

VOLUME 13

NUMBER 2

AUGUST 2004

TRANSNATIONAL CORPORATIONS



United Nations

United Nations Conference on Trade and Development
Division on Investment, Technology and Enterprise Development

Editorial statement

Transnational Corporations (formerly *The CTC Reporter*) is a refereed journal published three times a year by UNCTAD. In the past, the Programme on Transnational Corporations was carried out by the United Nations Centre on Transnational Corporations (1975-1992) and by the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992-1993). The basic objective of this journal is to publish articles and research notes that provide insights into the economic, legal, social and cultural impacts of transnational corporations in an increasingly global economy and the policy implications that arise therefrom. It focuses especially on political and economic issues related to transnational corporations. In addition, *Transnational Corporations* features book reviews. The journal welcomes contributions from the academic community, policy makers and staff members of research institutions and international organizations. Guidelines for contributors are given at the end of this issue.

Editor: Karl P. Sauvant

Deputy editor: Kálmán Kalotay

Associate editor: Grazia Ietto-Gillies

Book review editor: Shin Ohinata

Production manager: Tess Sabico

home page: http://www.unctad.org/en/subsites/dite/1_itncc/1_tncc.htm

Subscriptions

A subscription to *Transnational Corporations* for one year is US\$ 45 (single issues are US\$ 20). See p. 139 for details of how to subscribe, or contact any distributor of United Nations publications. United Nations, Sales Section, Room DC2-853, 2 UN Plaza, New York, NY 10017, United States – tel.: 1 212 963 3552; fax: 1 212 963 3062; e-mail: publications@un.org; or Palais des Nations, 1211 Geneva 10, Switzerland – tel.: 41 22 917 1234; fax: 41 22 917 0123; e-mail: unpubli@unog.ch.

Note

The opinions expressed in this publication are those of the authors and do not necessarily reflect the views of the United Nations. The term “country” as used in this journal also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgement about the stage of development reached by a particular country or area in the development process.

Unless stated otherwise, all references to dollars (\$) are to United States dollars.

ISSN 1014-9562
Copyright United Nations, 2004
All rights reserved
Printed in Switzerland

Board of Advisers

CHAIRPERSON

John H. Dunning, Emeritus Esmee Fairbairn Professor of International Investment and Business Studies, University of Reading, United Kingdom and Emeritus State of New Jersey Professor of International Business, Rutgers University, United States

MEMBERS

Edward K. Y. Chen, President, Lingnan College, Hong Kong, Special Administrative Region of China

Arghyrios A. Fatouros, Professor of International Law, Faculty of Political Science, University of Athens, Greece

Kamal Hossain, Senior Advocate, Supreme Court of Bangladesh, Bangladesh

Celso Lafer, University of Sao Paulo, Brazil

Sanjaya Lall, Professor of Development Economics, International Development Centre, Queen Elizabeth House, Oxford, United Kingdom

Theodore H. Moran, Karl F. Landegger Professor, and Director, Program in International Business Diplomacy, School of Foreign Service, Georgetown University, Washington, D.C., United States

Sylvia Ostry, Chairperson, Centre for International Studies, University of Toronto, Toronto, Canada

Terutomo Ozawa, Professor of Economics, Colorado State University, Fort Collins, Colorado, United States

Tagi Sagafi-nejad, Radcliffe Killam Distinguished Professor of International Business and Director, Ph.D. Program in International Business Administration, College of Business Administration, Texas A&M International University, Texas, United States

Mihály Simai, Professor, Institute for World Economics, Budapest, Hungary

John M. Stopford, Professor, London Business School, London, United Kingdom

Oswaldo Sunkel, Professor and Director, Center for Public Policy Analysis, University of Chile, Santiago, Chile

Transnational Corporations

Volume 13, Number 2, August 2004

Contents

	<i>Page</i>
PREFACE	1
ARTICLES	
Julia Manea and Robert Pearce	Industrial restructuring in economies in transition and TNCs' investment motivations 7
Christian Bellak	How performance gaps between domestic firms and foreign affiliates matter for economic policy 29
Maria Savona and Roberto Schiattarella	International relocation of production and the growth of services: the case of the "Made in Italy" industries 57
Mike Pournarakis and Nikos Varsakelis	Institutions, internationalization and FDI: the case of economies in transition 77
REVIEW ARTICLE	
John H. Dunning	Globalization reviewed 95
BOOK REVIEWS	103
JUST PUBLISHED	125
Books received	128
Press materials on FDI issued in February and March 2004	129

PREFACE

Grazia Ietto-Gillies and Marina Papanastassiou *

In December 2002, the Athens University of Economics and Business and its Department of International and European Economic Studies hosted the 28th Annual Conference of the European International Business Academy (EIBA) in Athens. The main theme of the Conference was “Regional integration, agglomeration and international business”. The core theme of the Conference was set as the use of knowledge of the strategic motivations and managerial practices of transnational corporations to understand and evaluate their interface with other players and processes in the global economy. These include economies at different stages of development, areas undergoing transformation and restructuring (the Balkans, Central and Eastern Europe (CEE)) and knowledge-generating geographical clusters.

More than 150 papers were presented at the Conference. Given the high quality of many submissions, it was decided that there was scope for publishing a selected number of papers in a special issue of the *Transnational Corporations* journal. An announcement was made to this effect at the Conference, and interested authors were urged to highlight the policy implications in their work, in line with the mission of this journal. Many submissions were received which then were refereed blindly by at least two referees. Now, eighteen months after the Conference, we are pleased to launch this special issue of the journal.

* The authors are, respectively, Emeritus Professor of Applied Economics and Director, Centre for International Business Studies, at London South Bank University; and Assistant Professor, Athens University of Economics and Business, and Chair of the 2002 European International Business Academy (EIBA) Annual Conference’. Contacts: iettogg@lsbu.ac.uk; marinap@aueb.gr.

Before proceeding with a brief analysis of the articles accepted for publication, it is important to underline the recent developments on the world investment scene, as illustrated by the 2003 *World Investment Report (WIR03)* devoted to: “FDI Policies for Development: National and International Perspectives”. The overview of *WIR03* is headed: “FDI FALLS AGAIN – UNEVENLY”. Thus it focuses on how the decline in foreign direct investment (FDI) is uneven across regions, countries and sectors. The key message of *WIR03* is therefore to advance our thinking on how FDI can enhance growth and development and *inter alia* to assess the impact of international investment agreements (IAAs) in particular at the bilateral, subregional or regional levels (*WIR03*, p. 83).

The present issue of *Transnational Corporations* complements *WIR03* as it is also committed to studying, both at the macroeconomic and microeconomic levels, a number of issues related to various effects, including the impact of the uneven distribution of FDI on the development prospect of countries and regions, the ultimate aim being to set the framework and direction of policy dynamics.

The selection of papers for publication resulted in a subset of six articles and, given the importance of the Conference theme in combination with the high quality of submissions, this encouraged us not to compromise on the number of articles to be published. Therefore, as the six selected papers could not be accommodated in a single issue, two papers of the subset were published in advance of the present issue of this journal, in April 2004. They are: “Multinational rules on FDI: Do we need them? Will we get them? A developing country perspective”, by Stephen Young and Ana Teresa Tavares (pp. 1-30), and “Knowledge transfer to China: policy lessons from foreign affiliates”, by Peter J. Buckley, Jeremy Clegg and Hui Tan (pp. 31-72).

Young and Tavares deal with the question of multilateralism versus bilateralism in the World Trade Organization rules governing FDI. They argue that, regarding

FDI, a multilateral accord may be relatively unimportant to investors. Moreover, it may be inappropriate for developing countries as well, as such an accord is very costly to negotiate and implement. The authors argue in favour of bilateral accords in the short to medium term, with a continuation of discussions and negotiations in the long run for a multilateral accord.

Buckley, Clegg and Tan consider the involvement of TNCs in China from two perspectives: (a) the desire of the Government of China to attract foreign technology and capital and its strategy for realizing this; and (b) the constraints on modality entry with preference for the joint-venture mode. Their conclusions are based on an analysis of the activities in China of four TNCs from developed countries: Alcatel Bell, DaimlerChrysler, Motorola, and Volkswagen.

In this issue of *Transnational Corporations*, Julia Manea and Robert Pearce use survey evidence and characterize TNCs' strategic positioning in CEE economies in terms of the relative status of seven motives for investing and of the degree of use of seven sources of technology. The results indicate that, although the initial goal of TNCs' entry into economies in transition is to supply the local market through the production of well-established products, the presence of secondary motives suggests a progressive evolution of affiliates towards more dynamic export-oriented roles with the support of local creative competencies.

Christian Bellak's article analyzes how performance gaps between domestic firms and foreign affiliates matter for economic policy. Based on a thorough analysis of 56 empirical research studies, the article establishes a relationship between the size of performance gaps and the main effects of FDI on the host economy in terms of spillovers, agglomeration effects, market structure and locational competition. The article concludes with a detailed policy section in which gap-specific policies are recommended in preference to ownership-specific policies.

Maria Savona and Roberto Schiattarella analyze the impact of international relocation of production (IRP) by companies operating in Italy – whether domestic firms or foreign affiliates – on the local economy. In their article they take a wide, systemic view of analysis of this impact, a view that involves considering the overall local system rather than just focusing on the firm(s) directly involved in the relocation. Their work concentrates on the “Made in Italy” sector in which there has, indeed, been a considerable amount of relocation. The impact on the domestic economy is assessed by analyzing the employment on the services sectors in the local economy affected by the “Made in Italy” production. They choose the “province” as the main geographical area of analysis. Their tentative conclusion is that IRP has a positive effect on traditional and downstream service industries; however it seems to “crowd out” the most innovative and upstream services.

CEE is the geographical region of analysis in the article by Mike Pournarakis and Nikos Varsakelis. The authors attempt to explain empirically the uneven allocation of FDI in economies in transition at the country level. Their findings show that market size and the degree of internationalization of the host economy explain a significant part of this cross-country variation. At the same time they also stress the importance of institutional factors as a reinforcing agent of location advantage.

All of these articles feature *policy implications* that may be summarized as follows. Young and Tavares put forward the idea that multilateral accords on FDI should be pursued as a long-term agenda. In the short to medium term, progress can be made more easily and, from the point of view of developing countries, more effectively by concentrating on bilateral accords and focusing on domestic policies to render countries more attractive to inward FDI.

The policy recommendations of Buckley, Clegg and Tan for the Government of China are of two types: (a) that China should liberalize its policy towards foreign equity ownership in restricted industries, particularly in the services sector; (b)

moreover, and contemporaneously, that China should follow policies to improve human and technological infrastructures.

Manea and Pearce advocate more transparency for CEE economies in order to facilitate informed decisions and decrease the amount of uncertainty and risk for foreign investors. They also advocate that those CEE countries with a good history of commitment to (and stock of) scientific research should devote more resources to research and development.

Bellak's article reviews the policy implications drawn from a variety of empirical studies. The following policies, aimed at narrowing the performance gap and minimizing the negative impact that performance gaps may exert on the actual effects of FDI, are among those advocated: incentives for domestic firms to operate in high-tech regions and thus benefit from spillover from other firms (a corollary of this could be incentives for the internationalization of domestic firms); enhancement of capabilities as well as of the absorptive capacity for innovation and technology of domestic firms; and incentives to stimulate domestic start-ups in high-productivity industries. In sum, the various studies analyzed by Bellak aim at upgrading the capabilities of domestic firms and encouraging a preference in strategic foreign locations.

Savona and Schiattarella advocate policies to enhance the growth of upstream and technologically advanced service industries, that is, of those industries that currently appear to be disadvantaged by the relocation strategies of companies operating in the "Made in Italy" industries.

Pournarakis and Varsakelis advocate the development or strengthening of political and civil institutions as well as the development of an efficient bureaucratic system. Such developments are needed to monitor the impact of after-entrance TNC programmes, which are considered as important for the initial attraction of FDI.

It is hoped that the Conference contributions published in this issue of *Transnational Corporations* will further enhance the academic debate on the areas under discussion and allow both practitioners as well as policy makers to draw useful conclusions regarding their concerns and priorities. The authors express their appreciation to the EIBA scholars and the reviewers for their contributions to the Conference and to this issue of the journal; to the editors and staff of *Transnational Corporations* for their support and encouragement; and the copy-editor of this volume of the journal, Frederick Glover.

Industrial restructuring in economies in transition and TNCs' investment motivations

Julia Manea and Robert Pearce *

Using survey evidence this article characterizes the transnational corporations' strategic positioning in central and eastern European economies in terms of the relative status of seven motives for investing and the degree of use of seven sources of technology. As a key theme the ways in which the diverse objectives and technological positioning of transnational corporations' operations in the economies in transition can affect both the initial industrial transformation and the further sustained development of such host countries is analyzed. The entry of transnational corporations' to these economies is found to target the supply of the local markets, using the groups' mature technologies as embodied in established products. However, the presence of various secondary motives and supporting localized technology sources demonstrates the presence of significant evolutionary processes. These may lead to individualized (export-oriented) roles of affiliates in the economies in transition using local technology and creative competences.

Key words: International business strategy; technology; economic transition; industrial restructuring.

Introduction

It was expected that the industrial restructuring of the Central and Eastern European (CEE) economies in transition would benefit from international competition and greatly improved access to international markets. The securing of such benefits of

* Julia Manea is Lecturer in International Business in the Manchester School of Management, University of Manchester, United Kingdom; Robert Pearce is Reader in International Business in Reading University Business School, Reading, United Kingdom. Contact: J.Manea@umist.ac.uk.

internationalization, it was normally suggested, would both require and facilitate immense improvements in the efficiency of industry located in these economies. Coexistent with such manifestations of increasing openness can be discerned, as a distinctively separate (but also significantly supportive) objective, the need to inculcate the practices of normal market-economy behaviour in these economies. Here local firms and customers should learn the competitive norms of their beneficial mutual interdependence, and factor markets (for labour of various skills, energy and local inputs) and should move towards operating in ways that routinely support efficient industrial behaviour and performance.

The successful initial addressing of the aims of *marketization* and *internationalization* would then secure the great increase in economic *efficiency* that is expected to be available in such economies in transition, through a vastly improved activation of latent sources of static comparative advantage. Thus unemployed or underemployed productive factors can be drawn, through the processes of industrial restructuring, into an internationally competitive manufacturing sector. This argument can then be seen to imply the inevitable, probably (and preferably) quite prompt, emergence of another developmental priority, in the form of the generation of *new* sources of competitiveness. Full employment of qualitatively unimproved inputs would lead to higher factor rewards that raise costs in ways that undermine the newly asserted international competitiveness. Within the emerging processes of orderly economic development (gradually, economies in transition, superseding more fundamental restructuring) the (desirable) higher factor rewards are supported competitively by higher productivity (upgraded skills, new production techniques) and higher-value products (innovation of new goods embodying new technologies). The activation of static comparative advantage is substantially replaced by generation of dynamic (or created) sources of competitiveness.

The analysis here undertaken investigates the issue of how the operations of transnational corporations (TNCs) in the CEE economies in transition can address the multifaceted and evolving needs of these economies as they progress through industrial restructuring towards sustainable development. It is suggested that the strategic heterogeneity of contemporary TNCs' affiliates (their

operation as a dynamic differentiated network) provides the potential to encompass the different host-country needs, and to embrace their changes in a positive manner through complementary processes of strategic evolution.¹ Sustained growth and development in CEE countries need not alienate the operations of TNCs, but instead can provide the basis for an impulsion towards upgrading and deepening of their commitment to the local economy (Pearce, 2001).

Technology is seen as central to the potential for mutually-shared evolutionary processes. Naturally the expectation would be that the technological status of affiliates would, at their setting up, be based around the local activation of elements of the standardized existing competences of the parent TNC group. However, studies of the developmental possibilities available to individual TNC affiliates have argued and demonstrated the potential for movements to higher-value-added (notably product development) roles through their in-house generation of distinctive technological capabilities (Pearce, 1992, 1999; Papanastassiou and Pearce, 1999). In turn the ability to achieve such technological individuality at the affiliate level is expected to reflect the availability of knowledge and expertise (for example, strong research and development (R&D) experience and capacity) from its host-country science base. The availability of a commercially underdeveloped potential of this type, inherited from high levels of scientific commitment (research funding, education and training) during central planning, may be an unexpected resource in CEE economies that enters the strategic thinking of entrepreneurial affiliate managers at an early stage (Manea, 2002; Manea and Pearce, 1997).

¹ The key conceptualizations of the modern TNC that underpin this line of argument, and the central themes of the article, are the heterarchy (Hedlund, 1986, 1993; Hedlund and Rolander, 1990), the transnational (Bartlett and Ghoshal, 1989, 1990) and the horizontal organization (White and Poynter, 1990). The ability to build global competitive capacity through networks of affiliates playing differential roles (including learning and knowledge generation) has been suggested in the work of Bartlett and Ghoshal (1986), Ghoshal and Bartlett (1990, 1998) and Ghoshal and Nohria (1989). The potential for affiliate evolution within such networks are analyzed by Birkinshaw and Hood (1997, 1998), Birkinshaw, Hood and Jonsson (1998), Birkinshaw (1996, 1997), Delany (1998) and Egelhoff et al. (1998).

Building on the work of John Dunning (1993) and Jack Behrman (1984) this analysis encompasses three types of primary motivation for TNC expansion into CEE. The first of these imperatives is *market seeking*. The crucial host-country attribute here is the potential of its market, and the TNC investment is thus made to strengthen its position in the supply of that market. In this case TNCs may have previously supplied these CEE countries to some degree through trade (notably from sites in Western Europe) but now respond to the opportunities of political and economic transformation by relocating at least some substantial parts of the value-chain into the region, in order to address the distinctive needs of competitiveness in these markets more completely and responsively.

An alternative initial motivation for investment takes the form of *efficiency seeking*. In its pure form efficiency-seeking behaviour would see no change in the market to which goods are to be supplied, but instead involves relocation of their production to sites providing lower input-costs and therefore securing a sharpening of efficiency and competitiveness. Thus an early prediction was that TNCs might assist the internationalization of CEE economies by moving the production of some of their currently most price-sensitive goods to low-cost parts of the region, with these then being mainly exported back to their established (notably Western European) markets. A concern with such efficiency-seeking activity is that it only remains viable as long as the relatively standardized inputs retain their cost competitiveness. As already indicated, however, the potential for affiliate evolution may provide an escape route from the alternative of closure, and thus from the perception of the efficiency-seeking operations of TNCs as being innately footloose.

The basis for affiliate upgrading will often take the form of the use of local knowledge and skill inputs to enhance the quality and individuality of its products (essentially acceding to product development status) and/or the productivity of its manufacturing processes. Building these affiliate-level capabilities from local technologies, skills and research results and capacities, represents one manifestation of *knowledge seeking* as a third key imperative within the globalized aims of the contemporary TNC.

This article develops these themes using material drawn from a survey of global or regional headquarters of leading TNCs, which asked them to evaluate a number of factors relating to their operations in CEE. The questionnaire was sent to 408 leading manufacturing and resource-based TNCs,² with replies received from 50 of these. Twenty-eight of these had manufacturing operations in CEE economies and 11 more had affiliates there which carried out other significant parts of the value-added chain (marketing, distribution, resource exploitation, strategic planning offices).³ The respondents reported on in this article covered those with manufacturing operations, along with a selection of those with other forms of substantive value-adding activities in CEE economies. Though this yields a relatively small sample of headquarters, it does provide quite clear perspectives on the strategic nature of early TNC entry into the CEE economies in transition, and also a basis for more speculative indicators of evolutionary potentials.

The next section reports the respondents' evaluation of seven possible influences on TNCs' investment in CEE economies. These seven factors are interpreted in terms of response to one (or more) of the three core strategic imperatives defined above. The manner in which current and emerging sources of technology define affiliates' roles and evolutionary potentials is also central, and the third section reviews the status of seven such sources (intra-group or host country; embodied in products or newly available for commercial adaptation). The concluding section distils the key themes of the analysis and indicates how this can inform CEE country policies towards TNC participation in processes of dynamic restructuring and sustained development.

² The starting point was *Fortune* magazine's listing of leading global corporations, published in August 1996. Since this, for the first time, covered all areas of business, only 207 relevant manufacturing and extractive enterprises were found. To increase the population the last listing of 500 industrial companies (*Fortune*, July 1994) was consulted and 201 firms not already derived from the 1996 listing were added to the 207.

³ The remaining respondents answered questions relating to their general evaluation of aspects of economies in transition, reasons why they had not invested and their future approach to the region.

Factors influencing investment in economies in transition

The first TNC aim, potentially supporting investment in a particular CEE economy, which respondents were asked to evaluate was defined as “to establish a strong position in the market of the host country” (HOSTMARKET). Market seeking is clearly at the core of this reason for investing, and would certainly define the dominant motivation impelling the initial establishment of an affiliate targeting this objective. Thus this motivation sees the particular CEE economy in terms of a significant extension of the TNC’s geographical market areas, and perceives the establishment of an affiliate there as providing the most effective way of obtaining a secure and well-rooted application of the group’s existing sources of competitiveness in that country. The potential offered to affiliates that are initially mainly driven by this host-market imperative to pursue locally responsive product and process adaptation may, however, very quickly bring elements of, at least low-level, knowledge-seeking, supported creativity into their operations.

Though production efficiency will clearly be a routine concern of HOSTMARKET behaviour (including through process adaptation, as already suggested), efficiency seeking is not seen as significantly relevant to the primary motivation for the initial implementation of such operations. If this is so, then a prevalence of knowledge seeking over efficiency seeking in supporting the achievement of the primary imperative of the HOSTMARKET reason for investment may also point towards the nature of the evolutionary potentials being generated within such local market operations.

In the survey 33 TNC headquarters provided information on the investment motivations for each of their individual CEE affiliates. Overall 135 affiliates were covered through separate replies reported in table 1. As this table demonstrates in summary form, HOSTMARKET emerges as the strongest currently perceived reason for investing,⁴ being rated as a “major” reason for investment for 78.4% of affiliates and as “not” a reason for only 8.6%.

⁴ Such dominance of market-seeking behaviour has been a pervasive result of survey studies (Svetlicic and Rojec, 1994; Rojec and Svetlicic 1993; Lankes and Venables, 1996; Mutinelli and Piscitello, 1997; Meyer, 1998 and case studies (Estrin et al., 1997).

The second predominantly market-seeking reason for investing in a CEE economy was defined as “to achieve better access to a new regional market (that is, other CEE countries)” (CEEMARKET). Once again the initial impulsion to the investment comes from pursuit of the most effective means of securing an enhanced degree of commitment to the supply of a newly-emergent market space. Though the motivation is thus defined by the market-seeking imperative of achieving a competitive positioning in a specific market area, the supporting status of efficiency seeking and/or knowledge seeking in securing and developing this position from a particular CEE economy are also a crucial part of the analysis.

Since the market targeted here is one comprising several national economies, the initial market-seeking decision to supply from within the region is followed by another involving the choice of the precise location of such a production facility. To the extent that this decision relates to the cost-efficiency of production of those parts of the TNC’s standard product range that provide the basis for its successful entry into the new regional market, then efficiency seeking becomes the main supplementary element embodied in securing the aims of CEEMARKET. However, as with HOSTMARKET, the full achievement of the market-seeking objective is likely to ultimately benefit from individualizing the supply capabilities so as better to respond to the tastes and conditions of the target market area. Since the customer base in the case of CEEMARKET is likely to be both more diverse and more extensive than for HOSTMARKET it may well need and justify a more thorough individualization of supply (that is, movement away from the current standardized norms of the TNC group), with a more complete product development process superseding the mere adaptation of existing goods. This may then call into play much more comprehensive and profound knowledge-seeking behaviour in the CEE-country affiliate. In this case creative capabilities may become part of those local attributes that sustain operations in one CEE economy as a supply base for the wider region.

