	16 April 1993	..
United Kingdom	22 May 1993	..
Greece	25 May 1993	..
Australia		
Indonesia	17 November 1992	29 July 1993
Romania	21 June 1993	..
Hong Kong	15 September 1993	15 October 1993
Czech Republic	30 September 1993	..
Lao People's Democratic Republic	6 April 1994	..
Austria		
Turkey	16 September 1988	1 January 1992
Cape Verde	3 September 1991	1 April 1993
Albania	18 March 1993	..
Paraguay	13 August 1993	..

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(Annex table 6, cont'd.)

Economy	Date of signature	Date of entry into force
Bangladesh		
Turkey	12 November 1987	21 June 1990
Italy	20 March 1990	..
Barbados		
United Kingdom	7 April 1993	7 April 1993
Belarus		
Poland	24 April 1992	18 January 1993
Finland	20 May 1992	21 March 1993
Germany	2 April 1993	..
Switzerland	28 May 1993	..
France	28 October 1993	..
United States	15 January 1994	..
United Kingdom	1 March 1994	..
Belgium-Luxembourg		
Georgia	23 June 1993	..
Bolivia		
Spain	24 April 1990	12 May 1992
Italy	30 April 1990	22 February 1992
Peru	30 July 1993	..
Argentina	17 March 1994	..
Brazil		
Chile	22 March 1994	..
Bulgaria		
Italy	5 December 1988	27 December 1990
United States	23 September 1992	2 June 1994
Greece	12 March 1993	..
Denmark	14 April 1993	..
Russian Federation	8 June 1993	..
Argentina	21 September 1993	..
Israel	6 December 1993	..
Sweden	19 April 1994	..
Canada		
Hungary	3 October 1991	21 November 1993
Argentina	5 November 1991	29 April 1993
Cape Verde		
Austria	3 September 1991	1 April 1993
Netherlands	11 November 1991	25 November 1992
Chile		
Spain	2 October 1991	29 March 1994
France	14 July 1992	..
Argentina	2 August 1992	..
Malaysia	11 November 1992	..
Italy	8 March 1993	..

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(Annex table 6, cont'd.)

Economy	Date of signature	Date of entry into force
Chile (cont'd.)		
Venezuela	2 April 1993	..
Sweden	24 May 1993	..
Finland	27 May 1993	..
Denmark	28 May 1993	..
Norway	1 June 1993	..
Ecuador	27 October 1993	..
Brazil	22 March 1994	..
China	23 March 1994	..
China		
Hungary	29 May 1991	..
Panama	26 March 1992	14 July 1992
Argentina	5 November 1992	..
Moldova	6 November 1992	..
Estonia	2 September 1993	..
Lithuania	8 November 1993	..
Chile	23 March 1994	..
Iceland	31 March 1994	..
Cyprus		
Hungary	25 May 1989	25 May 1990
Greece	30 March 1992	26 February 1993
Poland	4 June 1992	..
Colombia		
United Kingdom	9 March 1994	..
Congo		
United States	12 February 1990	..
Italy	17 March 1994	..
Cuba		
Italy	7 May 1993	..
Russian Federation	7 July 1993	..
Czech Republic		
United States	22 October 1991	19 December 1992
Hungary	14 January 1993	..
Poland	16 July 1993	..
Australia	30 September 1993	..
Thailand	12 February 1994	..
Peru	16 March 1994	..
Russian Federation	5 April 1994	..
Denmark		
Venezuela	18 February 1992	..
Lithuania	30 March 1992	9 December 1992
Estonia	6 November 1992	24 February 1993
Bulgaria	14 April 1993	..
Paraguay	22 April 1993	..
Chile	28 May 1993	..
Viet Nam	23 July 1993	..
Uzbekistan	23 September 1993	..