Though less prevalent than HOSTMARKET, the CEEMARKET confirms the overall predominance of market seeking in the early CEE activity of TNCs by revealing clearly the second highest average response in table 1. In fact CEEMARKET was

rated as a “major” reason for investing for 43.9% of affiliates, and as a “minor” (supporting) reason for another 34.5%.

Table 1. TNCs’ evaluation of reasons for investing in CEE countries

	Reasons for investing (average responses) ^a						
	HOST MARKET	CEE MARKET	EFF SEEK	LOW COST	LAB SKILL	SCIENCE INPUT	NATRES
<i>By home region</i>							
Asia	2.25	3.00	2.25	3.00	2.00	1.43	1.38
North America	2.73	2.30	1.34	1.55	1.39	1.18	1.18
West Europe	2.93	2.07	1.36	1.92	1.24	1.07	1.18
<i>By host country</i>							
Bulgaria	2.70	1.90	1.10	1.44	1.18	1.09	1.09
Czech Republic	2.81	2.38	1.62	1.95	1.48	1.10	1.10
Hungary	2.71	2.38	1.47	1.90	1.33	1.19	1.19
Poland	2.88	2.32	1.60	2.04	1.44	1.08	1.16
Romania	2.91	2.18	1.18	1.64	1.27	1.09	1.18
Russia	2.94	2.18	1.29	1.82	1.24	1.31	1.47
Slovakia	2.63	2.19	1.25	1.80	1.44	1.13	1.13
Slovenia	2.80	2.00	1.10	1.44	1.22	1.10	1.20
<i>By industry</i>							
Chemicals	2.69	1.92	1.26	1.31	1.16	1.05	1.05
Electronics	2.90	2.23	1.38	1.74	1.62	1.31	1.31
Mechanical engineering	2.86	2.48	1.48	2.29	1.18	1.09	1.36
Motor vehicles	2.86	2.86	2.29	2.86	1.57	1.33	1.43
Miscellaneous	2.70	2.30	1.33	2.04	1.35	1.00	1.00
Total	2.80	2.24	1.40	1.83	1.35	1.14	1.18

Source: Authors’ survey.

Reasons for investing.

HOSTMARKET - to establish a strong position in the market of the host country.

CEEMARKET - to achieve better access to a new regional market (i.e. CEE countries).

EFFSEEK - to improve our TNC group’s competitiveness in supplying its established markets (e.g. EU).

LOWCOST - availability of low-cost input factors (e.g. cheap labour; energy; raw materials).

LABSKILL - the skill quality of production labour.

SCIENCEINPUT - availability of scientific inputs.

NATRES - access to particular national research and technological expertise.

Note:

^a Respondents were asked to evaluate each reason, for each country in which they had investments, as (i) a major reason for investing, (ii) a minor reason for investing, (iii) not a reason for investing. The average response was calculated by allocating a “major” reason the value of 3, a “minor” reason the value of 2, and “not” a reason the value of 1.

Rather than extending markets geographically, as in the case of the two previous motives for investing, the aim of efficiency seeking is here to deepen (or defend) an already fully formulated position in a familiar area, by sharpening the competitiveness of those goods around which this presence has been built. This broad perspective of efficiency seeking was defined in the survey as “to improve our TNC group’s competitiveness in supplying its established markets (e.g. EU)” (EFFSEEK).

In its pure form, as envisaged by headquarters’ observers or planners, such efficiency-seeking behaviour would involve the effective operationalization of standardized technologies and practices, in order to replicate existing production processes, at lower cost, in a new CEE location. As such its cost stringency would be assumed normally to limit the likelihood of approval for any knowledge-seeking resource commitment. However, this might be less readily accepted at the affiliate level, where the technological dependency and strategic vulnerability of a severely truncated functional capability might generate serious frustration (especially in countries where creative potentials and competences can be clearly discerned). Where such frustration can be manifested around clearly articulated and persuasive knowledge-seeking potentials, an efficiency-seeking affiliate might occasionally be provided with a basis for some degree of speculative investigation where this does not compromise the coherence of its primary network-supply role. Though affiliates that manifest the EFFSEEK reason for investment may well supply some of their output to CEE markets, this would be seen as a spillover from the success of their efficiency-seeking aims and not as active market-seeking behaviour. Against the expectations of much early theorizing on TNC entry into CEE, this form of efficiency-seeking behaviour was reported as relatively rare. Thus it was not considered to have been a reason for investing in the case of 75.5% of the affiliates covered, and was rated a major one for only 13.7%.⁵

⁵ Other studies reinforce the view of the rather secondary relevance of either the efficiency-seeking motivation (Lankes and Venables, 1996; Rojec and Svetlicic, 1993) and of input costs (Svetlicic and Rojec, 1994; Rojec and Svetlicic, 1993; Meyer, 1998) though labour seeking was a quite significant factor in Italian investment in CEE economies (Mutinelli and Piscitello, 1997).

The three reasons for investing in CEE countries reviewed so far can be interpreted as representing forms of a strategic need for TNCs to extend geographically their supply capacity, in response to varied demand-side requirements (that is, to secure a more complete and responsive access to emerging CEE markets in the market-seeking cases, and to reinforce the competitiveness of provision to existing markets in the efficiency-seeking case). The remaining four factors relate more to what may be considered as supply-side characteristics, that is, a CEE economy's ability to supply those inputs that can support a local affiliate's capacity to play a particular role at a particular time (and, perhaps, to achieve evolution in its role over time).

The first of these supply-side influences was described as "the availability of low-cost input factors (e.g. cheap labour; energy; raw materials)" (LOWCOST). This may be seen as mainly supporting the ability to take an efficiency-seeking position within a TNC's supply capabilities. As table 1 shows, LOWCOST was in fact somewhat more strongly endorsed than the demand side form of efficiency seeking (EFFSEEK), being considered as a major reason for investment in 22.8% of affiliates and a minor reason for a further 32.4%. This does indicate that though cost consciousness is not a dominant motive for investing in CEE its influence does extend beyond those affiliates with an EFFSEEK orientation into support of the predominantly market-seeking affiliates. Again the expectation would be that strong response to LOWCOST would mitigate against simultaneous knowledge-seeking behaviour.

The second factor that relates to immediate supply capability was "the skill quality of local labour" (LABSKILL). Such skilled labour may support efficiency seeking, by enhancing productivity in established production processes. In market-seeking contexts its scope may go beyond this by manifesting specific locally-oriented capabilities and awareness that can assist in product or process adaptation. Indeed such localized skill dimensions can provide an input to knowledge-seeking activity, by helping with the individualization of affiliate competence that supports product development. Despite this eclectic range of possibilities, however, LABSKILL was rarely perceived as a significant influence on TNC

expansion into CEE, being a major reason for investing only for 3.6% of affiliates and rated as irrelevant for 70.5%.

The final two possible influences on investing encompass the availability of local attributes that can support the implementation of knowledge-seeking behaviour. The first of these, “availability of scientific inputs” (SCIENCEINPUT), provides a generalized basis for implementing creative and product differentiating activity in an affiliate. The second knowledge-seeking influence was formulated as “to access particular national research and technological expertise” (NATRES). Here the specification is of the particularly unique elements in the host-country’s technology and research capabilities, that can be accessed by an affiliate, in order to build a basis for offering a very explicit and distinctively original contribution to the extension of the product and knowledge scope of its TNC group. Whereas SCIENCEINPUT provides the in-house competence to benefit from evolutionary processes in the TNC, NATRES seeks to tap into more radical local knowledge potentials with the intention of attempting to assert a contribution to the more revolutionary dimensions of the group’s technological and product progress. As table 1 shows neither of these capacities have so far asserted sustained influence, with SCIENCEINPUT only relevant in 12.2% of affiliates and NATRES in 15.9%.

Sources of technology applied in Central and Eastern European operations of TNCs

The headquarters that responded to the survey were asked to evaluate the degree of importance of each of seven sources of technology that might be applied, or generated, within their CEE operations.⁶ This section describes these types of technology, indicates their possible associations with the investment motivations already outlined, and reports on their current relative prevalence (table 2).

⁶ Thirty-one respondents offered evaluation of the technologies used in their CEE operations. In the case of those that did not have producing affiliates in the region, the reported technologies are those relevant to the activities carried out and/or the technologies embodied in products distributed there.

The first source of technology evaluated was defined as “existing technology of the TNC group that is already embodied in established products that the affiliates undertake to produce” (ESTPRODTECH). Whatever the broad strategic reason for entering into the CEE economies, and however much awareness there is of the need for embeddedness and generation of evolutionary potentials once there, this form of standardized technology, underpinning the established product range and supply practices, is likely to be central in the early phases of operations. Thus entry into such new, unfamiliar, and potentially unstable emerging economic environments, is likely to be built around sources of competitive advantage with which the TNC *is* very familiar and in which it has fully verified confidence. Its core standardized product and process technologies are likely to exemplify this.

ESTPRODTECH is thus the defining core of the efficiency-seeking (EFFSEEK; LOWCOST) reasons for investing in CEE, since the dominant imperative is to pursue cost-effective supply of those successful goods that embody these standardized technologies. Similarly the market-seeking operations (HOSTMARKET; CEEMARKET) will be decisively initiated around ESTPRODTECH, to secure confident market penetration based around familiar goods of proven success. Here, though, there may be some innate impetus towards eventual affiliate-level technological diversification, invoking other sources of technology (accessed or generated by the affiliate) so as to secure competitive benefits of local responsiveness through product adaptation or development. As these core positionings would suggest, ESTPRODTECH proved to be by far the most prevalent of the seven types of technology investigated. In fact 87.9% of respondents considered it a “main” source of technology in their CEE operations, and 9.1% more as a “secondary” source.

A second source of technology that was expected to originate at the corporate level was defined as “TNC group technology from which the affiliates develop new products for their markets” (GROUPTECH). These are technologies that have not yet been systematically embodied in products, but which are available in sufficiently precisely-defined forms to be disseminated to affiliates that can then pursue their incorporation in specific localized processes

of product development. Thus here we can envisage the possibility of marketing-seeking CEE affiliates accessing GROUPTECH as a crucial input into the processes through which they develop new goods that seek to respond in a unique way to the precise needs of their specific local (host country or wider CEE) market space.

Table 2. TNCs' evaluation of sources of technology used by their affiliates in CEE countries

	Sources of technology (average responses) ^a						
	ESTPROD TECH	GROUP TECH	LOCAL TECH	OWN LAB	ENGUNIT	UNIRAD	COLLA BRAD
<i>By home region</i>							
Asia	3.00	2.33	1.33	1.00	2.00	1.00	1.33
North America	2.79	2.14	1.50	1.14	1.29	1.14	1.14
Western Europe	2.88	1.71	1.57	1.21	1.50	1.07	1.14
<i>By industry</i>							
Chemicals	2.67	1.83	1.83	1.17	1.50	1.00	1.00
Electronics	2.78	2.13	1.38	1.25	1.50	1.25	1.38
Mechanical Engineering	2.83	1.80	1.60	1.00	1.80	1.00	1.00
Motor vehicles	3.00	1.67	1.33	1.00	1.00	1.00	1.33
Petroleum	3.00	1.67	2.00	1.33	1.33	1.33	1.33
Miscellaneous	3.00	2.33	1.17	1.17	1.33	1.00	1.00
Total	2.85	1.97	1.52	1.16	1.45	1.10	1.16

Source: Authors' survey.

Sources of technology

- ESTPRODTECH - existing technology of our TNC group that is already embodied in established products that the affiliates undertake to produce.
- GROUPTECH - TNC group technology from which the affiliates develop new products for their markets.
- LOCALTECH - established host-country technology.
- OWNLAB - results of R & D carried out in the CEE affiliates.
- ENGUNIT - development and adaptation carried out less formally by members of affiliates' engineering units and production personnel.
- UNIRAD - R & D carried out for the affiliate by local scientific institutions (e.g. universities; independent laboratories; industry laboratories).
- COLLABRAD - R & D carried out in collaboration with local firms.

Note:

^a Respondents were asked to grade each source of technology as (i) a main source, (ii) a secondary source, (iii) not a source. The average response is calculated by allocating "main" the value of 3, "secondary" the value of 2 and "not" the value of 1.

Initially it would be expected that pure efficiency-seeking behaviour (EFFSEEK responding to LOWCOST) would preclude product development and, therefore, exclude any role for GROUPTECH. However, sensitive and strategically-adept headquarters may be aware of growing frustration in efficiency-seeking-oriented CEE affiliates that believe they can access and activate local creative scopes and, indeed, come to see this as a positive evolutionary potential. To harness such creative potentials in those CEE affiliates that are already well-positioned in the TNC's wider supply networks, they may be allocated responsibility for developing a particular piece of GROUPTECH into a new product that they can supply to their major established market areas. This would serve to allow creative potentials to be fully realized in these affiliates in a manner that is properly understood and authorized by central authority. Use of centrally provided GROUPTECH would then keep the product development process in these affiliates coherent with the evolution of the wider supply network of which they are part and, by limiting the use of locally derived knowledge inputs, lessen the potential for disruptive and contentious overlaps with goods produced by other affiliates. Furthermore, where GROUPTECH is invoked to support market-seeking or efficiency-seeking operations it can also drive a complementary recognition of knowledge-seeking-oriented reasons for investing in the form of local expertise (LABSKILL) or science (SCIENCINPUT and NATRES).

As indicated in table 2, GROUPTECH emerged as the second most relevant source of technology activated in TNCs' CEE affiliates, at least as perceived by headquarters' respondents. Thus it was rated as a main source of technology in 22.6% of cases and as a secondary one in a further 51.6%. This degree of prominence certainly seems to indicate that TNC headquarters recognize the potential for innovation processes to be activated in their CEE affiliates. That GROUPTECH emerges here as the strongest of the technology inputs likely to support such CEE product development may reflect headquarters' undervaluation of possible local inputs and/or a desire to constrain these creative processes towards group authorized aims by control over a key resource (that is, original technology perspectives).

The third technology source investigated was “established host-country technology” (LOCALTECH). This represents a technology that has been originated in a CEE economy, and has achieved some degree of commercial activation there. TNCs’ CEE operations can access LOCALTECH either as part of the competence of an indigenous enterprise that is acquired, or by licensing it from a local firm that remains independent (but which had failed to fully realize the scope of the technology). LOCALTECH can be most clearly associated with the HOSTMARKET and CEEMARKET motivations, since the localized preoccupations of such market-seeking operations provide both opportunity for detecting the availability of these technologies and scope to apply them in locally-responsive individualization processes. This would position LOCALTECH as a potentially supporting technology in the dominant market-seeking operations. Thus LOCALTECH did emerge as the most pervasive of the local technology inputs; as a secondary source for 38.6% of respondents, but a major one for only 6.5%.

Whereas LOCALTECH may have some scope to impel evolutionary processes in TNCs’ operations, a more profound and sustainable contribution would be expected to be made by the results of in-house R&D activity. Thus respondents were asked to evaluate “results of R&D carried out in CEE affiliates” (OWNLAB) as a source of technology. In fact OWNLAB was never rated as a major source of technology, and only 16.1% of respondents even considered it to be a secondary one. A number of factors may contribute to this. First, the reasons for investing that would be expected to most decisively require a local R&D unit (SCIENCINPUT, NATRES) have themselves been shown to be the least relevant to the early CEE operations of TNCs. Second, possession of an R&D unit is likely to be strongly alien to the strategic priorities of efficiency seeking, since it involves initially non-productive overhead expenditures and, also, may generate new capacities (technology and products) which do not fit neatly into a group-networked position. Third, although in-house R&D would be a logical element in market-seeking operations seeking to generate a systematic ability to individualize their competitive capabilities, such a deepening of functional scope would be a gradual evolutionary

development that is not yet yielding dividends in the form of activated technology.

An alternative means, through which TNCs may internalize particular aspects of local technological creativity in their CEE operations, is in the form of tacit knowledge that is reflected in the distinctive capacities of personnel employed. Thus respondents were asked to assess “development and adaptation carried out less formally by members of affiliates engineering units and production personnel” (ENGUNIT), as a technology input into their CEE operations. ENGUNIT would be expected to be particularly relevant to the HOSTMARKET and CEEMARKET reasons for investing. Thus, in such market-seeking cases, the types of locally-oriented understandings implied by ENGUNIT can help not only to assimilate ESTPRODTECH initially (as would also be relevant to efficiency seeking), but then facilitate (before possible recourse to OWNLAB) its active adaptation to local needs and build from it the knowledge platform for stronger (product development) localization processes. It also seems routinely plausible that where LABSKILL is a reason for investing one manifestation of this is the availability of ENGUNIT as a source of skill-related tacit technology. Though ENGUNIT does emerge in table 2 as the second most significant local source of technology, it was still only applicable to less than half of the respondents, with 32.3% considering it a secondary source of technology and 6.5% a major source.

The last two sources of technology represent the output of joint research between TNCs and CEE associates. The first of these was “R&D carried out for the affiliate by local scientific institutions (that is, universities; independent laboratories; industry laboratories)”, (UNIRAD). This can be seen as a knowledge-seeking attempt to secure access to original creative potentials that are embodied in the technology stock and ongoing research momentum of the local scientific community. In fact UNIRAD was only rated as even a secondary source of technology by 9.6% of respondents. The second source of technology deriving from joint research was defined as “R&D carried out in collaboration with local firms” (COLLABRAD). The immediate commercial context of an affiliate may be more influential on COLLABRAD (compared with the perhaps more

scientifically speculative UNIRAD), with local enterprise inputs to such research possibly supporting distinctive localization aims of TNCs' market-seeking facilities. Thus COLLABRAD was, marginally, more prevalent than UNIRAD, thought still only relevant to 16.2% of respondents.

Conclusions

The evidence presented indicates that the predominant strategic positioning of TNCs' initial operations in CEE economies is to use their mature standardized technologies and practices to supply already successful goods to affiliates' local national markets. Such prioritizing of market-seeking behaviour is seen to serve two purposes for TNCs. First, to assert a first mover involvement within distinctive and potentially significant newly open markets. Second, to leverage the confidence and strength in the local market that derives from the initial use of well-understood and highly competitive firm-level attributes so as to learn about the less understood supply potentials of the local economy.

The early (market-seeking) TNC entry into these economies in transition can thus be characterized as adopting an essentially bounded rationality decision process, which aims to explore the highly plausible potentials of an innately incoherent, unformulated, unfamiliar and risky new economic environment on the most secure basis available. An implied element of this is to avoid negative externalities from these initial uncertainties, by limiting interdependencies with other group operations (notably wider supply networks). All understandings of contemporary TNCs would suggest, however, that their growing familiarity with CEE economies would then lead towards a more optimized role for affiliates, with this being increasingly oriented towards serving wider group-level needs and aims. These can involve extending the supply network for established goods (efficiency seeking) or adding to product range and technological scope (knowledge seeking). The evidence is not taken to suggest that such potentials are not available in the formerly centrally-planned economies, but rather that their detection, evaluation and adoption is part of evolutionary learning processes in new environments and not often amenable to a priori optimized decisions. This, in turn,

suggests that the most important aspects of host-country policy towards TNCs in these countries will be more focused on securing the most appropriate embedding of affiliates in developmental processes rather than on the initial attraction of strategically unstructured FDI.

The first aspect of logical host-governmental priorities is simply to underline the need for CEE economies to provide an improved basis for informed decisions, in terms of policy transparency and consistency and the emergence of normalized market behaviour. While TNCs *need* this it is suggested that, through the activation of their early market-seeking behaviour, they can also contribute significantly to key aspects of such growing marketization. The ultimate aim of such an assertion of normal market behaviour is, of course, competitive integration into international markets. The contribution of TNCs to this would be the emergence of export-oriented efficiency-seeking behaviour. The evidence does suggest some limited early exporting from CEE affiliates, especially to other parts of the transition economy region, but also into the TNCs' traditional market areas. Specific policies to encourage this facet of affiliates' strategic evolution, however, need to be carefully moderated. Certainly better information about unrealized input potentials, together with appropriate quality enhancement (notably education and training of labour), can encourage TNC involvement in export-oriented industrial restructuring. But artificial policy inducements to efficiency-seeking behaviour, in the form of downward pressure on factor rewards or subsidies, are inappropriate in developmental terms and ultimately probably not conducive to sustained TNC participation.

Finally, science and technology policy are crucial to embedding TNC operations into any country's processes of sustainable development. There is little indication in this evidence, however, that TNCs are so far reacting to any perceived technological strength in the CEE economies resulting from the strong science commitments of the centrally-planned era. Therefore it is crucial that those economies in transition with a heritage of commitment to scientific research recognize the potential of persisting stocks of technology and R&D capacity as attributes relevant to TNCs' needs and global strategic priorities. ■

References

- Bartlett, Christopher A. and Sumantra Ghoshal (1986). "Tap your affiliates for global reach", *Harvard Business Review*, 64(b), pp. 89-94.
- _____ and Sumantra Ghoshal (1989). *Managing Across Borders: the Transnational Solution* (London: Hutchinson Business Books).
- _____ and Sumantra Ghoshal (1990). "Managing innovation in the transnational corporation", in C.A. Bartlett, Y. Doz and G. Hedlund, eds., *Managing the Global Firm* (London: Routledge), pp. 215-255.
- Behrman, Jack N. (1984). *Industrial Policies: International Restructuring and Transnationals* (Lexington, Mass: Lexington Books).
- Birkinshaw, Julian M. (1996). "How multinational affiliate mandates are gained and lost", *Journal of International Business Studies*, 27(3), pp. 467-495.
- _____ (1997). "Entrepreneurship in multinational corporations: the characteristics of affiliate initiatives", *Strategic Management Journal*, 18(3), pp. 207-229.
- _____ and Neil Hood (1997). "An empirical study of development processes in foreign-owned affiliates in Canada and Scotland", *Management International Review*, 37(4), pp. 339-764.
- _____ and Neil Hood (1998). "Multinational affiliate evolution: capability and charter change in foreign-owned affiliate companies", *Academy of Management Review*, 23(4), pp. 773-795.
- _____, Hood, Neil and Stefan Jonsson (1998). "Building firm-specific advantages in multinational corporations: the role of affiliate initiative", *Strategic Management Journal*, 19, pp. 221-241.
- Delany, Ed (1998). "Strategic development of multinational affiliates in Ireland", in J.M. Birkinshaw and N. Hood, eds., *Multinational Corporate Evolution and Subsidiary Development* (London: Macmillan), pp. 239-267.
- Dunning, John H. (1993). *Multinational Enterprises and The Global Economy* (Wokingham: Addison Wesley).
- Egelhoff, William, Gorman, Liam, and Stephen McCormick (1998). "Using technology as a path to affiliate development", in J.M. Birkinshaw and

-
- N. Hood, eds., *Multinational Corporate Evolution and Subsidiary Development* (London: Macmillan), pp. 213-238.
- Estrin, Saul, Hughes, Kirsty, and Sarah Todd (1997). *Foreign Direct Investment In Central and Eastern Europe* (London: Pinter).
- Ghoshal, Sumantra and Christopher A. Bartlett (1990). "The multinational corporation as an inter-organisational network", *Academy of Management Review*, 15(4), pp.603-625.
- _____ and Christopher A. Bartlett (1998). *The Individualised Corporation* (London: Heinemann).
- _____ and Nitin Nohria (1989). "Internal differentiation within multinational corporations", *Strategic Management Journal*, 10, pp. 323-337.
- Hedlund, Gunnar (1986). "The hypermodern MNC: a heterarchy?", *Human Resource Management*, 25, pp. 9-35.
- _____ (1993). "Assumptions of hierarchy and heterarchy, with applications to the management of the multinational corporation", in S. Ghoshal and E. Westney, eds., *Organisational Theory And The Multinational Corporation* (London: Macmillan), pp. 211-236.
- _____ and Dag Rolander (1990). "Action in heterarchies - new approaches to managing the MNC", in C.A. Bartlett, Y. Doz and G. Hedlund, eds., *Managing The Global Firm* (London: Routledge), pp. 15-46.
- Lankes, Hans-Peter, and Anthony J. Venables (1996). "Foreign direct investment in economic transition: the changing pattern of investments", *Economics of Transition*, 4(2), pp. 331-347.
- Manea, Julia (2002). "Multinational enterprises' strategies and their implications for the processes of transformation and development in Central and Eastern European transition economies", PhD Thesis, University of Reading, mimeo.
- _____ and Robert Pearce (1997). "The potential role of Romania's technological and scientific capacity in attracting FDI: an exploratory analysis of its national system of innovation", in R. Pearce, ed., *Global Competition and Technology* (London: Macmillan), pp. 183-216.
- Meyer, Klaus (1998). *Direct Investment In Economies In Transition* (Cheltenham: Edward Elgar).

-
- Mutinelli, Marco and Lucia Piscitello (1997). "Differences in the strategic orientation of Italian MNEs in Central and Eastern Europe. The influence of firm-specific factors", *International Business Review*, 6, pp. 185-205.
- Papanastassiou, Marina and Robert Pearce (1999). *Multinationals, Technology And National Competitiveness* (Cheltenham: Edward Elgar).
- Pearce, Robert (1992). "World product mandates and MNE specialisation", *Scandinavian International Business Review*, 1(2), pp. 38-58.
- _____ (1999) "The evolution of technology in multinational enterprise: the role of creative affiliates", *International Business Review*, 8(2), pp. 125-148.
- _____ (2001). "Multinationals and industrialisation: the bases of 'inward investment' policy", *International Journal of the Economics of Business*, 8(1), pp. 51-73.
- Rojec, Matija, and Marjan Svetlicic (1993). "Foreign direct investment in Slovenia", *Transnational Corporations*, 2(1), pp. 135-151.
- Svetlicic, Marjan, and Matija Rojec (1994). "Foreign direct investment and the transformation of Central European economies", *Management International Review*, 34(4), pp. 293-312.
- White, Roderick E., and Thomas A. Poynter (1990). "Organisation for world-wide advantage", in C.A. Bartlett, Y. Doz and G. Hedlund, eds., *Managing The Global Firm* (London: Routledge), pp. 95-113.



How performance gaps between domestic firms and foreign affiliates matter for economic policy

Christian Bellak *

Empirical evidence showing that foreign affiliates perform better in almost all areas than their domestic counterparts is piling up. Yet, contrary to arguments of the public debate, it is *not* primarily foreign ownership which accounts for performance gaps between domestic firms and foreign affiliates. Firm-specific assets, firm characteristics, the home country of the parent firms and the transnationality of the firm matter more. Based on a survey of 56 empirical studies, this article establishes a relationship between the size of the performance gaps and the main economic effects of foreign direct investment on the host economy (spillovers; agglomeration effects; market structure; locational competition). The article concludes that policies should be gap-specific rather than ownership-specific. Several gap-specific policies are proposed, focusing on different groups of target firms.

Key words: foreign direct investment; performance; economic policy; investment promotion; welfare; firm growth; spillovers; productivity.

Introduction

The impact of inward investment on the host economy has been studied widely (for example, Dunning 1994). It includes aspects of the balance of payments, employment, capital stock

* Associate Professor of Economics, Vienna University of Economics, Department of Economics, Vienna, Austria. An earlier version of this article was presented at the EIBA Annual Conference, Athens, 2002 Competitive Paper Session on “Multinationals and Performance”. The author would like to thank the Conference participants as well as two anonymous referees for useful comments and suggestions. Any remaining errors are the responsibility of the author. Contact: christian.bellak@wu-wien.ac.at.

and resources, rent shifting, welfare, and dependence. Part of the impact of inward investment on the host economy is related to the existence of performance gaps between foreign-owned and domestically owned firms. Such performance gaps have been revealed empirically in areas like productivity, profitability, wages, skills, labour relations, technology, factor intensity and growth. The role of such performance gaps for policy has not been addressed systematically in the literature.

The traditional view developed on the basis of empirical results (which show that foreign affiliates generally perform better) is that countries with a larger share of foreign affiliates are better off. In other words, raising the share of foreign affiliates will raise the average performance of the total economy. The important question with respect to policy is, whether foreign ownership (that is, the nationality of the investing firm) really explains the performance gaps, as is maintained in policy discussion, or whether there are other explanatory factors.

While the role of the nationality for performance gaps cannot be denied, empirical evidence shows that the explanation of performance gaps is not as straightforward and simple as the above example suggests. If this were the case, there would be a simple policy solution: increase the share of foreign affiliates thereby improving the average performance of the host economy and thus compensating for the weakness of the domestic economy. However, the real situation – never *quite* in line with the idealized picture drawn by theory – suggests that matters are more complicated. Complexity emerges for several reasons. First, assuming that foreign affiliates perform better in all fields denies the variety and interrelationship of the gaps. Second, there are positive and negative externalities from inward foreign direct investment (FDI) (Hanson, 2001) and the net effect thus may well turn out to be negative. Third, there is no single logical argument – apart from differences in corporate governance systems (see below) – that relates to the distinction between domestic firms and foreign affiliates by ownership.

What then is a more realistic view of the policy relevance of revealed performance gaps in economic terms? This article summarizes the main arguments of how the size of performance gaps matters for policy. Only a systematic exploitation of the theoretical and empirical literature on performance gaps allows us to design *gap-specific policies* rather than just *general policies*, which have been preached for decades (“build human capital”, “lower taxes” etc.). The article concludes that there is only a limited economic argument for discrimination of firms by foreign versus domestic ownership, but distinction between transnational and uni-national firms is relevant.

The article is structured as follows. First, a definition of performance gaps is briefly outlined. Second, empirical results of earlier studies are summarized and the quantitative relevance of performance gaps is shown. Third, the relation of five key impacts of FDI on the host economy and the size of performance gaps are discussed. Fourth, the pros and cons of policy intervention related to performance gaps are outlined. Finally, there is a short concluding section.

Performance gaps defined

The economic theory of transnational corporations (TNCs) deals with the questions: why do TNCs exist? Why do they invest abroad? At the centre of the theory of the TNC lies the specific-advantage hypothesis (Dunning, 1977; Caves 1974, 1996; Koutsoyiannis, 1982; Markusen, 1995). Why these firms invest abroad needs to be explained by the position of the TNC relative to its competitors abroad. It is conceivable that a foreign entrant into a market encounters some disadvantages vis-à-vis established firms, but the specific-advantage hypothesis states that the firm-specific advantage compensates for such disadvantages (Koutsoyiannis, 1982). The specific-advantage theory also argues that firm-specific advantages that allow TNCs to overcome the burden of foreignness in markets abroad constitute the basis of their direct engagement abroad (Dunning, 1973, 1988; Hymer, 1976).

A key prediction of this strand of theoretical literature then is that the firm-specific advantage gives rise to performance gaps. This argument is consistent with the notion that TNCs in knowledge-intensive industries possess assets, where imitation by competitors is very difficult and diffusion therefore slow. These assets can be denied to competitors (that is kept internally by the creator, the firm) and are transferable within the firm (that is, they are internationally mobile).

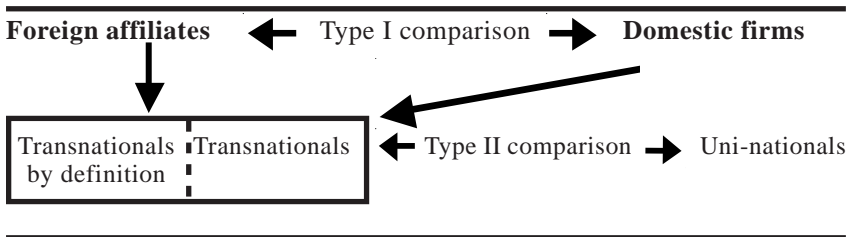
The *incentive to internalize* the advantage stems from the possibility of market failures when contractual market transactions are used. The *mobility* stems from its intangible nature and leads to low marginal cost when the advantage is used in an additional affiliate abroad. TNCs will therefore be concentrated in knowledge-intensive industries, which are generally characterized as growth and high-productivity industries. In the words of James R. Markusen: “multinationals tend to be important in industries and firms with four characteristics: high levels of R&D relative to sales; a large share of professional and technical workers in their workforces; products that are new and / or technically complex; and high levels of product differentiation and advertising. These characteristics appear in many studies, and I have never seen any of them contradicted in any study” (Markusen, 1995, p. 172). A sub-category of the *specific-advantage* hypothesis is the *strategic-advantage* hypothesis put forward by Nicola Acocella (1992), which assumes the firm-specific advantage to be the result of the strategic reactions of firms. It is important here, since TNCs have more options of strategic behaviour than un-national firms. Contrary to the specific-advantage hypothesis, here firm-specific advantages are not assumed as given. The internalization/ownership advantages (IO)-approach argues that the firm-specific advantages referred to above arise “as a product of oligopolistic rivalry” (Acocella, 1992, p. 234). The contribution of the IO-approach is therefore to reintroduce aspects of power and strategic behaviour. The strategic elements of FDI are important and include, for example: creation of excess capacities or overinvestment by the incumbent (foreign affiliate) in order to deter market entry by competitors (Lyons, 1987); the takeover of a competitor to reduce excess capacity and pressure on market

prices; the creation of entry barriers based on firm-specific advantages (for example, Harris, 2002); and the collusion and oligopolistic reactions. What these examples have in common is that their outcome is usually inefficient (Acocella, 1992, p. 241). Such behaviour is especially pronounced with TNCs, since “they face each other in several markets and hence recognize their mutual dependence more fully” (Caves, 1996, p. 90 et seq.).

Yet, to reduce the notion of strategic behaviour to the level of firm competition would fall short of the concept as “strategic interdependence with respect to governments and unions is particularly interesting” (Lyons, 1987, p. 78). It is sufficient to note here that strategic behaviour may also give rise to performance gaps and is especially important in industries in which market dominance and few firms are found. Kamal Abdel-Rahmen (1991), for example, emphasizes that performance gaps between firms with identical products – under given location-specific advantages – are explained by firm-specific, individual behaviour under the conditions of imperfect competition.

The theoretical concepts outlined are based on the firm-specific advantage literature and thus suggest a “Type II comparison” in figure 1. This aspect is stressed *inter alia* by Mark E. Doms and Bradford J. Jensen (1998), who find only small performance gaps between domestic-owned United States TNCs and foreign-owned TNCs in the United States. On the other hand, public perception, which is denoted as “Type I comparison” in figure 1, posits that foreign ownership matters for performance gaps. This view is, however, generally difficult to substantiate in the theoretical literature (Bellak, 2004).

Figure 1. Type of comparison



Empirical evidence on performance gaps

Turning to the empirical evidence on performance gaps between domestic firms and foreign affiliates and, without trying to generalize, we may briefly report a few results that emerge in many studies. These results, however, should not obscure the fact that the evidence is mixed in most cases. This subsection is based on a thorough survey of 56 empirical studies, most of which are very recent (that is, post-1995).¹ They are mainly studies of productivity gaps and wage and skill gaps. However, the lack of suitable data is still the most serious constraint to empirical analysis. For this reason, most of the studies have to date been carried out in the United States and the United Kingdom. Foreign affiliates generally perform better than domestic-owned firms, no matter which indicator is analysed – with the exception of profitability. Performance gaps may amount to several hundred times that of those recorded for domestic performance, depending on the indicator. To what extent are the five factors found to be relevant in empirical studies? Of course, this depends on the gap in question. Nevertheless, a few tentative results can be outlined.

- (i) *Ownership* mostly explains only a few percentage points of the variance after controlling for other variables.
- (ii) As *firm-specific advantages* cannot be observed *in praxi*, any unexplained variance after controlling for a number of factors is attributed to the transfer of firm-specific advantages. This is related to the next point.
- (iii) For the remaining variance *transnationality of firms* turns out to be important. Intra-firm spillovers between plants in different locations have been shown to be important. Cross-subsidization of plants has been reported in case studies. This means that gaps arise mainly between TNCs, whether they be foreign-owned or not, and uni-national firms (see figure 1 above).

¹ Since a satisfactory discussion of the empirical results obtained in different studies as well as a comparison of the different methodologies would require considerable space, a summary is provided here. For further and fuller information, see Bellak, 2004.

-
- (iv) *Firm-specific characteristics* are important determinants of performance gaps, which are found to be relevant at the establishment level and at the plant level. Primarily, size effects (economies of scale on the firm level) and efficiency are relevant.
 - (v) There have hardly been as yet any representative empirical studies carried out on the performance of TNCs which engage in (technological) *sourcing* abroad. Although there is some evidence derived from patent data and from the motivations for FDI which suggest the importance of such activities, such measures remain indirect. A recent study by Nigel Driffield and James M. Love (2002) showed not only instances of domestic-to-foreign spillovers, but the authors were able to relate these to technology sourcing, since such “reverse spillovers” appear primarily in research and development (R&D)-intensive industries.

The other determinants (“controls”) of the gaps are as follows: *industry distribution* accounts for the possibility that TNCs invest in better performing industries (for example, growth industries). Most studies reveal different impacts according to *parent countries*. While the parent country effect has not yet been explained on a satisfactory basis, corporate governance, history, legal environment, business cultures etc. may be the contributing factors. Factor-endowment differentials like the relative-unit labour cost gaps on the national level also contribute to performance gaps. Overall, the empirical evidence points to a limited explanatory power of foreign ownership and to a high importance of gains from transnationality per se. Thus, the empirical results are largely consistent with the theoretical argument.

Economic effects of FDI and the size of performance gaps

From a policy point of view the sources of an improvement of a host country’s performance derived from inward FDI comprise: (i) the “presence effect” and (ii) the “transmission effect”. In the former case, the average performance of the host economy may be raised *ceteris paribus* by the mere presence of

foreign affiliates, raising the average through their superior performance. This would reflect the relative disadvantage of the domestic sector (Driver and Temple, 1999, p. 172). In the latter case, the transmission effect may stem from two sources: (ii-1) the performance of domestic firms may be stimulated by spillovers from foreign affiliates to domestic firms (the source of the spillover is the firm-specific asset discussed in the previous section) and (ii-2) as with firm entry in general, the effect of foreign entry on competition may be stimulating or restricting in the affected industry (Caves, 1974).

This subsection raises the question: how are the size of performance gaps and five main effects of inward FDI related? In general economic terms the importance of the areas and the justification of policy intervention is defined by the net outcome of externalities (Hubert and Pain, 2001; Hanson, 2001). Competition among governments for TNCs is partly based on the belief in positive net effects of inward FDI. The size of the gaps is chosen as a decisive variable, since policies often aim to reduce the size of performance gaps of domestic-owned firms. Of central interest is the question: how to prevent negative effects and how to stimulate positive effects (direct and indirect)?

Spillover effects and linkage effects

Spillovers may take the form of positive or negative externalities arising from inward FDI (Blomström and Kokko, 1998; Blomström, 2002). They may emerge as intra-firm or within-industry, as inter-firm or across-industry spillovers (Hubert and Pain, 2001) and may derive from any forward or backward linkages between domestic firms and foreign affiliates. On the recipient side, spillovers “depend crucially on the conditions for local firms” (Blomström, 2002, p. 177).

Brian Aitken et al. (1996, p. 363) discuss the relationship between the size of spillovers and gaps (see also Blomström and Sjöholm, 1999). The larger the former, the lower should be the dispersion of the performance. Mona Haddad and Ann Harrison (1993, p. 53) find that foreign affiliates have higher

levels of productivity, but their rate of productivity growth is lower than for domestic-owned firms. Rather than suggesting a catch-up process, they conclude that domestic-owned firms do not have higher productivity *growth* in industries with a larger foreign presence (see also Aitken et al., 1997). The size of the gaps is thus one determinant for the likelihood of spillovers to occur between foreign-owned and domestic-owned firms (see for example, Driffield and Taylor, 1999; Girma et al., 2001; Hubert and Pain, 2001). *Small* gaps may typically arise in an industrialized country setting with high intra-industry FDI, where indigenous and investing firms from abroad have achieved a certain managerial and technical level. In such cases, spillovers may even tend to flow from domestic firms to foreign affiliates, yet generally will be small.

If gaps are of *medium* size, benefits derived from foreign affiliates are likely to be high in terms of technology spillovers (Girma et al., 2001; Castellani and Zanfei, 2002). A large absorptive capacity (Cohen and Levinthal, 1990) of domestic-owned firms is a decisive factor. If gaps are very *large*, such externalities arise to a small extent. Developing countries, which often lack absorptive capacity, will have to reach some threshold of their indigenous sector in order to reap such benefits. As Driffield and Taylor (1999) state, in such a case it is likely that domestic firms are unable to assimilate new technologies and therefore, spillovers are unlikely to occur.

If spillovers depend positively on foreign ownership, industries with a higher share of foreign affiliates should benefit most, while “national / local industries” would lose out with the danger of the emergence of a dual economy. If ownership does not matter, spillovers are possible in all industries and a rise in the foreign share would not automatically guarantee positive indirect effects.

Empirically, positive spillovers are hardly found. Evidence on the existence and magnitude of spillovers (for example, Blomström and Kokko, 1998) suggests that if they are significant at all, their size is rather small. Some studies (for example,

Aitken and Harrison, 1999) reveal positive spillovers within the foreign sector and negative ones in the domestic sector. (See also Zhou et al., 2002, who reveal an overall positive net effect, despite important negative, that is, crowding-out, effects.) Interesting evidence on spillovers is provided by Sourafel Girma et al. (2001), who show that domestic-owned firms in the United Kingdom are not gaining from the presence of foreign affiliates as there is only a weak link between the growth of FDI and productivity growth (see also Jungnickel, 2002).

The notion of positive spillovers is based on the idea that FDI leads to growth in the host country. Yet, as Caroline Freund and Simeon Djankov (2000, p. 4) argue, on the basis of foreign takeovers in the Republic of Korea, “growth induces FDI”. Thus, reverse causality has to be taken into account here, since gaps tend to be small.² The local nature of spillovers has been frequently emphasized and may limit the influence of policy decisions on location decisions of TNCs³ (Hanson, 2001). Since the net effect of positive and negative spillovers is difficult to calculate, optimal subsidies are difficult to determine.⁴

Agglomeration economies

Agglomeration economies *inter alia* comprise labour market effects, localized spillovers (see above) and supplier network advantages. If foreign ownership determines agglomeration effects they will arise even without the participation of domestic-owned firms and thus may limit inter-firm spillovers to indigenous firms. In contrast, if it does not matter, whether domestic-owned firms or foreign affiliates agglomerate, then foreign affiliates would contribute just their firm-specific advantages and agglomeration economies would arise. Market forces may lead to an additional positive or

² See also Benfratello and Sembenelli (2002) on the issue of causality.

³ See, e.g. Blomström and Sjöholm (1999): “local participation matters”.

⁴ See, e.g. the comment on Doms and Jensen, by Head (1998).

negative externality, if local concentration of firms attracts new foreign entry.⁵

Therefore, if agglomeration effects are of a limited geographical range as is suggested by the local nature of spillovers, performance gaps between regionally closely located firms should diminish quicker than between distant firms in the host country. The size of the gaps may be less decisive here, but as agglomeration effects are part of the spatial component of spillovers mentioned above, they are of high policy relevance.

Effect of ownership change

The literature on ownership change (for example, mergers, acquisitions) argues first a “disciplining effect” of a takeover on the management, whereby the takeover is stimulated by decreasing share prices. Favourable post-acquisition performance raises the value of the firm (see also Girma and Görg, 1994).⁶ Efficiency effects stem from a reduction of labour and are size related. The other approach is to view takeovers as a result of “managerial decisions for growth of the firm” with efficiency considerations often being of a secondary nature.

Other questions related to ownership change are: does the postulated causality hold? Are high-productivity properties more likely to be overtaken? How do they perform after acquisition? Robert McGuckin and Sang Nguyen (1995) show that high-productivity plants (in the United States food industry) are indeed more likely to be taken over and that their growth

⁵ Head, Ries and Ruckman (1998) report such important indirect effects on Japanese affiliates in the United States. Mayer and Mucchielli (1998) also find spatial and temporal agglomeration of Japanese affiliates. Driffield and Love (2002) empirically establish “reverse spillovers” from domestic firms to foreign affiliates in the United Kingdom, which are linked to local agglomeration of firms.

⁶ The substantial transaction costs incurred in a takeover may, however, limit efficiency gains. Support of the efficiency view is provided by a careful study of the effects of takeover and merger activity on firm employment in the United Kingdom (Conyon et al., 2002a).

performance tends to be better compared to plants without ownership change. Notable exceptions are recent studies on the United Kingdom (Conyon et al., 2002b) and Ireland (Girma and Görg, 1994). In the United Kingdom, acquired firms improved their efficiency while growth of unskilled labour declined in the short term in Ireland. Foreign entry has been found to exert effects on indigenous firms in various industries, measured by indicators like profits (for example, Driffield and Munday, 1998), productivity (for example, Baldwin and Gorecki, 1991), excess capacity, growth (Mata and Portugal, 2000), employment (McGuckin et al., 1995) or market share (Baldwin, 1995). These effects need not be necessarily positive as, for example, Driffield and Munday (1998) find that foreign entry leads to a profit squeeze in the domestic sector.

There does not seem to be a close relationship of the change of ownership to the size of gaps, apart from the fact that efficiency gains may be positively correlated. The lower the development of the laggard firm, the easier it is for the acquired firm to catch up.

Competition effects

The effects of inward FDI on the market structure of the host country are varied: Do entrants stimulate competition or do they, by takeovers, contribute to highly concentrated or oligopolistic markets? (Lichtenberg and Siegel, 1987) Further, do TNCs through the creation of linkages, have a positive effect on domestic entry or do they crowd-out domestic firms? Do takeovers lead to efficiency gains within the firm by reducing the gap or does it translate into efficiency gains for the host economy?

Contrary to the literature reviewed, here the gap is not related to some superior asset of the foreign-owned TNC, but is a result of the effect of a foreign-owned entrant on market structure. Entry affects the “rules of the game” and the type of

entry is important for the costs incurred, since a greenfield investment enjoys all the advantages of a newcomer.⁷

Holger Görg and Eric Strobl (2002a) in their study of the Irish manufacturing sector find a positive effect of the presence of TNCs on indigenous *entry*. This is due to the presence of foreign affiliates in the same industry as well as the presence of foreign affiliates in downstream industries. *Exit* and survival of firms have also been dealt with in the empirical literature, first with respect to a comparison between domestic-owned firms and foreign affiliates and, second, with respect to the effect of a foreign acquisition of a domestic plant. An article by Görg and Strobl (2002b) finds that the risk of exiting is higher in foreign-owned than in domestic-owned firms in Ireland. For Ireland, Girma and Görg (1994) report that acquired Irish firms are more likely to exit, which might be due to the selection process (entry strategy) of foreign affiliates. Yet, as the authors suggest, the exit of (inefficient) acquired plants may positively contribute to restructuring of industries and thus may have a positive effect on the host economy, despite short-run job losses. Here again, the size of the performance gap matters: Girma et al. (2001, p. 131) suggest that firms with inferior performance may be driven out of the industry, while firms with low technology gaps relative to the technological leaders can indirectly benefit from the presence of foreign affiliates regardless of other characteristics in the sector.