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Denmark (cont'd.)		
Russian Federation	4 November 1993	..
Hong Kong	2 February 1994	4 March 1994
Ecuador		
United States	27 August 1993	..
Chile	27 October 1993	..
Venezuela	18 November 1993	..
Paraguay	28 January 1994	..
Argentina	20 February 1994	..
Egypt		
United States	11 March 1986	27 June 1992
Argentina	11 May 1992	3 December 1993
Spain	3 November 1992	..
Greece	16 July 1993	..
Indonesia	19 January 1994	..
Estonia		
France	14 May 1992	..
Netherlands	27 October 1992	1 September 1993
Denmark	6 November 1992	24 February 1993
Switzerland	21 December 1992	18 August 1993
Poland	6 May 1993	6 August 1993
China	2 September 1993	..
Israel	14 March 1994	..
United States	19 April 1994	..
United Kingdom	12 May 1994	..
Finland		
Russian Federation	8 February 1989	15 August 1991
Romania	26 March 1992	6 January 1993
Ukraine	14 May 1992	1 March 1993
Belarus	20 May 1992	21 March 1993
Lithuania	12 June 1992	8 January 1993
Uzbekistan	1 October 1992	22 October 1993
Turkey	13 May 1993	..
Chile	27 May 1993	..
Argentina	5 November 1993	..
Thailand	18 March 1994	..
France		
Argentina	3 July 1991	..
Mongolia	8 November 1991	4 February 1994
Lithuania	23 April 1992	..
Estonia	14 May 1992	..
Latvia	15 May 1992	..
Chile	14 July 1992	..
Jamaica	25 January 1993	..
Algeria	13 February 1993	..
Peru	6 October 1993	..
Uruguay	14 October 1993	..
Trinidad and Tobago	28 October 1993	..
Belarus	28 October 1993	..

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Gambia		
Switzerland	22 November 1993	..
Georgia		
Turkey	31 July 1992	..
Belgium-Luxembourg	23 June 1993	..
Germany	25 June 1993	Provisional Application
United States	7 March 1994	..
Germany		
Russian Federation	13 June 1989	5 August 1991
Argentina	9 April 1991	8 November 1993
Ukraine	15 February 1993	Provisional Application
Belarus	2 April 1993	..
Viet Nam	3 April 1993	Provisional Application
Latvia	20 April 1993	Provisional Application
Uzbekistan	28 April 1993	Provisional Application
Georgia	25 June 1993	Provisional Application
Paraguay	11 August 1993	..
Slovenia	28 October 1993	..
Namibia	21 January 1994	..
Moldova	28 February 1994	Provisional Application
Kuwait	30 March 1994	..
Ghana		
Netherlands	31 March 1989	1 July 1991
Guinea Bissau		
Portugal	24 June 1991	..
Greece		
Hungary	29 May 1989	1 February 1992
Cyprus	30 March 1992	26 February 1993
Poland	30 July 1992	..
Bulgaria	12 March 1993	..
Armenia	25 May 1993	..
Russian Federation	30 June 1993	..
Egypt	16 July 1993	..
Morocco	16 February 1994	..
Honduras		
Switzerland	14 October 1993	..
United Kingdom	7 December 1993	..
Spain	18 March 1994	..
Hong Kong		
Netherlands	19 November 1992	1 September 1993
Australia	15 September 1993	15 October 1993
Denmark	2 February 1994	4 March 1994
Hungary		
Italy	17 February 1987	6 September 1989
Korea, Republic of	28 December 1988	1 February 1989
Cyprus	25 May 1989	25 May 1990
Greece	29 May 1989	1 February 1992

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Hungary (cont'd.)		
Uruguay	25 August 1989	1 July 1992
Kuwait	8 November 1989	1 March 1994
Spain	9 November 1989	1 August 1992
Israel	14 May 1991	14 September 1992
China	29 May 1991	..
Canada	3 October 1991	21 November 1993
Thailand	18 October 1991	18 October 1991
Turkey	14 January 1992	..
Indonesia	20 May 1992	12 September 1992
Poland	23 September 1992	..
Czech Republic	14 January 1993	..
Slovak Republic	15 January 1993	..
Argentina	5 February 1993	..
Malaysia	19 February 1993	..
Paraguay	11 August 1993	..
Romania	16 September 1993	..
Iceland		
China	31 March 1994	..
India		
United Kingdom	14 March 1994	..
Indonesia		
Korea, Republic of	16 February 1991	10 March 1994
Viet Nam	25 October 1991	3 December 1993
Tunisia	13 May 1992	12 September 1992
Hungary	20 May 1992	12 September 1992
Sweden	17 September 1992	18 February 1993
Poland	6 October 1992	1 July 1993
Australia	17 November 1992	29 July 1993
Egypt	19 January 1994	..
Malaysia	22 January 1994	..
Netherlands	6 April 1994	..
Israel		
Hungary	14 May 1991	14 September 1992
Poland	22 May 1991	1 January 1992
Bulgaria	6 December 1993	..
Latvia	27 February 1994	..
Estonia	14 March 1994	..
Italy		
Tunisia	17 October 1985	24 June 1989
Hungary	17 February 1987	6 September 1989
Kuwait	17 December 1987	21 May 1990
Malaysia	4 January 1988	25 October 1990
Philippines	17 June 1988	4 November 1993
Bulgaria	5 December 1988	27 December 1990
Poland	10 May 1989	..
Russian Federation	30 November 1989	8 July 1991
Uruguay	21 February 1990	..
Bangladesh	20 March 1990	..

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Italy (cont'd.)		
Bolivia	30 April 1990	
Viet Nam	18 May 1990	22 February 1992
Argentina	22 May 1990	..
Romania	6 December 1990	14 October 1993
Mongolia	15 January 1993	..
Chile	8 March 1993	..
Cuba	7 May 1993	..
Oman	23 June 1993	..
Jamaica	29 September 1993	..
Congo	17 March 1994	..
Jamaica		
France	25 January 1993	..
Italy	29 September 1993	..
United States	4 February 1994	..
Argentina	8 February 1994	..
Japan		
Turkey	12 February 1992	12 March 1993
Jordan		
Turkey	2 August 1993	..
Kazakhstan		
United States	19 May 1992	12 January 1994
Spain	23 March 1994	..
Switzerland	12 May 1994	..
Kuwait		
Italy	17 December 1987	21 May 1990
Turkey	27 October 1988	25 April 1992
Hungary	8 November 1989	1 March 1994
Moldova	4 February 1993	..
Germany	30 March 1994	..
Kyrgyzstan		
United States	19 January 1993	11 January 1994
Lao People's Democratic Republic		
Mongolia	3 March 1994	..
Australia	6 April 1994	..
Latvia		
France	15 May 1992	..
Taiwan Province of China	17 September 1992	8 October 1993
United States	28 October 1992	28 October 1992
Switzerland	22 December 1992	16 April 1993
Germany	20 April 1993	Provisional Application
Poland	26 April 1993	19 July 1993
United Kingdom	24 January 1994	..
Israel	27 February 1994	..
Netherlands	14 March 1994	..