Effects on policy-making and on locational competition

The larger the gaps, the more governments tend to rely on foreign affiliates to “solve” their competitiveness problems. The paradox situation arises that the larger the gaps, the lesser the chance to succeed on a regional or national level. Policy makers

⁷ The newcomer has the advantage of the choice of the optimum location, the implementation of the state-of-the-art technology and the choice of the optimum plant size. Established firms, on the other hand, may be located in marginal location, and may not follow regional shifts of markets or production etc.

typically assume that performance gaps are due to foreign ownership. Therefore they engage in “locational tournaments” and tend to subsidize inward FDI heavily. This creates high opportunity costs compared to subsidizing growth industries at home. Yet, as Charles Oman (2000, p. 119 et seq.) argues “evidence also fails to support the hypothesis that more intense policy competition for FDI tends to increase the aggregate supply of FDI. ... However, the causal relationship almost certainly has worked in the opposite direction, that is, the significant growth of FDI has spurred competition among governments that want to be sure to attract “their share” of that FDI while its growth lasts”. This points to ineffective policy intervention with a welfare loss for society.

Another gap-related effect is *rent-seeking* behaviour of TNCs. Knowing that through their superior performance they are attractive to governments, such conduct might “bid away most of the benefits after subtracting the cost of the incentive package” (Head, 1998). Playing-off one government against another creates a prisoner’s dilemma situation and incentives will be the higher, the more governments expect from TNCs. Such negative effects have been shown, for example, by Jan Haaland and Ian Wooton (1999) theoretically, namely, that subsidy competition transfers much of the rents to the TNCs and there is also ample empirical evidence (for example, quoted in Hanson, 2001; Loewendahl, 2001; OECD, 2001; UNCTAD, 1996). In addition, *rent extraction* by transfer pricing may seriously reduce public gains of host countries.

Policy conclusions

This final subsection outlines some implications for inward-FDI promotion policies.

The article questioned whether performance gaps and their impact on host countries can give rise to policy measures, and it was argued that there are important market failures involved that justify intervention in the form of FDI promotion. The foregoing discussion has cast doubt on the usefulness of a

discrimination of firms by ownership. Similar conclusions are reached in the literature on spillovers, summarized for example by Blomström (2002, p. 178): "The use of investment incentives focusing exclusively on foreign affiliates, *although motivated in some cases from a theoretical point of view*, is not a recommended strategy" (emphasis added). Rather it points to structural and firm-specific characteristics as the relevant variables and therefore gap-specific policies are justified. Knowledge of the explanatory factors of performance gaps – other than nationality – is of vital importance for the design of appropriate policy measures. Precondition is a "mutually supportive dynamic interface between the evolving local sources of comparative advantage and the companies' pursuit of sustained global competitiveness" (Pearce, 2001, p. 66).

Giving up past strategies of favouring FDI over domestic investment is frequently demanded as indicated in the following quote: "Foreign affiliates often feel limited by unfair treatment, but overly positive treatment could also hinder their growth since they would be a target of jealousy from local companies. Accordingly, we need to reduce or eliminate unnecessary favouritism ... tax incentives for foreign investment often fail to generate high rates of return..." (*Korean Times*, 2 March 2002, www download).

Since the size of the gap, as has been shown above, is related to the level of development of countries and their particular environment, any specific policy measure must be differentiated by developing and developed countries, as well as economies in transition. Sanjaya Lall (2001) discusses the central problem of applying policy guidelines across a large spectrum of countries.

A few guiding principles are developed below:

- The likely positive and negative externalities, that is, social gains and losses (table 1) derived on a theoretical basis suggest some scope and justification for policy measures.
- As a general rule, following from empirical results but also from the theoretical discussion, policies should be gap-specific rather than ownership-specific.

Table 1. Externalities and performance gaps

Positive	Negative
Spillovers of better performing firms to underperformers	Little empirical evidence of spillovers, yet some on negative spillovers
Spatial dimension of spillovers	Discouragement of entry by local firms
Competition enhancing effect	Crowding-out of weak domestic firms by foreign entry
Linkage creation	Foreign affiliates may reduce the opportunities for domestic agglomerative economies by confining their linkages to foreign suppliers and industrial customers. ^a

Source: author.

^a See Dunning, 1994, table 4.

A good deal of the effects will depend on whether foreign investors are “stickers” (long-run establishments (see also Sumner, 1999)) or “snatchers” (short-run establishments (McAleese and Counahan, 1979)). Frank Barry et al. (1999) also discuss similar issues with respect to Ireland. How to turn snatchers into stickers in order to maximize the possibility of positive externalities is one important guideline for policy measures.

In principle there are three mutually reinforcing strategies available:

- A. *Rely exclusively on foreign affiliates* (increase the share of foreign affiliates, if the domestic industry is small and weak) and therefore stimulate foreign entry and foreign takeovers. Several types of advantages for domestic firms of being integrated in the (global) network of a TNC after they have been acquired are mentioned in the recent literature:
- Foreign affiliates enjoy better access to foreign markets through intra-firm trade and network economies, such that they can operate more

profitable on a larger scale (Globerman et al., 1994, p. 154).

- Foreign affiliates can draw on their parent firm's managerial expertise to manage the complexity of larger scale.
- The possibility of spillovers between plants within a multi-plant firm should not be underestimated as a factor in the case of horizontal integration or gains of specialization deriving from the fragmentation of production stages in vertical integration.
- TNCs through their industrial and geographical diversification have a more extensive set of information and better capacity for evaluating different situations (Caves, 1996).
- Instruments available to a TNC against national governments and regulations are more incisive than those used for the same purpose by uni-national firms (for example, transfer pricing).
- Discussion of firm-specific advantages has led to the conclusion that TNCs are found in technology and knowledge-intensive industries. Access to superior technology creates additional possibilities for learning internally and building on existing strengths (path-dependency) is important in endogenous growth processes.
- To tap into local knowledge bases is also easier if a firm is geographically diversified. Non-TNCs may not have these possibilities and operate older, less efficient plants.
- Lastly, accounting practices of TNCs (e.g. profit shifting) may lead to gaps in the financial performance.

As TNCs are the main vehicles of technology and growth there is a high possibility of success, but this has to be weighed against the costs of losing national sovereignty and the scope for national policy actions. It is an expensive strategy (as the “deepest pockets” will win) and may have detrimental effects on the domestic sectors.

To avoid negative externalities governments may try to induce foreign affiliates to generate/disseminate more externalities (more spillovers, more competition, and more linkages) in a desirable manner and to minimize any TNCs’ negative externalities by way of appropriate measures (like strong commitment of the host government and a high degree of stability and transparency of regulations concerning FDI). Concentrating on TNCs from certain home countries or industries may be desirable in this respect as empirical results suggest large differences in gaps by parent companies. Yet, most locations are not in a position to cherry-pick among the “best TNCs”, that is, the technological leaders from particular home countries (Fosfuri and Motta, 1999, p. 627; Girma et al., 2001, p. 131).

B. Concentrate on domestic firms and do not give preferential treatment to foreign affiliates. The larger the gap, the more important is the focus on domestic firms. In particular such a strategy may be relevant for less advanced countries and industries.

- **Sourcing FDI.** As Andrea Fosfuri and Massimo Motta (1999) suggest, a possible route for the less advanced country, which addresses the technology gap, would be to supply “some national firms with the proper incentives to undertake investments in high-tech regions abroad where they could benefit from geographical proximity with market leaders” (p. 627) (that is, sourcing FDI). They argue for a *technology acquisition* rationale for FDI on the basis of spatially-bounded spillovers. In their view laggard firms acquire location-specific knowledge via FDI on which they subsequently build their firm-specific

advantages. Thus, FDI becomes the source, rather than the consequence of firm-specific advantages, and performance gaps may be reversed. Papanastassiou and Pearce (1997) describe the various roles of affiliates in technology sourcing.

- Internationalization: another aim could be to increase the degree of internationalization of domestic-owned firms, in order to induce more investment in firm-specific assets. Increasing the transnationality of domestic firms may thus help to build up firm-specific assets and may itself endogenously contribute to gap-closing given certain preconditions are met. In some industries, the gains from transnationality will be larger, which implies a concentration on those industries, where the potential is not yet exhausted.
- These gains from transnationality may spillover *within* the firm, thus justifying even outward-FDI promotion. A side effect of outward investment of domestic-owned firms may then be “reverse” spillovers, feeding back to the investing firm.
- Enhancing the absorptive capacity: increasing the absorptive capacity of domestic firms will strengthen their competitiveness. In particular, their capacity to learn should be promoted in order to enhance domestic firms’ ability to capitalize on positive externalities.
- Competition: domestic firms usually do not remain passive upon foreign entry, as they might try to lower their cost by job reduction and increase the capital-intensity of production, by relocation of value-added activities abroad. But such defensive behaviour is only one possibility, as incumbents may try to invest more in firm-specific assets, engage in sourcing FDI and build up (technological) entry barriers. Therefore, policies likely to improve the national innovation system are important forces in stimulating the latter behaviour.

-
- A policy which favours domestic start-ups in high-productivity industries may improve diffusion of knowledge into actual production and thus help to narrow technology gaps.
 - Special incentives to domestic firms to catch-up in capabilities (that is, domestic-firm-focused measures, such as R&D subsidies / tax breaks) – independent of TNC-generated externalities – should be considered. Domestic firms lacking firm-specific advantages should directly or indirectly be encouraged to develop competitive advantages. Firms having developed firm-specific advantages should be encouraged to exploit them on a wider scale – either regionally and/or in the form of diversification.

C. *The interaction between the two sectors should be enhanced where possible.* The creation of linkages (table 1) of all kinds and long-term cooperation between domestic and foreign affiliates is, however, only partly a policy task. Local linkages create a high degree of embeddedness, which makes TNCs less mobile. As a general rule, attention should be given to those gaps, where the likelihood of positive externalities in the process of catching-up is highest. Focus should be put on specific industries, either to stimulate within or between industry effects and agglomeration economies.

The gap-specific policies outlined differ considerably from general inward-FDI policies. The ownership of firms plays only a minor role. In the concluding subsection some limitations are discussed to put the proposed policies in perspective.

Limitations

The policy options need to be weighed against common sources of *government failure* in the promotion of inward FDI:

- Generally, the role of foreignness has been overstated compared to the influence of other (structural) factors.

-
- Proposed measures have been too crudely introduced, mainly in the form of overbidding of the “deepest pockets”. A lack of *ex post* evaluation hinders improvement. (See also Fosfuri and Motta, 1999, p. 627) “... it is not clear that such policies would be easy to implement correctly”).
 - Empirical results based on questionable or weak methodological evidence may have led to misguided policy advice. One major issue is the aforementioned question of “reverse causality” between FDI and growth.
 - Recent empirical evidence based on sound methodology is mixed and idiosyncratic and only partly justifies government intervention at all. Rather it creates a high degree of uncertainty of what should be implemented.
 - Negative effects of foreign presence, though established in various studies, have too often been deliberately neglected by governments.
 - The local nature of some of the effects may limit the possibility to close these gaps by policy intervention.
 - Incentives have a marginal impact on location decisions of firms (Wells and Wint, 2002).

Given the existence of the various types of government failure outlined above and the fact that TNCs carry these structural characteristics to a considerable extent, gap-specific policies are a first-best strategy. To promote inward FDI in general is only a second-best strategy, since it neglects domestic firms as well as the interactions between foreign and domestic firms. This article seeks to provide a systematic exploitation of the literature on performance gaps in order to design gap-specific policies. The theoretical concepts and the empirical evidence produced so far have provided useful arguments. The efficient implementation and the critical evaluation of the proposed measures are of course indispensable preconditions for the success of the gap-specific policies outlined above.

References

- Abd-el-Rahmen, Kamal (1991). "Firms' competitive and national comparative advantage as joint determinants of trade composition", *Weltwirtschaftliches Archiv*, 127(1), pp. 83-97.
- Acocella, Nicola (1992). "The multinational firm and the theory of industrial organization", in A. Del Monte, ed., *Recent Developments in the Theory of Industrial Organization* (Basingstoke: Macmillan), pp. 232-251.
- Aitken, Brian J. and Ann E. Harrison (1999). "Do domestic firms benefit from foreign investment? Evidence from Venezuela", *American Economic Review*, 89, pp. 605-618.
- _____, Ann E. Harrison and Robert Lipsey (1996). "Wages and foreign ownership: A Comparative Study of Mexico, Venezuela and the United States", *Journal of International Economics*, 40, pp. 345-371.
- _____, Gordon H. Hanson and Ann Harrison (1997). "Spillovers, foreign investment and export behaviour", *Journal of International Economics*, 43, pp. 103-132.
- Baldwin, Robert (1995). *The Dynamics of Industrial Competition* (Cambridge: Cambridge University Press).
- _____, and Paul K. Gorecki (1991). "Entry, exit and productivity growth", in Paul A. Geroski and Joachim Schwalbach, eds., *Entry and Market Contestability* (Oxford: Basil Blackwell), pp. 244-256.
- _____, John Bradley and Eoin O'Malley (1999). "Indigenous and foreign industry: characteristics and performance", in Frank Barry, ed., *Understanding Ireland's Economic Growth* (London: Macmillan Press), pp. 57-86.
- Bellak, Christian (2004). "How domestic and foreign affiliates differ and why does it matter?", *Journal of Economic Surveys*, 18(2), pp.1-32.
- Benfratello, Luigi and Alessandro Sembenelli (2002). "Foreign ownership and productivity: is the direction of causality so obvious?" (Torino: CERIS), mimeo.
- Blomström, Magnus (2002). "The economics of international investment incentives", in OECD, ed., *International Investment Perspectives* (Paris: OECD), pp. 165-179.

-
- _____ and Ari Kokko (1998). “Multinational corporations and spillovers”, *Journal of Economic Surveys*, 12, pp. 247-277.
- _____ and Frederik Sjöholm (1999). “Technology transfers and spillovers: does local participation with multinationals matter?”, *European Economic Review*, 43, pp. 915-923.
- Castellani, Davide and Antonello Zanfei (2002). “Technology gaps, absorptive capacity and the impact of inward investments on productivity of European firms”, in *Economics of Innovation and New Technology*, 12 (6), pp. 459-480.
- Caves, Richard (1974). “Multinational firms, competition and productivity in the host country”, *Economica*, 41, pp. 176-193.
- _____ (1974, 1996). *Multinational Enterprise and Economic Analysis* (Cambridge: Cambridge University Press).
- Cohen, Wesley M. and Daniel A. Levinthal (1990). “Absorptive capacity: a new perspective on learning and innovation”, *Administrative Science Quarterly*, 35, pp. 128-152.
- Canyon, Martin J., Sourafel Girma, Steve Thompson and Peter W. Wright (2002a). “The productivity and wage effects of foreign acquisition in the United Kingdom”, *The Journal of Industrial Economics*, L(1) (March), pp. 85–102.
- _____, Sourafel Girma, Steve Thompson and Peter W. Wright (2002b). “The impact of mergers and acquisitions on company employment in the United Kingdom”, *European Economic Review*, 46, pp. 31–49.
- Doms, Mark E. and Bradford J. Jensen (1998). “Comparing wages, skills, and productivity between domestically and foreign-owned manufacturing establishments in the United States”, in Richard E. Baldwin, Robert E. Lipsey and J. David Richardson, eds., *Geography and Ownership as Bases for Economic Accounting: Studies in Income and Wealth* (Chicago: University of Chicago Press), 59, pp. 235-255.
- Driffield, Nigel and Max Munday (1998). “The impact of foreign direct investment on UK manufacturing: is there a profit squeeze in domestic firms?”, *Applied Economics*, 30, pp. 705-709.
- _____ and Karl Taylor (1999). “Spillovers from FDI and skill structures of host-country firms” (Birmingham: Birmingham Business School Working Papers), mimeo.

-
- _____ and James H. Love (2002). "Domestic-to-foreign spillovers, technology sourcing and FDI" (Birmingham: Birmingham Business School Working Papers). (<http://business.bham.ac.uk/business/papers/techSourc.htm>).
- Driver, Ciaran and Paul Temple, eds. (1999). *Investment, Growth and Employment: Perspectives for Policy* (London: Routledge).
- Dunning, John H. (1973). "The determinants of international production", *Oxford Economic Papers*, 25 (November), pp. 289-336.
- _____ (1977). "Trade, location and economic activity and MNE: a search for an eclectic approach", in Bertil Ohlin, Per-Ove Hesselborn and Per Magnus Wijkman, eds., *The International Allocation of Economic Activity* (London: Macmillan), pp. 395-418.
- _____ (1988). "The eclectic paradigm of international production: a restatement and some possible extensions", *Journal of International Business Studies*, 18, pp. 1-31.
- _____ (1994). "Re-evaluating the benefits of foreign direct investment", *Transnational Corporations*, 3(1), pp. 23-52.
- Feliciano, Zadia and Robert E. Lipsey (1999). "Foreign ownership and wages in the United States, 1987-1992", *NBER Working Paper 6932* (Cambridge, MA: NBER), mimeo.
- Figini Paolo and Holger Görg (1999). "Multinational companies and wage inequality in the host country: the case of Ireland", *Review of World Economics*, 135(4), pp. 594-612.
- Fosfuri, Andrea and Massimo Motta (1999). "Multinationals without advantages", *Scandinavian Journal of Economics*, 101(4), pp. 617-630.
- Freund, Caroline and Simeon Djankov (2000). "Which firms do foreigners buy? Evidence from Korea", *World Bank Working Papers*, No. 2450 (September) (Washington D.C.: World Bank), mimeo.
- Girma, Sourafel and Holger Görg (1994). "Blessing or curse? Domestic plants' survival and employment prospects after foreign acquisition", *Discussion Paper Series No. 2994* (London: CEPR), mimeo.
- _____, David Greenaway and Katherine Wakelin (2001). "Who benefits from foreign direct investment in the UK?", *Scottish Journal of Political Economy*, 48(2), (May), pp. 119-133.

-
- Görg, Holger and Eric Strobl (2002a). "‘Footloose’ multinationals?", *Discussion Paper Series No. 3402* (London: CEPR), mimeo.
- _____ and Eric Strobl (2002b). "Multinational companies and indigenous development: An empirical analysis", *European Economic Review*, 46, pp. 1305-1322.
- Haaland, Jan I. and Ian Wooton (1999). "International competition for multinational investment", *Scandinavian Journal of Economics*, 101(4), pp. 631-649.
- Haddad, Mona and Ann Harrison (1993). "Are there positive spillovers from direct foreign investment?", *Journal of Development Economics*, 42, pp. 51-74.
- Hanson, Gordon J. (2001). "Should countries promote foreign direct investment?" *G-24 Discussion Paper Series*, 9, February (New York and Geneva: United Nations), mimeo.
- Harris, Richard I.D. (2002). "Foreign ownership and productivity in the United Kingdom: some issues when using the ARD establishment level data", *Scottish Journal of Political Economy*, 49(3), pp. 318-335.
- Head, Keith (1998). "Comment", in Richard E. Baldwin, Robert E. Lipsey, and J. David Richardson, eds., *Geography and Ownership as Bases for Economic Accounting. Studies in Income and Wealth* (Chicago: University of Chicago Press), 59, pp. 255-258.
- _____, Ries, J. and K. Ruckman (1998). "Industry agglomeration and the location of foreign affiliates", *Research in Global Strategic Management*, 6, pp. 53-85.
- Hubert, Florence and Nigel Pain (2001). "Inward investment and technical progress in the United Kingdom manufacturing sector", *Scottish Journal of Political Economy*, 48(2), pp. 134-147.
- Hymer, Stephen H. (1976). *The International Operations of National Firms: A Study of Direct Foreign Investment* (Cambridge, MA: MIT Press).
- Letto-Gillies, Grazia and Meloriah Meschi (1999). "The characteristics, performance and strategic behaviour of merged versus non-merged establishments in Britain", *Review of Industrial Organization*, 15 (1), pp. 1-24.
- Jungnickel, Rolf, ed. (2002). *Foreign-owned firms: are they different?* (Houndsmill, Basingstoke: Palgrave).

-
- Koutsoyiannis, Anna (1982). *Non-Price Decisions: The Firm in a Modern Context* (London: Macmillan Press).
- Lall, Sanjaya (2001). *Competitiveness, Technology and Skills* (Cheltenham: Edward Elgar).
- Lichtenberg, Frank R. and Donald Siegel (1987). "Productivity and changes in ownership of manufacturing plants", *Brookings Papers on Economic Activity: Microeconomics*, pp. 643-673.
- Loewendahl, Henry B. (2001). *Bargaining with Multinationals: The Investment of Siemens and Nissan in North-East England* (Basingstoke: Palgrave).
- Lyons, Bruce (1987). "Strategic behaviour by firms", in: Roger Clarke and Tony McGuinness, eds., *The Economics of the Firm* (Oxford: Basil Blackwell), pp. 62-82.
- Markusen, James R. (1995). "The boundaries of multinational enterprises and the theory of international trade", *Journal of Economic Perspectives*, 9, pp. 169-189.
- Mata, José and Pedro Portugal (2000). "Patterns of entry, post-entry growth and survival: a comparison between domestic and foreign owned firms" (Lisbon: Universidade Nova de Lisboa), mimeo.
- Mayer, Thomas and Jean-Louis Mucchielli (1998). "Agglomeration effects, State policies, and competition in the location of Japanese FDI in Europe", *Research in Global Strategic Management*, 6, pp. 87-116.
- McAleese, Dermot and Michael Coughan (1979). "Stickers or snatchers? Employment in multinational corporations during the recession", *Oxford Bulletin of Economics and Statistics*, 41, pp. 345-358.
- McGuckin, Robert H. and Sang V. Nguyen (1995). "On productivity and plant ownership change: new evidence from the longitudinal research database", *RAND Journal of Economics*, 26(2) (Summer), pp. 257-276.
- _____, Sang V. Nguyen and Arnold P. Reznick (1995). "The impact of ownership change on employment, wages and labour productivity in US manufacturing 1977-1987", *Working Paper, Center for Economic Studies*, CES 95-98 (Washington D.C.: Bureau of Census), mimeo.
- OECD (2001). "Corporate tax incentives for foreign direct investment", *OECD Tax Policy Studies* (Paris: OECD).

-
- Oman, Charles P. (2000). *Policy Competition for Foreign Direct Investment* (Paris: OECD).
- Papanastassiou, Marina and Robert Pearce (1997). "Technology sourcing and the strategic roles of manufacturing subsidiaries in the UK: local competences and global competitiveness", *Management International Review*, 37(1), pp. 5-25.
- Pearce, Robert (2001). "Multinationals and industrialisation: the bases of 'inward investment' policy", *International Journal of the Economics of Business*, 8(1), pp. 51-73.
- Sumner, Michael (1999). "Long-run effects of investment incentives", in C. Driver and P. Temple, eds., *Investment, Growth and Employment: Perspectives for Policy* (London: Routledge), pp. 292-300.
- United Nations Conference on Trade and Development (UNCTAD) (1996). *Incentives and Foreign Direct Investment* (Geneva and New York: United Nations), United Nations publication, Sales No. E.96.II.A.6.
- Wells, Luis T. and Alvin G. Wint (2000). *Marketing a Country: Promotion as a Tool for Attracting Foreign Investment* (Washington D.C.: World Bank).
- Young, Stephen and Neil Hood (1994). "Designing developmental after-care programmes for foreign direct investors in the European Union", *Transnational Corporations*, 3(2), pp. 45-72.
- Zhou, Dongshen, Shaomin Li and David K. Tse (2002). "The impact of FDI on the productivity of domestic firms: the case of China", *International Business Review*, 11, pp. 465-484.



International relocation of production and the growth of services: the case of the “Made in Italy” industries

Maria Savona and Roberto Schiattarella *

This article first presents a “systemic” approach to the international relocation of production, one that looks at local production systems as a whole, rather than at the activities of a single transnational corporation. This approach is used as the basis for an assessment of the effects of the international relocation of production on the local economy and specifically on the growth of service industries. The empirical application relates to “Made in Italy” industries (textiles, clothing and leather products). These have increasingly relocated parts of the production chain abroad over the past decade, with effects on the employment growth of those services that are located in the same local production system. The term “province” is chosen as a proxy for the latter and as the geographical unit of analysis in the empirical research. Overall, the empirical results show that the international relocation of production processes is associated with the growth of services. In particular, a high degree of internationalization is associated with a positive employment growth of the service sector as a whole and of its most traditional industries, such as trade, transport and financial services. However, a negative relationship has been found in the case of business services and, in particular, for the “science-based” industries (engineering, research and development, software industry). The conclusion is that the international

* The authors are, respectively, researcher at the University of Camerino, IT and SPRU, Science and Technology Policy Research, The Freeman Centre, University of Sussex, Falmer, Brighton, United Kingdom, and Professor of Economics at the University of Camerino, Department of Law and Political Sciences, Camerino (MC), Italy. The authors thank Grazia Ietto-Gillies and two anonymous referees for their valuable comments and suggestions on previous versions of this article. The usual disclaimer applies. Contact: M.Savona@sussex.ac.uk; r.schiattarella@libero.it.

relocation of production processes seems to “pull” employment growth by way of increasing the outsourcing of the most traditional and downstream service industries. However, the international relocation of production also appears to crowd-out the most innovative and upstream service industries. There are policy implications from these results. The article concludes with a call for specific industrial and technology policies to enhance the growth of upstream and technologically advanced service industries, in order to preserve the competitive strength of the local production system as a whole.

Key words: international relocation of production; local production systems; service industries; Italian local economy; “Made in Italy” industries.

Introduction

This article has two main aims. First, to present a systemic approach to internationalization; more specifically a systemic approach to the process of the international relocation of production (IRP). Second, to use this approach to evaluate the effects of IRP. In this context the article will explore the causal relationship between IRP and the growth of service industries in the provinces that specialize in the “Made in Italy” (“MiI”) type of production.¹ The “MiI” industries include traditional manufacturing such as textiles and clothing, leather and shoes. The “MiI” is a very good arena of analysis, because firms operating in these sectors are part of well-integrated local production systems; moreover, they have experienced a great deal of relocation of production over the past decade.

Provinces are the chosen spatial unit of analysis. A “provincia” is one of the three territorial administrative units in Italy. The others are: “comune” and “regione”. The “provincia” comprises several “comuni”, that is, towns of various sizes including at least a large one. The whole of Italy comprises 103

¹ For a review of various economic issues on the “Made in Italy” industries, see Becattini, 1979, 1991.

provinces grouped in 19 regions. The choice of province as the territorial unit of analysis assumes that the geographical boundaries of the local system of production specialized in the “MiI” sectors roughly coincide with those of the administrative province.²

The evaluation of effects (the second aim of the article) is made in relation to the effects of IRP on services in the provinces affected by the relocation. The article proceeds as follows. The following section deals with the theoretical approach underlying the analysis. The third section presents the empirical results and the final section briefly discusses the methodological implications of the approach adopted and draws some general policy implications from the empirical findings.

International relocation and the internationalization of production

The international relocation of production can be analyzed from various perspectives and in particular using the following approach (Buckley and Mucchielli, 1997):

- (1) Undertaking an assessment of the volume and pattern of international trade to which IRP gives rise.
- (2) The internal relocation by transnational corporations (TNCs) of production originally based in country (A) – whether the home or a host country – to another country (B). By internal relocation is meant the fact that the TNC has equity control over the unit (affiliate) where the output is relocated.

The relocation of production between different countries can take place internally to a particular TNC (as in point 2 above), but it can also take place externally to it or with various degrees of externalization; in other words a TNC can outsource the production relocated abroad. This is a third approach to the

² The debate on the identification - and related measurement - issues related to the concept of local production system is large and includes issues of local system of innovation. For a review, see Breschi and Lissoni, 2001.

IRP and the one taken in this article. It is a wider view of the relocation process, one that has implications for the assessment of effects. By international relocation is therefore meant a shift of production from firms based in a given country (whether owned by nationals of that country or not) to other firms based abroad (again, not necessarily owned by nationals of the foreign country). Following the outsourcing of the production process, the output can be imported back into the country from which it was relocated by the TNC, most likely to be sold under that company's own brand name. In this case the IRP involves the outsourcing of parts of the value chain; the main TNC becomes involved in the final stages: marketing of the final product under its own brand name. The whole process has effects on the local economy of country A, in this case Italy.

This approach stems from the integration of two somewhat different approaches to the relocation issue. The first one is what we could call the international fragmentation of production approach (Arndt, 1997a, 1997b; Jones and Kierskowski, 1997; Baldone et al., 2000). It refers to the fact that the production process is decomposed and its parts are located in different countries. This line of research studies the phenomenon primarily from the point of view of the organization of production and the international division of labour (Jones and Kierkowsky, 1997). The second approach focuses on "outsourcing" on which concept Feenstra and Hanson write:

"...we adopt a more general definition of outsourcing, which in addition to imports by U.S. multinationals, includes all imported intermediate or final goods that are used in the production of, or sold under brand name of, an American firm" (Feenstra and Hanson, 1996a, p. 92).

This wider approach to the IRP has, in our view, two main advantages:

- (1) It considers IRP as a unitary process independently of whether it involves direct investment and/or equity holdings.

-
- (2) It highlights the fact that the firms involved in the relocation process are in asymmetrical position as regards power and control.

Traditionally control has been considered in terms of legal control and thus in terms of equity control. This means that the power of the relocating firm has been analysed mainly when the relocation process takes the form of foreign direct investment (FDI) and direct international production. The approach here proposed aims to capture the following: a TNC that outsources internationally may not have equity control over the smaller foreign firm; however, it has a large degree of economic control (Cowling and Sugden, 1998). This includes control over product specification as well as over the market to which the output is directed.³

The approach of this article therefore goes beyond the analysis of TNCs as the one characterized by legal control over foreign assets. Such a definition is appropriate when one wants to analyze large firms. However, when the involvement of many small and very small firms in the international processes is considered, there is a need to look at the system as a whole to understand (i) how these small firms become involved; and (ii) how they are affected by the wider international activities. This means that the internationalization processes can best be understood by looking at the whole system and the wider relationships between firms involved in the production chain. It follows that the effects must also be evaluated by looking at the wider system and its implications. This is what is attempted in the following sections.

The “MiI” sector is a particularly interesting area of analysis for the application of this systemic approach, because it is characterized by the presence of small and very small firms

³ In the attempt to analyse the wider relationships between firms, some authors (Ietto-Gillies, 2001) have used the concept of “fuzzy boundaries” of the firm in general. What this article is saying is that though the boundaries of the single firm may be “fuzzy”, the control that some firms have over others may be less uncertain. Fuzzy boundaries do not necessarily imply fuzzy control.

mostly organized in local production systems (districts). Moreover, the “MiI” sector implies the presence of a possible hierarchical and control relationship between the Italian and foreign firms. The services sector was chosen as a focus for the assessment of the effects because it is the one most affected by the reorganization of production following relocation. This is true in relation to the effects on TNCs and the relocating sector itself, as well as in relation to the overall local production system.

The empirical analysis

This section considers the effects of internationalization of “MiI” industries on the local economy and in particular on the growth of employment of the local service industries.⁴ Specifically, the relationship between IRP processes in the “MiI” specialized provinces and the growth of services in the same provinces over the period of 1991-1996 is tested. The data used in the empirical analysis are drawn from the International Trade (ISTAT, 1995, 1998a) and the Italian Census of Manufacturing and Service Enterprises (ISTAT, 1998b) statistics. Two main dimensions are identified as having a potential effect on the growth of services: the degree of involvement in IRP and the level of specialization in the “MiI” industries. Accordingly, three groups of provinces are identified, which share a high level of specialization in the “MiI”. The firms located in these provinces have different strategies of international relocation of production, so that the “MiI” specialized provinces have different average intensity of IRP.

⁴ The choice of employment rather than output or value added as an indicator of economic growth in services is due to different interrelated reasons. First of all, the use of employment growth allows us to capture potential compensation mechanisms operating at the local level between the “MiI” industries and the service industries. Moreover, the problems of conceptual definition of activities that produce and deliver intangible products raise issues of adequate output measurement, including those linked to the use of an appropriate deflator to quantify the added value of services (Griliches, 1992).

This section is divided into three subsections, the first of which identifies three groups of provinces on the basis of the IRP and the “MiI” specialization, drawing upon the results of previous studies (Schiattarella, 1999a, 1999b, 2001). The second subsection considers the employment growth in the service industries located in the three groups of provinces, in order to provide a preliminary picture of the relationship between the degree of international involvement in the “MiI” specialized provinces, and the growth of services. In the third subsection, a simple model is tested, which aims to capture the effects of IRP on the patterns of growth in different services sectors. In particular, the degree of involvement in IRP has been considered as an explanatory variable of the employment growth differentials across services. The model controls for the overall employment trend in the rest of the economy across provinces and for the level of specialization in the “MiI” branches, by including dummy variables which capture the effects of IRP within the three groups of provinces identified above.

Identification of the groups of provinces

Table 1 reports three groups of provinces, identified on the basis of the different degree of IRP involvement and the “MiI” specialization. The provinces reported in the table are considered to be specialized in the “MiI” industries, because the share of employees in these industries of the total manufacturing employment is higher than 25%. This percentage is, in fact, higher than the national average of the “MiI” in the total of manufacturing employment, which is less than 20%. The provinces chosen, though representing only a quarter of all Italian provinces, employ more than a half of the total “MiI” labour force.

The three groups of provinces in table 1 differ according to the degree of involvement in international relocation of production, measured by an International Relocation Index (IRI). The index – which is calculated for all the Italian provinces – is developed as follows.⁵

⁵ See Schiattarella, 2001.

Table 1. Employment in “Made in Italy” sectors and international relocation of production index (IRI)
 Provinces specialized in “Made in Italy” (“MiI”) industries, 1996
 (Percentage share)

<i>Province</i>	(a) Employment share in “MiI”	(b) IRI
<i>Group 1</i>		
Arezzo	35.12	1.57
Lecce	51.38	1.00
Padova	25.07	1.67
Pistoia	47.27	1.25
Treviso	25.49	2.01
Varese	26.75	1.32
Total	29.92	
<i>Group 2</i>		
Ascoli	59.67	0.56
Como	33.82	0.59
Firenze	35.38	0.72
Macerata	52.13	0.68
Mantova	30.55	0.69
Novara	25.12	0.90
Perugia	25.39	0.54
Prato	84.52	0.66
Teramo	46.02	0.66
Vercelli	27.52	0.68
Vicenza	28.31	0.79
Total	37.97	
<i>Group 3</i>		
Avellino	30.04	0.17
Bari	32.07	0.31
Benevento	31.05	0.14
Biella	72.39	0.28
Enna	27.19	0.00
Pescara	27.96	0.18
Pisa	43.47	0.27
Rovigo	37.63	0.01
Total	40.36	
Italy	18.99	

Sources: ISTAT, 1998a, 1998b.

- (a) Share of employment in “Made in Italy” sectors (textiles, clothing and leather) in the whole manufacturing sector, by province. The provinces included have a share of employment of “MiI” higher than 25%.
- (b) The groups of provinces have been identified according to the value of IRI: (group 1: IRI higher than 1; group 2: IRI between 0.5 and 1; group 3: IRI lower than 0.5).

$$\text{IRI} = \frac{\text{Province "MiI" import due to relocation/Italy "MiI" import due to relocation}}{\text{Province "MiI" employment / Italy "MiI" employment}}$$

The numerator is a ratio between the level of import due to relocation processes in each province, and the national level of import due to relocation processes. The denominator is a ratio between the employment in the “MiI” industry in each province and the total employment in the “MiI” industry in Italy. The index can therefore provide a rough measure of the relative importance of the international involvement of “MiI” in each province, weighted by the relative dimension of the “MiI” branch in the province, in comparison with the national average. In particular, Group 1 provinces show the highest degree of international involvement with an IRI higher than 1. In turn, provinces in Groups 2 and 3 show a medium and low international involvement (IRI between 0.5 and 1 and IRI lower than 0.5, respectively).

The identification of the three groups of provinces responds therefore to a twofold criterion of selecting local systems of production where: (a) the relative importance of the “MiI” industries is higher than the national average; and (b) the processes of internationalization represent a pervasive phenomenon within the local industrial environment.

The growth of services across groups of provinces

Tables 2 and 3 report the average annual rates of employment growth over the period 1991-1996 in services across the three groups of provinces and compare them to the national averages. Special attention has been devoted to the business service industries (table 2), both as a whole and for the three digit level branches, such as legal and accounting, engineering, technical consultancy, marketing, other business, security and cleaning services.

Table 2. Growth of employment in business and total services by sector and group of provinces, 1991-1996
(Per cent)

Province	(a) Legal & accounting	(b) Engineering	(c) Technical consulting	(d) Marketing	(e) Security	(f) Cleaning	(g) Other business services	(j) Total business services	(k) Total services
Group 1	4.0	6.7	20.0	-5.3	3.4	6.5	7.9	5.4	0.5
Group 2	3.8	6.6	3.2	-5.6	1.1	4.0	8.8	4.9	0.4
Group 3	4.3	6.9	4.0	-3.9	0.5	8.1	8.9	5.5	-0.4
Italy	4.2	3.7	-5.5	-6.9	-3.5	2.7	9.5	3.8	-0.6

Source: ISTAT, 1998b.

Note: Average annual rate of growth of number of employees.

Table 3. Growth of employment in ICT, R&D, financial, trade and transport services, by group of provinces, 1991-1996
(Per cent)

Province	(a) Computer & software	(b) R&D	(c) Financial services	(d) Transport & communication	(e) Trade & hotel restaurant
Group 1	2.4	-1.6	-0.3	0.1	-1.1
Group 2	2.1	-1.3	0.4	-0.6	-0.9
Group 3	0.8	12.0	0.7	-1.3	-2.3
Italy	1.9	-19.3	-0.7	-1.4	-1.7

Source: ISTAT, 1998b.

Note: Average annual rate of growth of number of employees.

Table 2 also reports the average annual growth rate of employment in the whole services sector (column k). A link emerges between the growth of employment in services and the international involvement of the “MiI” industries across the provinces in which they are located. The growth rate in the whole services sector in Group 1 provinces is higher than the rate for the other groups, as well as higher than the one for the national average. Over the period considered, in fact, the employment growth in the whole services sector is decreasing at the national level, though not so dramatically (-0.6%), whereas Groups 1

and 2 present a positive, though low rate of growth (respectively 0.5 and 0.4).

Looking at the other columns (a to g) in table 2, the following emerges. The “technical consultancy and security” branches grow faster in the first group of provinces, both compared to the other groups’ averages and to the national average, which is negative for both branches. The case of technical consultancy is particularly striking: the branch’s growth rate in the first group is 20%, whereas the other two groups show on average 3.5% and the national average growth is even negative (-5.5%). The selected “MiI” specialized provinces, regardless of the different propensity to internationally relocation, systematically show a positive services’ employment growth compared to the national average.

Table 3 shows the average annual growth rate of employment, respectively, in ICT (computing, software and related activities in column a), R&D services (column b) and in the most traditional branches, such as financial services (column c), transport and communication (column d) and trade (column e). The trade industry includes trade and repair of motor vehicles, wholesale, retail trade and hotel and restaurants; transport includes land, sea, air transport and travel and transport agencies; finally, the financial services include banking, insurance and other financial services.

A relationship between growth rates of services and IRP across different groups emerges clearly as far as the ICT, R&D, financial and transport industries are concerned. In particular, the degree of internationalization (identified by the three groups) and service growth seem to be positively related for the ICT (2.4% in Group 1) and transport services (0.1% in Group 1), while it is negative for R&D (-1.6% in Group 1) and financial services (-0.3% in Group 1).

At first glance, it seems therefore that the services’ growth performance and the international involvement of the “MiI” activities located in the same provinces are related. This is the case, for instance, for the software, technical consultancy,

security and transport services. Overall, all the groups show better employment trends as compared to the national average, regardless of both the specific sector and the degree of international involvement of “MiI”.

This seems to suggest that for some service industries the driving factor for a positive employment growth performance, as compared to the national trend, might be related to other structural factors. It could be due to an overall positive employment growth rate of the whole economy (primary, manufacturing and services sectors) at the provincial level, and/or to factors related to the industrial specialization of the province considered. In other words, services might grow better in the chosen provinces because the whole local economy has performed better compared to the national average. Conversely, the fact that a province is specialized in the “MiI” sectors, as is the case for the selected provinces, might boost services’ employment performance, due to a strong sectoral interdependence between “MiI” and services located in the same province. Both factors will be controlled for when the presence of a structural association between IRP and service growth is tested through regression analysis.

IRP and the growth of services across groups of provinces

The empirical evidence presented in the previous sections shows that the average annual growth rate of employment in some of the service industries varies considerably across the three groups of provinces specialized in the “MiI”. It is tested for whether the growth of these industries at the provincial level might be affected by the different propensity of the “MiI” sector to relocalize production internationally.

A model is here developed in order to test the extent to which a structural relationship exists between patterns of services growth and the international relocation of production in the “MiI” industries across Italian provinces. Econometric estimates have been carried out for all the 103 Italian provinces, in the attempt to isolate the effect of IRP processes on the growth of services.

The chosen specification for the model is the following:

$$[1] \quad \dot{s}_i = \alpha + \beta \cdot \dot{irp}_i + \delta \cdot \left(\dot{e}_i - \dot{e}_N \right) + \sum_{j=1}^3 (\chi_j \cdot D_j) + \varepsilon_i$$

where:

- \dot{s}_i : Average annual growth rate of employment in service sectors over the period 91-96 across provinces (SERV9196);
- \dot{irp}_i : Change of the value of the relocation index in the “MiI” branch over the period 91-96 by province (IRI);
- $\left(\dot{e}_i - \dot{e}_N \right)$: Difference between the provincial and the national average annual growth rate of employment of the total economy (that is, primary, manufacturing and services) (DTOTE9196);
- D_j : Dummy for provinces with a share of employees in the “MiI” of total manufacturing above 25% and value of International Relocation Index respectively: above 1, between 0.5 and 1, and below 0.5 (GROUP, with $j = 1, 2, 3$);
- ε_i : Error term for province i, where $\varepsilon_i \approx IN(0, \sigma^2)$

and:

α is the constant; β , δ and χ_j are the parameters to be estimated.⁶

Table 4 lists the variables to be entered in a traditional ordinary-least square regression with robust standard errors. The variable IRI is the change in the value of the relocation index discussed above and is included as a proxy of the changes in the propensity to internationalization of the “MiI” industries across provinces. The dummy variables (GROUP₁, GROUP₂, GROUP₃) are meant to capture the effects of different degrees of propensity to internationalization in the “MiI” jointly with a high level of specialization in these industries, that is within the three groups of provinces identified in the previous subsections.

⁶ For the sake of simplicity, from now the indices i and j will be implied and no longer explicitly indicated.

The variable DTOTE9196 is the difference between the employment growth of the total economy in the province and in Italy. This allows control for the relative position of each province with respect to the national average in relation to total employment. In other words, the variable DTOTE9196 controls for cyclical effects, because it repositions each province in relation to the national average in terms of employment trends. Moreover, the use of a difference variable allows us, from an econometric point of view, to avoid problems of identification inherent in the particular specification of the model.

Table 4. List of variables used in the model

Dependent variables ^a	
Acronym	Proxy
ENG9196	Engineering
LEG9196	Legal and accounting
OTHB9196	Other business services
RD9196	Research and development
SOFT9196	Computer, software and related
TBUS9196	Total business services (legal, engineering, technical consultancy, marketing, training, security, cleaning and other business services)
TECH9196	Technical consultancy
TFIN9196	Total financial services (banking, insurance, other financial services)
TTRACO9196	Total transport and communication (land, air, sea transport, travel agencies and post and telecommunication)
TTRADE9196	Total trade services (trade and repair of motorvehicles, retail, wholesale trade and hotel and restaurants)
TSER9196	Total services
Explanatory variables ^b	
IRI	Change of the value of the relocation index by province, 1991-1996
GROUP1	Dummy for provinces with IRI above 1 and share of employees in "MiI" above 25%
GROUP2	Dummy for provinces with IRI between 0.5 and 1 and share of employees in "MiI" above 25%
GROUP3	Dummy for provinces with IRI below 0.5 and share of employees in "MiI" above 25%
DTOTE9196	Difference between the provincial and the national average annual growth rate of employment in total economy

Source: Author's calculation.

^a All variables are standardized average annual growth rates of employment 1991-1996.

^b All variables are standardized values.

Equation [1] is tested separately for each dependent variable reported in table 4. These variables are constructed as an average annual growth rate of employment of different services and for the services sector as a whole. As the variables have been standardized, the parameters can be interpreted as elasticity of the employment growth rates of services with respect to IRI and DTOTE9196.

It is worth noting that the series of explanatory variables are quite heterogeneous, though a preliminary check of the correlation among them has been performed to control for multicollinearity. Therefore it is expected that the variable DTOTE9196 will capture most of the variance to be explained. This allows the isolation of the effects of the variable IRI, by formulating quite a conservative specification, such as the one proposed above. However, this also makes the econometric exercise quite risky, for the variables related to the intensity of the international involvement and the “MiI” specialization are likely to have quite a low explicative power, when compared to the DTOTE9196 variable.

The results of the regression estimates are reported in table 5. The first equation refers to the average annual growth rate of the whole services sector. The estimated relationship seems to be quite effective in capturing the variance of the dependent variable, as the value of the adjusted R-squared is quite high (over 73%). The internationalization of the “MiI” branches has a significant and positive impact on the growth performance of the whole service sector located within the same province. As expected, most of the variance is explained by the variable DTOTE9196, which proxies the relative position of each province in terms of growth of the whole economy. The results of the estimates also show that internationalization in the “MiI” has an impact *per se* on service growth, regardless of the level of “MiI” specialization of each province.

The following equations test the effects of the explanatory variables included in the model respectively on the most traditional branches of services, that is trade, transport and

finance, as well as for R&D and software industry. Moreover, the regressions have also been run on some of the business services disaggregated at the three-digit level (engineering, legal, technical consultancy in the last three rows of table 5), as well as for the whole business services industry (TBUS9196). This selection allows us to explore whether the most innovative and high-growth services over the last decades have been affected by the process of international relocation carried out by the “MiI” branches.