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Libyan Arab Jamahiriya		
Morocco	25 January 1984	18 September 1993
Lithuania		
United States	28 October 1991	7 February 1992
Denmark	30 March 1992	9 December 1992
France	23 April 1992	..
Finland	12 June 1992	8 January 1993
Poland	28 September 1992	6 August 1993
Switzerland	23 December 1992	..
United Kingdom	17 May 1993	21 September 1993
Korea, Republic of	24 September 1993	9 November 1993
Turkey	15 October 1993	..
China	8 November 1993	..
Netherlands	26 January 1994	..
Malaysia		
Italy	4 January 1988	25 October 1990
Chile	11 November 1992	..
Hungary	19 February 1993	..
Poland	21 April 1993	..
Indonesia	22 January 1994	..
Moldova		
Romania	14 August 1992	..
China	6 November 1992	..
Kuwait	4 February 1993	..
United States	21 April 1993	..
Turkey	14 February 1994	..
Germany	28 February 1994	Provisional Application
Mongolia		
France	8 November 1991	4 February 1994
Ukraine	5 November 1992	5 November 1992
Italy	15 January 1993	..
Lao People's Democratic Republic	3 March 1994	..
Morocco		
Libyan Arab Jamahiriya	25 January 1984	18 September 1993
United States	22 July 1985	29 May 1991
Spain	27 September 1989	15 January 1992
Romania	28 January 1994	..
Greece	16 February 1994	..
Namibia		
Germany	21 January 1994	..
Nepal		
United Kingdom	2 March 1993	2 March 1993
Netherlands		
Uruguay	22 September 1988	1 August 1991
Ghana Russian Federation	31 March 1989	1 July 1991

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Netherlands (cont'd.)		
Cape Verde	5 October 1989	20 July 1991
Poland	11 November 1991	25 November 1992
Estonia	7 September 1992	..
Nigeria	27 October 1992	1 September 1993
Hong Kong	2 November 1992	1 February 1994
Lithuania	19 November 1992	1 September 1993
Latvia	26 January 1994	..
Indonesia	14 March 1994	..
	6 April 1994	..
Nicaragua		
Spain	16 March 1994	..
Niger		
Tunisia	5 June 1992	..
Nigeria		
Netherlands	2 November 1992	1 February 1994
Norway		
Chile	1 June 1993	..
Oman		
Italy	23 June 1993	..
Panama		
United States	27 October 1982	30 May 1991
China	26 March 1992	14 July 1992
Paraguay		
Taiwan Province of China	6 April 1992	..
Korea, Republic of	22 December 1992	25 July 1993
Denmark	22 April 1993	..
Hungary	11 August 1993	..
Germany	11 August 1993	..
Austria	13 August 1993	..
Spain	11 October 1993	..
Ecuador	28 January 1994	..
Peru	31 January 1994	..
Peru		
Thailand	15 November 1991	15 November 1991
Korea, Republic of	3 June 1993	20 April 1994
Bolivia	30 July 1993	..
United Kingdom	4 October 1993	21 April 1994
France	6 October 1993	..
Paraguay	31 January 1994	..
Czech Republic	16 March 1994	..
Philippines		
Italy	17 June 1988	4 November 1993
Poland	9 September 1992	..
Spain	19 October 1993	..

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Poland		
Italy	10 May 1989	..
Israel	22 May 1991	1 January 1992
Argentina	31 July 1991	1 September 1992
Uruguay	2 August 1991	..
Belarus	24 April 1992	18 January 1993
Cyprus	4 June 1992	..
Greece	30 July 1992	..
Spain	30 July 1992	1 May 1993
Netherlands	7 September 1992	..
Philippines	9 September 1992	..
Hungary	23 September 1992	..
Lithuania	28 September 1992	6 August 1993
Indonesia	6 October 1992	1 July 1993
Romania	8 December 1992	..
Thailand	18 December 1992	10 August 1993
Ukraine	12 January 1993	14 September 1993
Albania	5 March 1993	9 August 1993
Portugal	11 March 1993	..
Tunisia	29 March 1993	..
Malaysia	21 April 1993	..
Latvia	26 April 1993	19 July 1993
Estonia	6 May 1993	6 August 1993
Singapore	3 June 1993	..
Czech Republic	16 July 1993	..
Portugal		
Guinea Bissau	24 June 1991	..
Poland	11 March 1993	..
Republic of Korea		
Hungary	28 December 1988	1 February 1989
Indonesia	16 February 1991	10 March 1994
Paraguay	22 December 1992	25 July 1993
Peru	3 June 1993	20 April 1994
Lithuania	24 September 1993	9 November 1993
Spain	17 January 1994	..
Romania		
Italy	6 December 1990	..
Finland	26 March 1992	6 January 1993
United States	28 May 1992	15 January 1994
Moldova	14 August 1992	..
Poland	8 December 1992	..
Thailand	30 April 1993	..
Australia	21 June 1993	..
Hungary	16 September 1993	..
Russian Federation	29 September 1993	..
Switzerland	25 October 1993	..
Morocco	28 January 1994	..
Russian Federation		
Finland	8 February 1989	15 August 1991
Germany	13 June 1989	5 August 1991