Table 5. Relationship between the growth of services and international relocalization of production

Dependent variable	Explanatory variable						N° Obs.	Adj. R-Squared
	CONST.	IRI	GROUP1	GROUP2	GROUP3	DTOTE9196		
TSER9196	.002 [.04]	.10** [2.32]	.008 [.04]	.06 [.46]	-.13 [-.53]	.818** [10.03]	103	.732
TTRADE9196	.004 [.07]	.110** [1.92]	-.04 [-.26]	.139 [.82]	-.217 [-.69]	.773** [8.97]	103	.675
TTRACO9196	.001 [.01]	.098* [1.50]	.190 [.42]	-.162 [-.57]	.06 [.20]	.378** [3.11]	103	.175
TFIN9196	-.043 [-.40]	.151** [2.78]	-.102 [-.31]	.139 [.61]	.451 [1.46]	.323** [3.05]	103	.160
RD9196	.087 [.75]	.062 [.72]	-.656** [-2.18]	-.583** [-2.18]	.133 [.33]	-.134 [-1.10]	99	.080
SOFT9196	.104 [.95]	-.072 [-.85]	-.240* [-1.50]	-.223 [-.81]	-.862 [-1.70]	.195* [1.68]	103	.092
TBUS9196	.073 [.67]	-.170 [-1.30]	-.287 [-.88]	-.325 [-1.29]	-.285 [-.60]	.319** [2.44]	103	.112
ENG9196	-.006 [-.05]	-.153* [-1.65]	.063 [.26]	.055 [.17]	-.040 [-.23]	-.092 [-.95]	103	.040
LEG9196	.086 [.75]	-.207** [-2.93]	-.351** [-2.12]	-.420* [-1.71]	-.273 [-.72]	.210** [2.09]	103	.090
TECH9196	-.073 [-.69]	-.143* [-1.52]	1.34** [2.56]	-.163 [-.68]	.156 [-.69]	.246** [2.01]	101	.160

Source: author's calculation.

Notes: OLS estimates with robust standard errors in square brackets.

* significant at 10%.

** significant at 5%.

The results show that the IRP processes significantly affect the growth patterns of most of the service industries considered. In particular, the variable IRI has a positive impact on the growth patterns of the traditional service industries (first six rows of table 5). Conversely, the estimated coefficient of IRI is negative in the cases of the business services, both considered as a whole and for most of the single branches, such as engineering and legal services. However, the level of specialization in the “MiI” does affect the growth of employment in the case of technical consultancy, as the value of the coefficient of the variable GROUP1 is positive and significant (1.34). This confirms, as emerged in the previous section, that in some cases it is the joint presence of strong specialization and high propensity to internationalize that affects services’ employment growth.

As expected, the coefficient of the variable DTOTE9196 is positive and statistically significant in most of the estimates. This confirms that the employment trend of services is strongly associated with the overall trend of the total economy at the provincial level.

Summary and implications

This article has developed a systemic approach to internationalization and has used it to analyse the effects of the international relocation of production (IRP) in the Italian provinces specialized in the “Made in Italy” (“MiI”) industries. The analysis of this article has aimed therefore to give content and dimension to the notion of *systemic* effects of the IRP. By using the word “systemic”, attention is drawn to the fact that IRPs have an impact on those firms and industries that are not necessarily directly involved in the IRPs. Their indirect involvement is connected to the fact that they belong to the same production chain and are located in the same local area (province).

The effects of IRPs on the system are assessed through econometric estimates of the growth of services in the relevant Italian provinces. Overall, the results of the empirical analysis

presented in this work show that IRPs carried out by “MiI” firms have considerable effects on the growth patterns of services in the chosen provinces. In particular, the more internationally involved a province, the higher the employment growth in the services sector as a whole. Such a positive relationship occurs for the most traditional branches like trade, transport and financial services. Conversely, a negative relationship emerges in the case of business services and, in particular, for the science-based industries (engineering, R&D, software industry). From these results it can therefore be inferred that IRPs – which involve major changes in the organization of production – seem to pull the growth of traditional branches of services. However, IRP processes seem also to crowd out the growth of science-based business service industries.

This suggests that the structural change in the organization of production represented by IRPs is associated with (and possibly drives) further organizational changes aimed at internalizing the most innovative service functions within the relocating firm. In other words, the higher the international involvement, the higher the demand for innovative service functions: the choice of internalizing rather than outsourcing them in the case of the “MiI”, would explain the negative impact of IRPs on the most innovative and upstream services industries.⁷

There are policy implications from these findings. The positive overall employment impact of IRPs on service industries has to be complemented and further reinforced by specific policy actions, aiming at sustaining the growth of the most technologically advanced and upstream service industries. These sectors seem rather to be penalized by the processes of IRPs occurring at the local level, most probably due to the choice of internalizing rather than outsourcing the most innovative service functions carried out by the “MiI” firms. The results may justify policy interventions aiming at affecting the structural composition of services – in favour of those service industries

⁷ See also the empirical findings presented in Rossetti and Schiattarella, 2003.

that are science-based and high in value added – in the context of an increasing internationalization of production of some manufacturing industries. It is crucial therefore to create the conditions for a virtuous circle between increasing internationalization, innovation and the changing composition of the industrial structure towards technologically advanced services. ■

References

- Arndt, S. (1997a). “Globalization and the open economy”, *North American Journal of Economics & Finance*, 8 (1), pp. 71-79.
- _____ (1997b). “Globalization and the gains from trade”, in K. Jaeger and K. J. Koch, eds., *Trade, Growth and Economic Policy in Open Economies* (New York: Springer-Verlag).
- Baldone, S., F. Sdogati and L. Tajoli (2000). “La posizione dell’Italia nelle nuove forme di divisione internazionale del lavoro”. Presentation at the 2000 seminar on “Globalization, Division of Labour and New Rules, Trade, Varese, Italy, 29-30 September, mimeo.
- Becattini, G. (1979). “Dal settore industriale al distretto industriale. Alcune considerazioni sull’unità di indagine dell’economia industriale”, *L’industria*, 1, pp. 7-21.
- _____ (1991). “Il distretto industriale come concetto socioeconomico”, in F. Pyke, G. Becattini and W. Sengerberger, eds., *Distretti industriali e cooperazione tra imprese in Italia* (Studi della Banca Toscana).
- Breschi, S. and F. Lissoni (2001). “Knowledge spillovers and local innovation systems: a critical survey”, *LIUC Papers in Economics*, 84.
- Buckley, P. and J-L. Mucchielli (1997). *Multinational Firms and International Relocation* (Cheltenham, UK: Edward Elgar).
- Cowling, K. and R. Sugden (1998). “The essence of the modern corporation: markets, strategic decision-making and the theory of the firm”, *The Manchester School*, 66 (1), pp. 59-86.
- Feenstra, R. C. and G. H. Hanson (1996a). “Foreign investment, outsourcing, and relative wages”, in R. C. Feenstra, G. M. Grossman and D. A. Irwin eds., *The Political Economy of Trade Policy* (Cambridge, Massachusetts: MIT Press), pp. 89-127.

-
- Feenstra, R. C. and G. H. Hanson (1996b). "Globalization, outsourcing and wage inequality", *American Economic Review. Papers and Proceedings of the 108 Annual Meeting of the AEA*, 86(2), pp. 240-245.
- Griliches, Z. (1992). *Output Measurement in the Service Sector* (Chicago: NBER).
- Ietto-Gillies, G. (2001). *Transnational Corporations: Fragmentation Amidst Integration* (London: Routledge).
- Istituto Nazionale di Statistica (ISTAT) (1995). *International Trade Data* (Rome: ISTAT).
- _____ (1998a). *International Trade Data* (Rome: ISTAT).
- _____ (1998b). *I Censimenti delle Attività Produttive dal 1951 al 1996* (Rome: ISTAT).
- Jones, R. W. and H. Kierzkowski (1997). "Globalization and the consequences of international fragmentation", in R. Dornbusch, G. Calvo and M. Obstfeld, eds., *Money, Capital Mobility and Trade: the Festschrift in Honor of Robert A. Mundell* (Cambridge, Massachusetts: MIT Press), pp. 365-381.
- Rossetti, S. and R. Schiattarella (2003). "Un approccio di sistema all'analisi della delocalizzazione internazionale", in N. Acocella and E. Sonnino, eds., *Movimenti di persone e movimenti di capitali in Europa* (Bologna: Il Mulino).
- Schiattarella, R. (1999a). "La delocalizzazione internazionale: problemi di definizione e di misurazione. Un'analisi per il settore del 'MiI', *Economia e Politica Industriale*, XXVI (103), pp. 207-239.
- _____ (1999b). "Dalla teoria dell'impresa multinazionale alla teoria dei processi di multinazionalizzazione?", in N. Acocella, G. M. Rey and M. Tiberi, eds., *Saggi di Politica Economica*, Vol. III (Milano: Franco Angeli).
- _____ (2001). "The impact of the international relocation of production in the 'MiI' sector". Paper presented at the AITEG (Assessing the Impact of Technological Innovation and Globalization on Employment) workshop in Madrid, Universidad Complutense, May, mimeo.

Institutions, internationalization and FDI: the case of economies in transition

Mike Pournarakis and Nikos C. Varsakelis *

The attempts in the literature to explain the uneven allocation of foreign direct investment in the economies in transition for the most part stress the role of the market as the most significant factor in the attraction of such investment. This article attempts to verify empirically the argument that institutional factors such as civil rights and internationalization of the national economy are critical in explaining the behaviour of foreign direct investment inflows in the economies in transition. It uses a panel data set for the economies in transition, which are to become member states of the European Union. The findings show that market size and degree of internationalization of the host economy explain a significant part of the cross-country variation of foreign direct investment. However, institutional factors related to investment decisions strengthen these location advantages and help a country become an attractive location for such investment.

Key words: foreign direct investment, transition economies, institutions, economic integration.

Introduction

The interlinkages of trade and foreign direct investment (FDI) influence the economic growth and welfare of countries in a global environment, which undergoes continuous change.

* The authors are, respectively, Professor of Economics, Department of Economics, Economic University of Athens, Athens, Greece and Associate Professor of Industrial Policy, Department of Economics, Aristotle University of Thessaloniki, Thessaloniki, Greece. The authors would like to express their gratitude to the participants of the EIBA Annual Conference, December 2002, Athens, Greece, Marina Papanastasiou and two anonymous referees of this journal for their helpful comments. The usual disclaimer applies. Correspondence: barsak@econ.auth.gr.

In this sense, FDI inflows are viewed as a measure of the extent to which a country or a region is integrating into the world economy. Therefore, policies to attract FDI are included in the governmental agenda of many countries. Despite these policies, FDI growth is unevenly distributed among the economic regions of the world. Recent statistics (UNCTAD, 2001) show that 80% of total world FDI inflows are accounted for by the “*Triad*” (European Union-Japan-United States) which also hosts 90% of the world’s largest (in terms of foreign assets) transnational corporations (TNCs). In fact, the top 30 host countries account for 95% of the total world FDI inflows and 90% of the total stock of FDI.

Economies in transition in Central and Eastern Europe (CEE) attract a small share of the world’s FDI, a share that is moreover unevenly distributed in the region. Central Europe and the Baltic States have received more FDI per capita than South-Eastern Europe and the Commonwealth Independent States (Sengenberger, 2002).

The recent literature in the field has tried to explain this uneven allocation of FDI in the economies in transition. Most of the studies, whether descriptive (for example, Glaiser and Atanasova, 1998; Tuselmann, 1999; Pournarakis, 2001; Sengenberger, 2002; Barry, 2002), or empirical (Tondel, 2001; te Velde, 2001), stress the market as being the most significant factor for the attraction of FDI in the economies in transition, while institutions are hardly included in their analysis.

Economies in transition have only recently received the attention of researchers regarding the impact of institutional change on their economic performance. A. Brunetti, G. Kisunko and B. Weder (1997), using the findings of a survey, have verified that institutions are correlated with economic growth and foreign direct investment. To explain the cross-country variation in economic performance, C. Zinnes, Y. Eilat and J. Sachs (2001) have emphasized the deep privatization, while L. Grogan and L. Moers (2001) have emphasized the role of quality institutions.

This article aims to verify empirically whether the “deep determinants” (geography, integration and institutions) proposed by D. Rodrik and A. Subramanian (2003) explain the behaviour of FDI inflows in a sample of economies in transition, using a set of institutional variables that differ from the ones found in other studies. The article uses a panel data set for eleven countries of the region for the period 1997-2001. The first group of countries includes the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia, which have already been accepted to join the European Union (EU) by the year 2004. The second group of countries includes Bulgaria, Croatia and Romania, which may join the EU in the second enlargement phase of the Union. Finally, Albania is also included in the sample. The period 1997-2001 has been chosen as the reference period because, during the first half of the 1990s, most of the countries in our sample were subject to the turbulence of transition from the old planning regime to a market economy (war in Croatia, the political split of Czechoslovakia and political instability in Albania, Bulgaria and Romania). All the countries of our sample now enjoy vigorous democratic institutions. However, there are still substantial differences in their relative success in building quality institutions, especially those related to law enforcement.

This article is organized as follows: in the second section, the theoretical framework is presented; the third section presents the data used in our empirical analysis; the fourth section presents the empirical results and related discussion; and, finally, the fifth section consists of concluding observations.

The theoretical framework

The flow of FDI is viewed as an integrating factor in the world economy. The economies in transition, having lagged behind in the race for FDI attraction, are called upon to agree on a more efficient investment regime. Among other things, this means the recognition and exploitation of their location advantages, while the progressive removal of their disadvantages should be incorporated more fully into their development

strategies. According to John H. Dunning (1993), the location advantages derive from the supply side (labour skills and costs, corporate taxation), the demand side (market size and growth) and the political and social infrastructure. To date the literature on FDI in economies in transition has focused on both the supply and demand side location advantages, but market size stands out as being the most significant factor in the attraction of FDI. There is a widespread argument that most CEE bound FDI has been market seeking (Sengenberger, 2002; Tuselmann, 1999; Tondel, 2001; Te Velde, 2001). In this respect the Balkan countries are in a disadvantageous position for various reasons. The region suffers from the syndrome of fragmentation rather than unification. Long-standing rivalry and instability have created distances among the countries of the area and thus make cross-border trade and FDI activity more difficult.

Of course, good market performance does not exclusively depend on market liberalization and privatization. The enabling market setting requires, among others, an appropriate kind and degree of regulation, effective law enforcement and qualitative public services (Sengenberger, 2002). Thus, excessive bureaucracies, delays in privatization, unclear and arbitrarily enforced rules, monopoly control of the real sector (Glaister and Atanasova, 1998), the lack of tripartite social dialogue, and unsatisfactory industrial relations (Sengenberger, 2002) could constitute strong investment barriers even for market-seeking TNCs (Ekholm and Markusen, 2002). Brunetti, Kisunko and Weder (1997) found that differences in the degree of predictability of the institutional framework might explain to a significant degree the differences in FDI across economies in transition. Zinnes, Eilat and Sachs (2001) present empirical evidence that the change of ownership resulting from privatization programmes was not an adequate explanation of the variation of economic performance. The firm's objective function (profit maximization), the severity of the budget constraints and the legal and institutional framework that enables a firm's agents to monitor and control enterprise managers, are also critical in explaining the variation in economic performance, as measured by economic growth and FDI inflows. Finally,

Grogan and Moers (2001), using different institutional measures, verify the previous findings that quality institutions are important for economic growth and FDI in economies in transition, for the period 1990-1998.

This article seeks to explain the cross-country variation of FDI inflows for the period 1997-2001 in those countries that will become full members of the EU in 2004. Rodrik and Subramanian (2002) proposed three fundamental factors influencing the economic performance of a country: geography, economic integration in the global economy and institutions. This article will test for the last two, integration and institutions, controlling for geography.

Integration in the global economy is proxied by two alternative variables, exports and international trade as a percentage of GDP. Countries that have become more integrated in the global economy – the level of their annual exports is higher – are expected to attract more FDI than countries with a lower degree of integration. Thus, the following hypothesis is posited:

H1: The more integrated a country is in the global economy the higher are FDI inflows.

Quality institutions, and the rules of the game in a country are defined in terms of the degree of property rights protection, the degree to which laws and regulations are fairly applied and the extent of corruption (IMF, 2003). Civil liberties, the freedom of expression, freedom of association and organization rights, and the rule of law and human rights, are all important influences on business decision-making. For example, the lack of free trade unions and collective bargaining is an important factor since feelings of job insecurity inevitably run high and FDI performance worsens in the host country. Empirical research, as noted by Sengenberger (2002), has shown that this feeling is present in the CEE countries. The independence of the judiciary system, the prevalence of the rule of law in civil and criminal matters, the treatment of population under law with equality, and other related issues such as corruption and the mafia, may

also significantly influence the decision of a TNC to enter a new market. As K.W. Glaister and M. Atanasova (1998) point out, even though Bulgaria has adopted a very liberal legal framework for FDI, the endemic nature of organized crime in business and the strength of the official bureaucracy have resulted in a “lagging behind” of Bulgaria when compared to other CEE countries in terms of FDI. Thus, the following hypothesis is posited:

H2: The higher the institutional quality that a country exhibits the higher FDI inflows.

The data

In the following section, the two hypotheses stated in the previous section are tested, using data from the aforementioned sample of economies in transition for the period 1997-2001. Recent studies (Mauro, 1995; Brunetti, Kisunko and Weder, 1997; Zinnes, Eilat and Sachs, 2001; Grogan and Moers, 2001) used information about the perceived quality of institutions trying to explain the cross-country variation of economic performance. Subjective institutional measures, as Grogan and Moers (2001) point out, could lead to more interesting conclusions about the mechanism at work and the policies needed. These subjective measures are constructed by commercial, international country-risk agencies using surveys of the opinions of economic agents who make investment relevant decisions, and for that reason are more relevant to FDI.

The first source of our data for institutional measures is Freedom House. Three indices are used to measure the quality of political institutions (Freedom House, 2002b). These indices are constructed using survey methodology. The first is an index of political rights. The index ranges from one to seven. In countries that receive a rating of one, elections are free and fair; those who are elected rule the country, the opposition plays a significant role in the political system and citizens enjoy self determination. The countries that receive a rating of two are

less free, and factors such as political corruption, political discrimination against minorities, or foreign or military influence may be present. In countries that receive a rating of three, four or five, the presence of military involvement, unfair elections, one party dominance and civil war are considered harmful to civilians' freedom.

The second index involves civil liberties. The index ranges from one to seven. Countries receiving a rating of one are distinguished by an equitable system of rule of law, are free of corruption and enjoy free economic activity. Countries that receive a rating of two exhibit some deficiencies in civil liberties but could still be characterized as free. Finally, countries receiving ratings of three, four or five present significant deficiencies in terms of free association and limitations in business activity imposed either by governmental institutions or non-governmental agents (that is, terrorists, mafia).

The third index is related to freedom of the press. The data reported in Freedom House (2000a) are used. They measure the degree to which each country of our sample permits the free flow of information. The free press is the sum of ratings for the news delivery system as functioning under country's laws and administrative decisions; the degree of political influence over the content of news media; and the economic influence on media content (that is, government funding, corruption). The free press index ranges from zero to one hundred, zero indicating a completely free press and one hundred a completely non-free press.

The second source of data for the institutional measure is derived from Transparency International. The Transparency International's Corruption Perception Index is used as a measure of corruption. This is a composite index based on international surveys of the perception that business people and country experts have regarding corruption in over fifty countries. The results of individual surveys are standardized, that is, they are expressed in standard deviations from the mean. The index is

the simple average of these standardized values and it is a continuous scale from 0 representing an absolutely corrupted state to 10 representing a completely clean one. The sample consists of data for the period 1998-2001, but the data are not available for the full range in all countries of the sample.

The degree of internationalization of an economy is captured by two measures, the share of exports in gross domestic product and the ratio of international trade to gross domestic product. The data are drawn from the World Bank Economic Indicators for the years 1997-2001.

The endogenous variable is FDI inflows per capita. The data for FDI inflows are published by UNCTAD for the period 1997-2001. The control variables that a priori may be expected to matter for the behaviour of FDI in economies in transition are drawn from the literature gathered in the field. A proxy for market size is per capita gross national income. Data are used (Atlas method in current dollars) as reported in World Bank Economic Indicators for the years 1997-2001. The annual inflation rate for a country as reported in World Bank Economic Indicators for the period 1997-2001 is used as a proxy for macroeconomic stability.

The cluster typology proposed and developed by Zinnes, Eilat and Sachs (2001) – who assign countries based on similarities in variables at the start of transition – is used to control for the initial conditions. This clustering exercise resulted in seven clusters of economies in transition, and four of them are used: Cluster 1: Albania; Cluster 2 (Baltic States): Estonia, Latvia, Lithuania; Cluster 3 (the “Balkans”): Bulgaria and Romania; and Cluster 4 (EU Border States): Croatia, Czech Republic, Hungary, Poland, Slovakia, Slovenia.

Empirical results and discussion

Based on the discussion of the previous section, equation (1) is set, which is the model to be estimated:

$$LFDIC_{ij} = a + b_1INST_{ij} + b_2INT_{ij} + b_3LGNII_{ij} + b_4INFL_{ij} + Cluster\ Dummies \quad (1)$$

where $LFDIC_{ij}$ is the logarithm of per capita FDI inflows for country i in year j , INT_{ij} the internationalization degree for country i and the year j , and $INST_{ij}$ stands for the institutional variables used in our paper to capture the impact on FDI. The CPI_{ij} , the corruption perception index, the $LPRESS_{ij}$, the logarithm of the press freedom index, the $POLIT_{ij}$, the index for the political rights, and the $CIVIL_{ij}$, the index for the civil rights, are used alternatively. In order to deal with macroeconomic stability, the annual inflation rate for the country i and the year j , $INFL_{ij}$ is used. Two alternative indices to capture the degree of internationalization, INT_{ij} , are used: first, the percentage of exports to gross domestic product in logarithms, denoted as $LEXP_{ij}$ in the data set; second, the percentage of international trade to gross domestic product in logarithms, denoted as $LINTR_{ij}$ in our data set.

In order to face the endogeneity problem between FDI and per capita gross national income (GNI) the log of the per capita GNI with one lag, $LGNII_{ij}$ in equation (1) is used. Considering that FDI takes one to two years to affect the national income of a host country, the use of per capita GNI with one lag solves the endogeneity problem satisfactorily (Griffiths, Hill and Judge, 1993).

The expected signs, according to the hypotheses set in the previous section and the literature, are: $b_2, b_3 > 0, b_4 < 0$. The signs of the institutional variable depend on the measurement scale. Thus, we expect positive sign for CPI and negative for $LPRESS, POLIT$ and $CIVIL$.

Table 1 presents the descriptive statistics and table 2 the correlation coefficients. Table 3 evaluates a series of pair-wise relationships between $LFDIC$ and the individual determinants. Individually, only $LGNII$ explains almost 45% of the overall variation of the $LFDIC$, while the individual contribution of the other determinants ranges between 11% and 27%. The individual estimated parameters of the institutional variables and

integration are statistically significant and have the expected signs. The *LFDIC* is correlated with lower corruption, more press freedom and better political and civil rights. Finally, the *LFDIC* is correlated with the degree of internationalization. However, as these are only univariate regressions, the conclusions must be viewed with caution.

Table 1. Descriptive statistics

Variable	Mean	Max	Min	s.d.
COR	3.95	6	2.30	1.035
PRESS	31.76	75	17	14.34
FDIC	143.29	614.22	12.12	128.17
CIVIL	2.45	5	2	.87
POLIT	1.62	4	1	1.01
GNI	3787.13	10070	750	2277.47
INFL	27.83	949	-1	122.75
EXP	48.79	95	9	19.20
INTR	104.73	192	41	35.41

Source: Authors' own calculation.

Table 2. Correlation matrix

Variable	COR	PRESS	FDIC	CIVIL	POLIT	GNI	INFL	EXP
COR								
PRESS	-.583**							
FDIC	.309	-.353**						
CIVIL	-.558**	.768**	-.282*					
POLIT	-.673**	.915**	-.238	.880**				
GNI	.706**	-.302*	.379**	-.553**	-.366**			
INFL	-.190	.140	-.136	.064	.074	-.193		
EXP	.541**	-.504**	.463**	-.493**	-.542**	.354**	.037	
INTR	.507**	-.479**	.443**	-.399**	-.492**	.323*	-.031	.983**

Source: Authors' own calculation.

* correlation is significant at the 0.05 level.

** correlation is significant at the 0.01 level.

Table 3. Single OLS estimations: dependent variable *LFDIC*

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Constant</i>	2.404 (0.001)	7.340 (0.000)	0.761 (0.326)	-1.204 (0.364)	6.106 (0.000)	4.959 (0.000)	-2.864 (0.011)	4.736 (0.000)
<i>COR</i>	1.707 (0.001)							
<i>LPRESS</i>		-0.772 (0.006)						
<i>LEXP</i>			1.039 (0.000)					
<i>LINTR</i>				1.286 (0.000)				
<i>CIVIL</i>					-1.534 (0.001)			
<i>POLIT</i>						-0.739 (0.001)		
<i>LGNII</i>							0.944 (0.000)	
<i>INFL</i>								-0.0009 (0.332)
<i>R2-adj</i>	0.25	0.110	0.307	0.249	0.27	0.155	0.447	-0.001
<i>F-stat</i>	12.664**	2.256**	26.74**	20.27**	13.7**	11.78**	48.78**	0.959
<i>Observations</i>	35	59	58	58	59	59	59	59

Source: Authors' own calculation.

Note: p-values in parenthesis.

** statistically significant at the 0.01 level

Table 4 presents the estimates of the *LFDIC* equation. Eight different modes of equation (1) were estimated.¹ As a

¹ Heterogeneity between countries has been tested, that is whether equation (1) is the adequate one by assuming that all parameters are equal for the ten-cross-country units. If the assumption is correct, there are no behavioural differences across countries and the data can be treated as one sample of 58 observations. In order to test for common or different intercepts in individual countries the least squares dummy variable model (Griffiths, Hill and Judge, 1993) was applied. The estimated F-statistic suggests that the null hypothesis, the constant terms of the individual countries are equal, could not be rejected at p=0.01. Thus the constant term is the same across countries and it was possible to proceed by considering the data set as one sample.

control variable, the *LGNI*, *INFL* and the cluster dummies were used, and tested for the overall significance of the institutional variables and internationalization. The conclusions that can be inferred from these regressions are two. First, the *LGNI*, *LEXP*, and *LINTR* are statistically significant in all regressions (with the exception only of *LINTR* with *COR* and *CIVIL* as regressors). Second, for all specifications institutional variables have a statistically insignificant effect on FDI inflows, even though the estimated coefficients have the expected signs (with the exception of *LPRESS* with *LEXP* as regressor). Thus, the results verify the previous findings in the literature that market size, as captured by *LGDI*, and internationalization, as captured either by *LEXP* or *LINTR*, are very important factors influencing the decision of TNCs to enter the host countries. The results also suggest that institutional variables do not contribute substantially

Table 4. OLS estimations: dependent variable *LFDIC*

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Constant</i>	-2.730 (0.186)	-3.408 (0.165)	-3.248 (0.071)	-4.224 (0.045)	-4.677 (0.008)	-3.612 (0.014)	-0.866 (0.623)	-1.713 (0.391)
<i>COR</i>	0.067 (0.927)	0.151 (0.837)						
<i>LPRESS</i>			0.0115 (0.963)	-0.031 (0.899)				
<i>CIVIL</i>							-0.422 (0.270)	-0.624 (0.147)
<i>POLIT</i>					0.051 (0.816)	0.112 (0.617)		
<i>LGNI</i>	0.673 (0.041)	0.711 (0.033)	0.744 (0.000)	0.804 (0.000)	0.822 (0.000)	0.768 (0.000)	0.476 (0.046)	0.550 (0.027)
<i>LEXP</i>	0.522 (0.138)		0.517 (0.032)			0.562 (0.021)	0.593 (0.065)	
<i>LINTR</i>		0.489 (0.244)		0.565 (0.068)	0.605 (0.05)			0.573 (0.196)
<i>INFL</i>	0.0006 (0.886)	0.0009 (0.849)	-0.0005 (0.914)	0.0001 (0.866)	0.0001 (0.886)	-0.0001 (0.883)	-0.0004 (0.596)	-0.0001 (0.822)
<i>Cluster Dummy</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>R2-adj</i>	0.36	0.34	0.47	0.46	0.46	0.475	0.513	0.485
<i>F-stat</i>	5.901**	5.53**	13.97**	13.326**	13.35**	14.1**	10.21**	9.224**
<i>Observations</i>	35	35	58	58	58	58	58	58

Source: Authors' own calculation.

Note: p-values in parentheses.

** statistically significant at the 0.01 level.

to the explanation of the cross-country variation of FDI inflows, beyond the control variables. The results, however, do not imply that institutional variables have no impact on FDI and that only market or internationalization matters. It would be more appropriate to test whether FDI decisions require simultaneous improvements in markets, internationalization and institutions. These simultaneous improvements were tested by adding interaction terms to the model. The interaction terms are the products of the *LGNI*, *LEXP* and *LINT* with the variable *CIVIL*. The corresponding results for *LPRESS*, *COR* and *POLIT* are not statistically significant and therefore they are not reported here.

Table 5 presents the estimation results of an alternative specification of the model. The synergetic effects are given by the *LGNI***CIVIL*, *LEXP***CIVIL* and *LINTR***CIVIL* interactive terms. The strong conclusion of these regressions is the role of *CIVIL* in support of *LGNI*, *LEXP* and *LINTR*, on FDI inflows.² The interpretation of these results is that, the better the civil rights level of a country, the more positive is the impact of an increase in per capita income on FDI. Thus, countries in our sample that have promoted economic growth would have attracted more FDI if this had been followed by reforms to improve civil rights.

These results, using different measures for institutional quality, verify previous findings in the literature. Quality institutions render a country attractive for TNCs beyond its market size, its productive endowments and internationalization. The countries in the sample have made significant progress, in terms of political stability, privatization, macroeconomic stabilization and the adoption of laws protecting property rights. However, this progress should be accompanied by improvements in civil rights. Countries that are distinguished by a more equitable system of rule of law, lower corruption and more freedom in economic activity achieved much better performance than countries that are characterized by significant deficiencies. Countries that suffer from limitations in economic activity either

² To check the robustness of the result we repeated the regressions for various specifications and methods (random effects, inclusion of quadratic terms, i.e. *CIV* squared, cluster dummies and country dummies).

by governmental institutions or non-governmental agencies (that is, the mafia, armed groups) exhibit the worst performance in attracting FDI.

Table 5. Synergetic effects of the interaction between LGNII, LEXP, LINTR and CIVIL: dependent variable LFDIC

Variable	(1)	(2)	(3)	(4)
<i>Constant</i>	-13.701 (0.003)	-17.824 (0.003)	-9.448 (0.064)	-13.424 (0.002)
<i>CIVIL</i>	0.500 (0.038)	0.431 (0.07)	0.0511 (0.887)	-0.818 (0.145)
<i>LGNII</i>	2.088 (0.000)	2.074 (0.000)	2.127 (0.000)	2.521 (0.000)
<i>LEXP</i>	0.468 (0.037)		-0.812 (0.322)	
<i>LINTR</i>		0.461 (0.101)		-0.480 (0.305)
<i>INFL</i>	0.0003 (0.722)	0.0004 (0.563)	-0.00003 (0.965)	0.00001 (0.983)
<i>LGNII*CIVIL</i>	-0.0001 (0.01)	-0.0001 (0.015)	-0.0001 (0.008)	-0.0205 (0.002)
<i>LEXP*CIVIL</i>			0.0127 (0.108)	
<i>LINTR*CIVIL</i>				1.005 (0.017)
<i>Cluster Dummy</i>	Yes	Yes	Yes	Yes
<i>R2-adj.</i>	52.7	51.2	54.2	55.5
<i>F-Statistic</i>	13.942**	13.170**	12.429 **	13.054**
<i>Nr. Obs</i>	58	58	58	58

Source: Authors' own calculation.

Note: p- values in parentheses.

** statistically significant at 1%.

Even though the data span is rather narrow (five years for each country), however, they are the most stable for our sample countries. Furthermore, taking into consideration previous findings in the literature, the findings of this article are an initial hint for policy orientation in these countries in order to catch up with their Western neighbours. Since good institutions guarantee property rights and minimize transaction costs they create an environment conducive to investment. Thus, the

application of policies that aim at the stabilization of the political and social environment and the implementation of an efficient judiciary and bureaucratic system will help these countries to increase FDI inflows. As FDI is a major integrative factor, the new members of the EU will integrate faster into the European economy. As far as the countries of the next wave of enlargement are concerned, the EU should focus not only on policies that will help these countries to improve their physical infrastructure, internationalization, privatization and macroeconomic stability, but also on policies to help them substantially to improve the quality of their institutions, and on creating an environment in which property rights and entrepreneurship are well protected. In this way these countries could be rendered more attractive to foreign firms and they would be enabled to improve their economic performance and to converge faster towards meeting the European standards.

Conclusions

This article, using a data set for a sample of economies in transition for the period 1997-2001, has verified empirically that market size and the internationalization of the host economy explain a significant part of the cross-country variation of FDI inflows. This is the strong point of the region, and in this respect it can be taken as advantageous. However, civil rights, which are related to investment decisions, strengthen these location advantages and also help a country to become a more attractive location for FDI.

The above discussion suggests that a great deal of groundwork, in terms of policy changes, is needed for the new and future members of the EU to increase substantially their share of FDI activity. If there is a role for the host country government, it surely lies in the creation of the necessary preconditions for FDI inflows. A significant component of this changed economic policy must be concerned with the development of political and civil institutions together with an efficient bureaucratic system. Emphasis should be given not only to the attraction of TNCs, e.g. by providing tax incentives, but

also “after entrance-care programmes” for foreign affiliates and this certainly would include the adoption of efficient institutions (Williams, 1997). In view of their expected EU membership, some of these countries could aim at creating a transparent legal environment (Barry, 2002) by adopting the EU institutional framework. The EU could also help its new members in this respect, especially those with lower quality institutions. On the other hand, the countries of the next wave should now start the process of development of quality institutions and the EU should support this process. ■

References

- Barry, F. (2002). “EU accession and prospective FDI flows to CEE countries: A view from Ireland”, (Dublin: University College Dublin), working paper, (August), mimeo.
- Brunetti, A., G. Kisunko, and B. Weder (1997). “Institutions in transition: Reliability of rules and economic performance in former socialist countries”, (Washington, D.C.: World Bank), *Working Paper*, No. 1809, mimeo.
- Dunning, J. (1993). *Multinational Enterprises and the Global Economy* (Berkshire: Addison Wesley).
- Ekholm, K. and J.R. Markusen (2002). “Foreign direct investment and EU-CEE integration”, (Copenhagen: Centre for Economic and Business Research), *CEBR, Working Paper*, (May), mimeo.
- Freedom House (2002a). *Press Freedom Worldwide*, www.freedomhouse.org/.
- Freedom House (2002b). *Annual Survey of Freedom Country Scores*, www.freedomhouse.org/.
- Glaister, K.W. and H. Atanasova (1998). “Foreign direct investment in Bulgaria: patterns and prospects”, *European Business Review*, 98 (2), pp. 122-134.
- Griffiths, W.E., R.C. Hill, and G.G. Judge (1993). *Learning and Practicing Econometrics* (New York: John Wiley and Sons).

-
- Grogan, L. and L. Moers (2001). "Growth empirics with institutional measures for transition economies", *Economic Systems*, 25, pp. 323-344.
- International Monetary Fund (2003). *World Economic Outlook* (Washington D.C.: IMF).
- Mauro, P. (1995). "Corruption and growth", *Quarterly Journal of Economics*, 110 (3), pp. 681-712.
- Pournarakis, M. (2001). "Development integration and FDI in the Balkans", Paper presented at the International Conference on Current Issues for Transition Economies in the Broad Balkan Region, Xanthi (December), mimeo.
- Rodrik, D. and A. Subramanian (2003). "The primacy of institutions", *Finance and Development*, 40 (2), pp. 31-35.
- Sengenberger, W. (2002). "Foreign direct investment, industrial restructuring and local labour markets in the transition economies of Central and Eastern Europe: issues for debate", (Geneva: United Nations Economic Commission for Europe), (May), mimeo.
- Tondel, L. (2001). "Foreign direct investment during transition: determinants and patterns in Central and Eastern Europe and the former Soviet Union", (City: Chr. Michelsen Institute), *working paper* No. 2001:9, mimeo.
- Transparency International (2002). "Transparency International Corruption Perception Index", www.transparency.org/.
- Tuselmann, H.J. (1999). "German direct foreign investment in Central and Eastern Europe: relocation of German industry?" *European Business Review*, 99 (6), pp. 359-367.
- United Nations Conference on Trade and Development (UNCTAD) (1999) "World Investment Report 1999", *Transnational Corporations*, 8 (3), pp. 55-100.
- _____ (UNCTAD) (2001) "World Investment Report 2001", *Transnational Corporations*, 11 (1), pp. 77-111.
- Zinnes, C., Y. Eilat and J. Sachs (2001). "The gains from privatization in transition economies: is "change of ownership" enough?" *International Monetary Fund Staff Papers*, 48 (Special Issue), pp. 146-170.

-
- Te Velde, Willem D. (2001). "Policies towards foreign direct investment in developing countries: emerging best-practices and outstanding issues", (London: ODI), *working paper* (March), mimeo.
- Williams, D. (1997). "Strategies of multinational enterprises and the development of the Central and Eastern European economies", *European Business Review*, 97 (3), pp. 134-138.
- World Bank (2001). *World Development Report 2000/2001: Attacking Poverty* (New York: Oxford University Press).

REVIEW ARTICLE

Globalization reviewed

John H. Dunning*

Globalization in Historical Perspective

Michael D. Bordo, Alan M. Taylor and Jeffrey G. Williamson, eds.
(Chicago, University of Chicago Press, 2003), ix+588 pages

Challenges to Globalization: Analysing the Economics

R.E. Baldwin and L. Alan Winters, eds.
(Chicago, University of Chicago Press, 2004), 544 pages

*Global Governance: An Architecture for the World
Economy*

H. Siebert, ed.
(Berlin and New York, Springer, 2003), 276 pages

As one who has had a lifelong interest on this subject, I was looking forward to reading these three books on globalization. Their specific themes – an historical perspective, an economic appraisal and the governance of the global economy – were ones I was eager to know more about. For reasons that will become clearer as this review article proceeds, and notwithstanding some excellent individual contributions, my intellectual appetite was only partially satisfied; indeed, in the case of two of the three volumes, I was disappointed and frustrated by the tunnel vision and limited analytical perspective taken by the editors.

* Emeritus Esmee Fairbairn Professor of International Investment and Business Studies, University of Reading, United Kingdom and Emeritus State of New Jersey Professor of International Business, Rutgers University, United States.

Let me start my comments by identifying a number of general characteristics of the three volumes, which, for shorthand purposes, I shall refer to as the *history*, *economics* and *governance* volumes. The first characteristic is that the contents of each contain the results of academic seminars held in 2001 and 2002. Two of these events were organized by the National Bureau of Economic Research (NBER), and the third by the Kiel Institute of Economics. In all, the volumes contain 35 chapters, spanning 1,400 pages. Each of the editors and about two-thirds of the contributors are economists, the balance economic historians, political scientists and legal specialists.

Second, each of the volumes also contains comments from a broader church of specialists, including representatives from the business community, international agencies and civil society. In the case of the NBER seminars, about 55% of the participants were from the United States and the rest mainly from Europe; the corresponding percentage for the Kiel seminar was 50%. Finally, the majority of economists contributing to each of the seminars were specialists in trade, finance and development. Only Richard Lipsey, James Markusen, Gary Hufbauer and Anthony Venables had previously contributed to our understanding of foreign direct investment (FDI) and transnational corporations (TNCs). Interestingly, no international business scholar was a contributor to the three volumes.

Third, broadly speaking, each volume takes a neo-classical economics approach to its subject matter. To their credit, each author presents his or her views cogently and rigorously, and most either eschew anecdotal evidence and casual empiricism about causes and effects of globalization, or are highly critical of them. Where possible, the contributors use well-versed quantitative techniques to back up their propositions and theories.

However, with few exceptions – noticeably in the introduction to the *governance* volume and the *economics* volume – little attention is paid to the role of institutions and institutional capabilities as they affect the pattern, causes or

effects of globalization. Questions such as incentive structures and enforcement mechanisms are generally ignored or regarded as of secondary importance. Almost all the contents of the *history* volume are directed to the ways in which the widening spatial distribution of economic activity has affected the workings of cross-border markets – and mainly arms length markets at that! Very little attention is given to the changing role of non-market actors in affecting the course and content of globalization. There is also little attempt to treat globalization as a systemic phenomenon.

But most of all, I was surprised that so few contributions adequately acknowledged the importance of FDI in the current globalization debate. Admittedly in the *economics* volume, chapters by Robert Lipsey on the home and host country effects of FDI, by Drusilla Brown, Alan Deardoff and Robert Stern on the impact of transnational production on wages and conditions in the developing countries, and by David Carr, James Markusen and Keith Maskus on competition for FDI in developing countries, tackle some of the costs and benefits of transnationalization. But in the *history* volume, there is virtually no attention given to FDI (it is not even mentioned in the index!) while only Peter Lindert and Jeffrey Williamson touch on the interaction between TNCs and the global inequality of income. How any volume that purports to describe and evaluate globalization from an historical perspective can (completely) overlook or ignore the seminal contributions of Mira Wilkins to our understanding on international business history, I do not know!

But perhaps I do – or at least a clue to the approach of the *history* volume is in the interpretation of the term, “globalization”. In their introduction, Michael Bordo, Alan Taylor and Jeffrey Williamson ask the question “What do economists mean by the term globalization?” Their answer: “Typically their agenda is defined by between country integration in three markets” (p. 1). Then, they go on to identify *commodity*, *labour* and *capital* markets and to examine, in subsequent chapters, the implications of the increasing transnationalization of these markets and its reasons and effects. At the same time, no mention is made of *extra* market modalities

of cross-border commerce, by notably TNCs internalizing such markets, nor of the role of national governments and international agencies affecting the spatial allocation of economic activity.

I must admit that the relatively scant attention given to TNCs and FDI – and, for that matter, cross-border non-equity alliances – by mainstream economists over the past two decades has consistently puzzled me. It somehow does not square with the fact that, in 2002, for example, the value of sales of companies accounted for by their foreign affiliates was twice that of exports (UNCTAD, 2003, p. 3); or that, over the period 1980 to 2002, the significance of the world's combined inward and outward FDI stock to its gross national product rose on average from 13% to 44% (UNCTAD, 2003, p. 278). Could it be that, apart from some notable exceptions such as Keith Maskus and James Markusen, international economists *still* regard the firm as a black box and, by so doing, pay little heed to firm specific and institutional variables affecting the allocation of scarce resources and capabilities?

Another search through the index of the three volumes reveals that, out of several hundred references, the Nobel Laureate Douglass North is mentioned only three times. Two other Laureates – Joseph Stiglitz and Amartya Sen, who have done so much to incorporate ideologies and values into the objectives and strategies of economic decision makers – fare only slightly better. Stiglitz is cited once in the *history* volume, twice in the *economics* volume and twice in the *governance* volume; the corresponding references for Sen are zero, four and zero.

Even more to my surprise (indeed consternation!) the work of UNCTAD – most certainly the leading international organization regularly producing facts about and analyzing the determinants and the impact of TNCs in the world economy – is given short shrift in the *economics* volume (except in the Lipsey and Everett chapters) and completely ignored in the other two volumes. The absence of any explicit acknowledgement of UNCTAD by authors in the *governance* volume is particularly

surprising as the annual *World Investment Report* and most contributions to the triannual journal *Transnational Corporations* have always paid special attention to the ways in which the interface between TNC activity and the policies of national regimes and the role of supranational entities can be made more productive and socially acceptable. Could it be that the contributors regard the publications of UNCTAD as simply assembling and reinterpreting the work of others? If so they cannot have studied them very carefully!

Earlier in this review, I identified the somewhat narrow interpretation of globalization taken by the *history* volume. The same criticism cannot be directed to the other two books. Indeed both are keen to identify both the actual and the perceived upsides and downsides of globalization. In their introductory chapter to the *economics* volume, Kimberly Ann Elliott, Debayani Kar and J. David Richardson set out well the key concerns of the critics of globalization and urge economists to embrace more fully these in their model building and empirical research. Examples include issues relating to public “goods” or “bads”, values, education, corporate social responsibility and institutions. While I was heartened that several authors in the *economics* volume recognized the increasing role of non-governmental organizations in influencing attitudes towards, and behaviour as a result of, globalization, I was disappointed that, apart from a useful general discussion on the role of international economic institutions by Elliott, Kar and Richardson in the *economics* volume, so little attention was given to the kind of international policy options identified by Stiglitz in his recent volume (Stiglitz, 2002).¹

As might be expected from its title, the *governance* volume does its best to address these issues. It too starts off (in this case with excellent and sympathetic chapters by Horst Siebert and

¹ In this volume, Stiglitz offers some trenchant criticisms of the recent roles of the World Bank and the International Monetary Fund (IMF) in helping to make the forces of globalization less volatile, more inclusive and socially acceptable. Much of his disquiet arises from the influence which he perceived (his interpretation of) the Washington Consensus as still having on the workings of the IMF.

Jagdish Bhagwati) with an analysis of how economists might best respond to the anti-globalization movement. Bhagwati, in particular, in a section entitled “Why globalisation is socially benign, but good is not good enough”, acknowledges the need to make better use of dialogue and moral suasion to emphasize the social benefits of globalization. Like other contributors – and this reviewer – he ardently believes that responsible globalization is part of the solution, and not the problem, of many of the world’s economic ills.

There are several other good chapters in the *governance* book. Ann Florini emphasizes the importance of the need to give voice to, and respect, the views of civil society. In particular, she emphasizes that the critical issue at stake is not *whether* civil society groups should be participating in the debate but *how*. Sylvia Ostry, in her usual incisive way, suggests ways in which the governance of the World Trade Organization might be improved to meet new challenges of enlarged membership and new issues, e.g. FDI and intellectual property rights. Barry Eichengreen (who also has a chapter in the *history* volume) argues that the best way to limit global financial crises is to increase transparency on the part of the lenders and borrowers, and for international financial organizations to be reformed. (Surprisingly, however, he offers no comment on the merits (and demerits) of the Tobin tax.) Other contributions include those that examine the links between globalization and environment, problems of how national governments may best retain their fiscal manoeuvrability in an era of global competition, and on the institutional challenges facing host governments in developing countries if these are to provide the public services needed for economic restructuring.