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Russian Federation (cont'd.)		
Netherlands	5 October 1989	20 July 1991
Italy	30 November 1989	8 July 1991
Spain	26 October 1990	28 November 1991
Turkey	14 December 1990	..
United States	17 June 1992	..
Bulgaria	8 June 1993	..
Greece	30 June 1993	..
Cuba	7 July 1993	..
Romania	29 September 1993	..
Denmark	4 November 1993	..
Slovak Republic	30 November 1993	..
Czech Republic	5 April 1994	..
Senegal		
Argentina	6 April 1993	..
Singapore		
Poland	3 June 1993	..
Slovak Republic		
United States	22 October 1991	19 December 1992
Hungary	15 January 1993	..
Russian Federation	30 November 1993	..
Slovenia		
Germany	28 October 1993	..
Spain		
Morocco	27 September 1989	15 January 1992
Hungary	9 November 1989	1 August 1992
Bolivia	24 April 1990	12 May 1992
Russian Federation	26 October 1990	28 November 1991
Tunisia	28 May 1991	..
Argentina	2 October 1991	28 March 1994
Chile	2 October 1991	29 March 1994
Poland	30 July 1992	1 May 1993
Egypt	3 November 1992	..
Paraguay	11 October 1993	..
Philippines	19 October 1993	..
Korea, Republic of	17 January 1994	..
Nicaragua	16 March 1994	..
Honduras	18 March 1994	..
Kazakhstan	23 March 1994	..
Sri Lanka		
United States	20 September 1991	1 May 1993
Sweden		
Indonesia	17 September 1992	18 February 1993
Chile	24 May 1993	..
Viet Nam	8 September 1993	..
Bulgaria	19 April 1994	..

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Switzerland		
Albania	22 September 1992	30 April 1993
Estonia	21 December 1992	18 August 1993
Latvia	22 December 1992	16 April 1993
Lithuania	23 December 1992	..
Uzbekistan	16 April 1993	5 November 1993
Belarus	28 May 1993	..
Honduras	14 October 1993	..
Romania	25 October 1993	..
Venezuela	18 November 1993	..
Gambia, the	22 November 1993	..
Kazakhstan	12 May 1994	..
Taiwan Province of China		
Paraguay	6 April 1992	..
Latvia	17 September 1992	8 October 1993
United Republic of Tanzania		
United Kingdom	7 January 1994	..
Thailand		
Hungary	18 October 1991	18 October 1991
Viet Nam	30 October 1991	7 February 1992
Peru	15 November 1991	15 November 1991
Poland	18 December 1992	10 August 1993
Romania	30 April 1993	..
Czech Republic	12 February 1994	..
Finland	18 March 1994	..
Trinidad and Tobago		
United Kingdom	23 July 1993	8 October 1993
France	28 October 1993	..
Tunisia		
Italy	17 October 1985	24 June 1989
Spain	28 May 1991	..
Turkey	29 May 1991	7 February 1993
Indonesia	13 May 1992	12 September 1992
Niger	5 June 1992	..
Argentina	17 June 1992	..
Poland	29 March 1993	..
Turkey		
Bangladesh	12 November 1987	21 June 1990
Austria	16 September 1988	1 January 1992
Kuwait	27 October 1988	25 April 1992
Russian Federation	14 December 1990	..
Tunisia	29 May 1991	7 February 1993
Hungary	14 January 1992	..
Japan	12 February 1992	12 March 1993
Georgia	31 July 1992	..
Finland	13 May 1993	..

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
Turkey (cont'd.)		
Jordan	2 August 1993	..
Lithuania	15 October 1993	..
Moldova	14 February 1994	..
Ukraine		
Finland	14 May 1992	1 March 1993
Mongolia	5 November 1992	5 November 1992
Poland	12 January 1993	14 September 1993
United Kingdom	10 February 1993	10 February 1993
Germany	15 February 1993	Provisional Application
United States	4 March 1994	..
United Arab Emirates		
United Kingdom	8 December 1992	13 December 1993
United Kingdom		
United Arab Emirates	8 December 1992	13 December 1993
Ukraine	10 February 1993	10 February 1993
Nepal	2 March 1993	2 March 1993
Barbados	7 April 1993	7 April 1993
Lithuania	17 May 1993	21 September 1993
Armenia	22 May 1993	..
Trinidad and Tobago	23 July 1993	8 October 1993
Peru	4 October 1993	21 April 1994
Uzbekistan	24 November 1993	24 November 1993
Honduras	7 December 1993	..
United Republic of Tanzania	7 January 1994	..
Latvia	24 January 1994	..
Belarus	1 March 1994	..
Colombia	9 March 1994	..
India	14 March 1994	..
Albania	30 March 1994	..
Estonia	12 May 1994	..
United States		
Panama	27 October 1982	30 May 1991
Morocco	22 July 1985	29 May 1991
Egypt	11 March 1986	27 June 1992
Congo	12 February 1990	..
Sri Lanka	20 September 1991	1 May 1993
Slovak Republic	22 October 1991	19 December 1992
Czech Republic	22 October 1991	19 December 1992
Lithuania	28 October 1991	7 February 1992
Kazakhstan	19 May 1992	12 January 1994
Romania	28 May 1992	15 January 1994
Russian Federation	7 June 1992	..
Bulgaria	23 September 1992	2 June 1994
Latvia	28 October 1992	28 October 1992
Kyrgyzstan	19 January 1993	11 January 1994
Moldova	21 April 1993	..
Ecuador	27 August 1993	..

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(Annex table 6, (cont'd.)

Economy	Date of signature	Date of entry into force
United States (cont'd.)		
Belarus	15 January 1994	..
Jamaica	4 February 1994	..
Ukraine	4 March 1994	..
Georgia	7 March 1994	..
Estonia	19 April 1994	..
Uruguay		
Netherlands	22 September 1988	1 August 1991
Hungary	25 August 1989	1 July 1992
Italy	21 February 1990	..
Poland	2 August 1991	..
France	14 October 1993	..
Uzbekistan		
Finland	1 October 1992	22 October 1993
Switzerland	16 April 1993	5 November 1993
Germany	28 April 1993	Provisional Application
Denmark	23 September 1993	..
United Kingdom	24 November 1993	24 November 1993
Venezuela		
Denmark	18 February 1992	..
Chile	2 April 1993	..
Argentina	16 November 1993	..
Ecuador	18 November 1993	..
Switzerland	18 November 1993	..
Viet Nam		
Italy	18 May 1990	..
Indonesia	25 October 1991	3 December 1993
Thailand	30 October 1991	7 February 1992
Germany	3 April 1993	Provisional Application
Denmark	23 July 1993	..
Sweden	8 September 1993	..

Source: UNCTAD, Division on Transnational Corporations and Investment, based on information provided by member countries.

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Accounting, Valuation and Privatization. 190 p. Sales No. E.94.II.A.3. $25.

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Small and Medium-sized Transnational Corporations: Role, Impact and Policy Implications. 242 p. Sales No. E.93.II.A.15. $35.

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World Investment Report 1993: Transnational Corporations and Integrated International Production. An Executive Summary. 31 p. ST/CTC/159. Free-of-charge.

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