In several places, and in each of the three volumes, I felt that globalization was being used to describe sometimes the global market place, sometimes global capitalism and sometimes as a generic term to describe the extent and depth of connectivity between economic agents across national boundaries. In my own book, *Global Capitalism at Bay?* (Dunning, 2001), I tried to distinguish between these terms, as their implications and the policy responses to them are likely to be very different. Certainly

this distinction could, I think, have been more clearly made in the *history* and *economics* volumes. More specifically, I think each of the volumes would have been much improved had they more specifically addressed issues arising from the globalizing of national capitalist systems and of how the gains from integrating markets, information flows and business decisions need to be reconciled with the demands of cultural differences and subsidiarity, both at a country and a firm levels.

Although – as will have been seen – I have several qualms about the content and methodology of these publications, and particularly the lack of acknowledgement afforded to international business scholars, who have done so much to advance our understanding about the cross-border operations of firms and their interactions with governments,² I believe that readers of *Transnational Corporations* will gain many new insights from a close study of these volumes. In particular, the chapters entitled “Globalization in history: a geographical chapter”, and a panel discussion on “Globalization in interdisciplinary perspective” in the *history* book, and those already referred to in the *economics* and *governance* books will, I think, particularly appeal to those interested in the policy responses to FDI and TNC activity.

Finally, occasionally, we are given some glimpses into the future. Gary Hufbauer’s chapter in the *governance* volume, “Looking 30 years ahead in global governance” sets out an imaginative and, I believe, realistic vision of the future economic and political scenario facing all stakeholders in the globalization process. In particular, he foresees a growing attention being paid to security issues, global warming, poverty, oil and culture, financial crises and trade and investment. He envisages a revitalization of several international organizations and the growing power of what he terms super-regional trade

² To give just one figure: there are 2,800 members of the Academy of International Business who have produced tens of books and hundreds of articles on the issues discussed in these three books over the past decade. Yet there are only eight references to four of these scholars in the whole of the three volumes.

arrangements, including one centred on China. Indeed, he concludes that the relationship between China and the United States could well set the global stage in which the extent, character and effects of cross-border commercial transactions will operate in 30 years time.

Finally, in his comments on Hufbauer's chapter, Robert Lawrence argues for a broader conception of global governance to incorporate international civil society. His concluding words are worth repeating and as they are ones that most readers of *Transnational Corporations* would surely endorse:

“In sum therefore, in my view the most important item on the agenda for global governance is aligning the mission, means and legitimacy of international organisations in a world in which international governance has become increasingly complex because the central players are no longer organized neatly within the border of national states” (p. 274).

Has this not been the scenario – have these not been the issues – that UNCTAD (and the UNCTC before it) and, indeed, the scholars of international business, have been actively addressing for the past two decades?

References

- Dunning, John H. (2001). *Global Capitalism at Bay?* (London and New York: Routledge).
- Stiglitz, Joseph E. (2002). *Globalization and Its Discontents* (London and New York: W.W. Norton).
- United Nations Conference on Trade and Development (UNCTAD) (2003). *World Investment Report 2003. FDI Policies for Development: National and International Perspectives* (New York and Geneva: United Nations), United Nations publication, Sales No. E.03.II.D.8.

BOOK REVIEWS

*Parental Supervision: The New Paradigm for Foreign
Direct Investment and Development*

Theodore H. Moran

(Washington, D.C.: Institute for International Economics,
2001), 88 pages

Theodore Moran's short, but well-researched and written book, *Parental Supervision*, is an interesting and valuable exercise in rhetoric. His main purpose is to show that affiliates in developing countries that are tightly integrated into the parent firm's strategy and operations are most likely to benefit the host economy through up-to-date knowledge transfer to the affiliate, linkages with local suppliers, positive spillovers and other externalities. The main underlying reason is that transnational corporations (TNCs) engaged in fierce international competition must, perforce, ensure that all parts of their global operations are efficient, which encourages, for example, ongoing transfer of technology to host country affiliates and a tight supervision of suppliers' quality, delivery and other aspects of performance. The argument is based on substantial empirical evidence, drawing on studies from across the world, especially in the automotive and computer/electronics sectors (which is reasonable since these industries are among the most internationalized and, potentially, major harbingers of knowledge transfer and broader development). Based on this evidence, Moran makes a very important case for measuring the impact of foreign direct investment (FDI) on development in a careful and appropriate manner.

His examination of the evidence shows that many previous studies do not, for instance, properly distinguish various forms of ownership (for example, joint venture versus wholly owned affiliates, with the latter presumably being more tightly linked with the parent firm) or the directions of potential spillover

(horizontal versus vertical integration, with TNCs being less likely to prevent technology leakage in the latter). Such studies tend to understate the positive impact of FDI on development. Various policy implications for governments flow from this.

However, rhetoric – even excellent, empirically based rhetoric such as this – can lead to a case being overstated or, perhaps, not being nuanced. This is the case here. Moran is right to stress the need for appropriate measures, especially regarding the degree of an affiliate’s integration into a parent’s strategy, but by the same token there are other control factors to consider. In terms of ownership, for example, a joint venture might arise because the affiliate is local-market orientated (not because of government requirements, which Moran decries), and the possible subsequent lower transfer of technology (because of goods being made for “less sophisticated” developing country markets) would thus be fully in line with the parent company’s strategy. At the same time, there are examples – from the Republic of Korea, Singapore and elsewhere – of joint ventures playing a valuable role in development as part of an industrial policy. It is telling that the best evidence available to Moran on the impact of efficiency spillovers comes from studies in two *developed* countries, Germany and the United Kingdom. This reflects the paucity of relevant studies in developing countries (making it difficult to draw definitive conclusions), but it also reflects the nature of such economies. In particular, rapid, large gains from FDI are undoubtedly dependent on the existing capabilities of host-country companies: these might be reasonably expected in developed countries, but are often weak or absent in developing countries. As a result, it is not unusual for supplier linkages, for instance, to be made with affiliates of other foreign TNCs, with little impact on local suppliers. This is contrary to Moran’s expectations, based on the book’s arguments, but it results from his ignoring of other evidence and, in particular, of the possibility that careful and selective government policies (including the creation of local capabilities through joint ventures and other measures) can potentially accelerate the benefits that an economy might enjoy from FDI.

This being said, of course there is considerable truth in Moran's arguments. But all truth is contingent on context, circumstances and goals (of companies and countries), especially in a dynamic and complex world. Moran makes a good case for the benefits which can flow from FDI where a *wholly owned* affiliate is tightly integrated into a parent's *global market* strategy; however, this is not a sufficient condition and it is a mistake to imply that all other types of FDI are hindered in terms of their contribution to economic development.

Hafiz Mirza

Professor of International Business
Bradford University School of Management
Bradford, United Kingdom

***Globalisation? Internationalisation and Monopoly
Capitalism: Historical Processes and Monopoly Capitalism***

Bob Milward

(Cheltenham and Northampton, MA, Edward Elgar, 2003),
viii + 198 pages

In a world in which the trend is for academics to research deeper and deeper into smaller and smaller aspects of the world, this is a book that unusually adopts a broad, sweeping approach to a range of issues that ultimately shed light on key dilemmas facing humanity such as poverty, development and globalization. In less than two hundred pages, the author rejects globalist and internationalist positions as explanations of contemporary developments in the world economy and offers an alternative Marxian framework of analysis as a way of rationalizing the world's economic, social and political problems. He does this both from a theoretical perspective and by examining a number of factors that figure prominently in what has conventionally become known as "globalization" but which the author would regard as simply another phase in capitalist development. It is this broad sweep that is both a strength and weakness of the book.

The book benefits from a clear structure. The first three substantive chapters are key and set out the author's stance on conventional explanations of globalization and establish his own position. Later chapters examine key related individual facets of globalization from within his preferred explanatory framework.

The first substantive chapter is a critique, and ultimately rejection, of the neo-liberal paradigm that underpins explanations of increasing global interconnectedness. The author acknowledges that globalization has a diversity of meanings but argues that it has essentially become "a synonym for the idea that we live in a world in which certain forces cannot, and should not, be restrained or questioned" (p. 10) and is dominated by the idea

of free market economies, free trade and western style democracies. A distinction is made between “weak” and “strong” globalization that depends on the extent to which the nation state retains influence over trade, production and financial markets but, ultimately, in the author’s terms, what unites the globalists is far more important. The author argues that globalization is not really global, that it relies erroneously on variations of the argument that there is no alternative to globalization and that factors of production are not truly mobile given the relatively immobility of labour. None of these arguments on their own, or even together, necessarily invalidate the notion of globalization, they merely make it more complex and highly nuanced. Indeed, in trying to dispense with the neo-liberal paradigm within fourteen pages, the author is in danger of setting up a straw man that can easily be knocked down and would not necessarily be recognized by those engaged in debates over the concept.

However, for the author, the argument that really exposes the flaw in the neo-liberal case is the paradox surrounding competition that, according to the neo-liberals, underpins markets, leading to greater efficiency. However, from the monopoly capitalist perspective, as capitalism develops, economies of scale lead to bigger and bigger enterprises that cover wider geographical areas. The survival instinct under this intense competition results in mergers, acquisitions and a tendency towards monopolization rather than competition. This tendency to monopolization forms a key component in the author’s alternative explanatory framework for developments in the world economy.

The second substantive chapter explores the internationalization thesis that argues that globalization is not new and that the interdependence talked of by globalists is nowhere near as developed as claimed. Transnational corporations (TNCs) remain rooted in the advanced economies and the movement towards freer trade has resulted in regionalism, not necessarily a precursor to greater openness. However, for the author, the internationalization perspective retains the underpinning of the neo-liberal paradigm with the

difference that it tends to be supported by the social democratic view that the excesses of unfettered markets can be restrained to provide improvements in living standards for all. According to the author, this overlooks the inevitable widening of inequality and the increase of impoverishment arising from the capitalist mode of production.

Having rejected both globalization and internationalization, the author offers his own perspective in the third substantive chapter. Essentially, he turns to ideas of monopoly capitalism to provide “a more credible theoretical framework, one that has greater potential for explaining the empirical facts and ... how the internationalization of the relations of production is logically the outcome of the inner workings of the capitalist system” (p. 37). The core of the argument is that the “dynamic nature of the capitalist mode of production itself produces the need for competitive firms to expand markets and to find more labour to exploit” (p. 37).

Intrinsic in this view is the labour theory of value in which it is labour that creates the added value within the production process. However, capitalists see it in their interest to maintain a large surplus of labour, perhaps by new forms of technology and organization, to keep the cost of labour (that is, wages) down. Inherent in this is one of the contradictions of the capitalist process: large armies of unemployed labour help capitalists retain the upper hand in the labour-capital power relationship but they are unable to make a profit out of the surplus value created by labour as low wages mean there is insufficient demand for the product. Welfare systems can offset this problem for a while but not indefinitely. The continuous search for profit results in increasing merger and concentration, initially at a national level and then internationally first through imperialism and colonialism and then through imperialism via the TNCs rather than by the State – a condition that represents the current state of play. However, in the long term, capitalism will destroy itself because the contradictions and problems inherent at national level will manifest themselves in an increasingly serious series of international crises.

Having established where his own theoretical preference lies, the author then embarks upon a series of short chapters that examine important factors in the current globalization debate from within a Marxian framework and the perspective of monopoly capitalism. These chapters cover global finance, industry, culture, labour, welfare states, trade, development and underdevelopment, regulation and regionalism. These chapters raise many interesting issues and provide food for thought but in many respects they are also unsatisfactory. In the process of covering so much material in an extremely short space, the author has inevitably had to condense and simplify arguments. In one sense, this has been done very well. The author has explained issues and developed his critique with a great deal of clarity. However, there is also an element of oversimplification that inevitably reduces the effectiveness of the author's own case. The author has declared the need for a theory that better explains empirical facts. However, for example, in his zeal to explain what he views as the inevitable exploitation of workers as capitalists search for lower-cost workers to exploit, he fails to explain why wages often increase in places where transnational corporations are active.

The development chapter similarly mentions the role of developmental States in East Asia (a model that certainly rejects the notion of pure neo-liberalism). However, these States still represent essentially capitalist systems of production and, albeit not in their early stages of development, did seek to make progress through increasing engagement with the international system, and their populations have seen their living standards improve as a result. The author's preferred Marxian framework will have an explanation for this phenomenon but the inevitable simplification of the arguments required by the sweeping scale of the book often do not lend themselves to convincing the reader of the strength of the author's case.

Notwithstanding these caveats, the author is to be commended for covering such a wide range of issues and for putting forward a consistent perspective that provides an alternative to the many shades of neo-liberalism and

internationalism that dominate these debates. He has attempted an almost impossible task in covering so many, albeit related, issues within such a tight space and, although far from totally convincing in his advocacy of monopoly capitalism as the prime explanation of what he sees as an essentially unharmonious and conflict-ridden world, he is thought-provoking. The book is a welcome and useful addition to the growing mountain of literature on globalization.

Debra Johnson
Hull University Business School
Hull, United Kingdom

***Holding Corporations Accountable: Corporate Conduct,
International Codes and Citizen Action***

Judith Richter

(London and New York, Zed Books, 2001), xii+241 pages

This book approaches the controversial subject of global governance and the regulation of transnational corporations (TNCs). It argues in favour of a shift from global governance to democratic control, and contributes to the debate by stating precise ways of achieving this aim. Judith Richter, a sociologist specializing in international development, uses the case of the infant nutrition industry as an illustration of the evolution of relationships between regulators, civil society and corporations. The author's analysis focuses on the two main actors of this power struggle: the private sector and associations of citizens.

The first two chapters set the scene by providing a historical overview of the evolution of TNCs' regulation. In particular, the author highlights the shift from the idea of democratic control of corporations to the notion of co-regulation by industry and other societal actors. Globalization and the economic and political changes of the past 30 years have created the need for new means of holding corporations accountable to society at a global level. The author explains how the initial attempts to control businesses through international binding regulation in the 1970s failed because of a strong political opposition, based on neo-liberal economic theories, which view interventionist policies as stifling trade and investment, and eventually reducing global welfare. The early 1990s have seen the growing consensus that companies would behave in a more responsible manner if left to regulate themselves through guidelines, standards of good practice and other voluntary initiatives.

In the late 1990s, however, the collapse of the Mexican economy and the Asian crisis convinced the international community, as well as TNCs, that a wholly unregulated global

market could have negative impacts on society and corporations alike. Businesses turned to the United Nations, asking for better regulations for improving the predictability of the business environment, while still minimizing interference with the ability of companies to maximize shareholder value. The author argues that this resulted in the creation of numerous public-private partnerships, whereby the private sector kept a certain level of control over the formulation of regulations of corporate activity.

Today, the consensus is that the problem of checks and balances on the market is an issue of good governance rather than that of democratic control. However, civil society organizations and some United Nations agencies continue to demand regulations that are independent from the industry. The United Nations Development Programme, for example, advocates the establishment of a more coherent and democratic architecture for global governance that would include a binding code of conduct for transnational corporations.

The following five chapters are devoted to a comprehensive and detailed account of the development of regulations of the infant food industry's marketing practices, from the moment manufacturers came under international criticism in the 1970s, to the current implementation of the International Code of Marketing of Breast-milk Substitutes. The book analyses the role played by the industry in the process undertaken by intergovernmental organizations to develop, adopt and implement an international code of conduct regulating marketing practices. It highlights the industry's initial resistance to initiatives taken by health professionals, citizen action groups and United Nations agencies, and the influence of campaigns raising public awareness in the decision of corporations to take the issue seriously. It also shows how the consequent actions taken by the industry resulted in the formulation of an International Code of Marketing of Breast-milk Substitutes, which is a mix of external regulation and co-regulation. It indicates that, under industry pressure, the code evolved from a tightly worded text into a code open to interpretation, and that it was adopted by the World Health Assembly in 1981 as a

“recommendation”, the weakest of the three legal forms allowed under the World Health Organization’s constitution.

The book goes on to explain how the implementation of the Code at national level was uneven and in some cases non-existent. The author argues that this is due to legacies of the process of code formulation and adoption, to the industry dissemination of its own interpretations of it, and more generally to a change in the international political climate concerning transnational corporations’ regulation. To date, 21 countries have enacted national laws based on the entirety of the Code. In some cases, political will and support from United Nations agencies and civil society groups have helped overcome obstacles to the implementation of the Code. Linking this initiative to the Convention on the Rights of the Child also helped in doing so, but still there are reported cases of harmful marketing activities on the part of the infant food industry.

The International Code of Marketing of Breast-milk Substitutes is one of the few codes envisaged in the 1970s that were eventually adopted. The author argues that the analysis of the process of its formulation, adoption and implementation raises issues that are relevant to the current debate on the regulation of TNCs. For example, it shows the gap existing between industry statements of corporate responsibility and actual practices, and puts in perspective the comparative powers of civil society organizations and those of business associations. It also shows how corporations influence legislation and political processes through newly developed public relations tools – specifically, international issue management and engineering of consent – and how dialogues and public-private partnerships can be used to further corporate interests.

The final chapter of the book draws the lessons learnt from this case, and argues that they should be taken into account in any attempt to increase corporations’ accountability towards society. First, it argues that self-regulation and co-regulation are insufficient provisions for ensuring that corporations take a comprehensive approach to social concerns. The reason for this

lies in the inability of industry associations to determine and to implement effective self-regulation: policies might interfere with profit maximization; industry associations are not always representative of all companies in their sectors and do not have power to police their members; and the determination of acceptable standards of risk for society is a political decision. A second lesson to be drawn from the case of breast-milk substitutes is that the regulated party should not play any a part in the formulation of regulation, nor in the monitoring and sanctioning of its implementation. The assessment of what is best for society should remain exclusively as a political process, and should not be brought into balance with the interests of corporations.

The third and final lesson concerns the balance of powers between TNCs and governments, particularly those of the poorest countries. These governments need support from the United Nations and other international agencies, and public interest networks in order to be able to implement and enforce strong regulations. A good knowledge and understanding of corporate power is necessary to determine the appropriate support. The author outlines strategies to be explored in the way of making corporations more accountable to society.

This book should be read by anyone who is not yet familiar with the history and current mechanisms of TNCs' regulation. It gives a comprehensive and easily readable overview of the concepts and institutions involved in this debate and describes in a clear manner its actors, their interests and power resources. The use of the case study on the infant food industry's marketing practices gives a context to the discussion and grounds it into reality. The particular interest of this book lies not only in the quality of its analysis of the balance of powers between the various societal actors and the arguments for and against external binding regulation, but also in the fact that the analysis is supported by concrete proposals for the ways and means of making corporations more accountable to society. These include, for example, relaunching the debate on political antitrust legislation at the international level in order to restore the

balance of power between TNCs and governments. The author also recommends recognizing the need of corporations for social legitimacy at the global level, and offsetting the ability of corporations to engineer consent. A United Nations Centre on Transnational Corporations should be re-established to provide public insights into the practices and structures of large corporations. Another recommendation made is to reassess the value of public-private partnerships and to set ethical baselines for such partnerships where there are conflicts of interest. Finally, the author recommends the strengthening of civil society organizations in their monitoring and whistle-blowing activities, and the use by United Nations agencies, national authorities and moderate civil society groups of the mechanism of naming and shaming, thus avoiding the “radicalism” stigma currently attached to groups using this method.

Gwenael Quéré
Economic Affairs Officer
United Nations Conference on Trade and Development
Geneva, Switzerland

Selling China: Foreign Direct Investment during the Reform Era

Yasheng Huang

(Cambridge and New York, Cambridge University Press, 2003), 383 pages

For many observers, the reason that China has become the new centre of global foreign direct investment (FDI) flows is essentially due to its large fast-growing domestic economy and its progressively opening markets. Yet, Yasheng Huang provides an alternative explanation for this development by provocatively arguing that it is fundamental institutional weakness in China that has really underpinned the large inflows of foreign capital in recent years.

In his intellectually stimulating book, *Selling China: Foreign Direct Investment during the Reform Era*, Huang states that it is the uncompetitiveness of Chinese domestic firms resulting from “political pecking” and market fragmentation that has paved the way for foreign firms to invest heavily in China. Domestic firms have failed to capitalize on new business opportunities because of the legacy of the economic planning system and administrative barriers to capital mobility, thus enticing foreign firms to move in to capture growing markets. State ownership underlies both “political pecking” and market fragmentation as it constrains market-based investment decisions and free movement of capital by domestic firms. Establishing joint ventures with foreign companies becomes a way of gaining economic freedom and management know-how. In this sense, the phrase “selling China” is appropriate, as many Chinese assets in the form of land, plant, franchise and brand are sold out as inputs of newly established foreign affiliates.

To support his assertion, Huang provides detailed evidence on the nature and structure of FDI in China. He starts by describing a number of anomalous patterns of FDI in China: (1)

an unusually high dependency on FDI relative to domestic investment and contractual alternatives; (2) a sharp rise in FDI inflows combined with a dramatic contraction of contractual alliances; (3) the dominance of foreign affiliates in the production and exporting of labour-intensive industries; (4) the presence of small-scale foreign investors. Then he proceeds to conduct an institutional analysis to provide explanations for these anomalies after introducing his analytical framework in chapter 2.

In chapter 3, the author sets the stage for a detailed analysis of FDI in China by describing the institution-driven inefficiency of Chinese corporate sectors. Chapters 4 and 5 demonstrate the contrast in the motivations for attracting FDI between non-state firms and state-owned enterprises. For the former, it is largely due to the capital constraint that non-state firms face and market expansion considerations. For the latter, it is an alternative way of securing privatization by transferring existing assets and management control to foreign investors. In an overall common context, in line with the Government's discrimination against domestic private firms and insolvent state-owned enterprises, Chinese authorities have resorted to FDI as a means of privatizing state-owned enterprises. In chapter 6, Huang shows how market fragmentation associated with administrative decentralization raises the demand for FDI, which facilitates capital mobility across regions, to fill unsatisfied needs for capital. Again, it is a lack of an adequate number of effective domestic private firms that induces FDI to play a major role in this area.

The author also argues that, precisely because of the unique nature of investment flows to China, FDI has provided many of the functions required for privatization. These functions include provisions of venture capital to credit-constrained private entrepreneurs, and the promotion of interregional capital mobility. The author further argues that domestic firms should be able to supply these functions and advocates that China should rethink its overall reform strategies.

Both of these assessments are particularly valid given the sharp contrast in efficiency between foreign affiliates and domestic firms: in 2002, FDI accounted for only one-tenth of China's gross fixed capital formation. However, foreign affiliates contributed to one-third of the industrial output, one-quarter of the value added, more than a half of the exports and nearly three-quarters of the foreign-exchange balances held in the Chinese banks by business corporations. Foreign affiliates also generated nearly one-fifth of the total tax revenues and 23.5 million jobs, employing about one-tenth of the urban workers (National Bureau of Statistics of China, 2003). These numbers reveal that foreign affiliates are highly efficient and contribute greatly to the Chinese economy. The state-owned enterprises and domestic private firms cannot compete with foreign affiliates in many manufacturing industries. As entry barriers are further reduced in the services sector, foreign affiliates will play an even more dominant role in the Chinese economy. How to encourage stronger development of domestic entrepreneurship has thus become a strategic issue in order to sustain the rapid growth of the Chinese economy.

Like many other good writers, the author raises issues in the book that deserve further critical consideration. Among them are the balance between economic factors and institutional factors in explaining large amounts of FDI inflows, and formulation of effective development policies for encouraging both foreign investment and domestic private investment.

It is true that the institutional factors elaborated by Huang are critical in understanding the *pulling elements* of FDI in China (that is, factors that attract investment), a transition economy characterized by a pervasive inertia of the traditional planning system and by regional development gaps. At the same time, as the assessments of investment opportunities into China are made by transnational corporations (TNCs), we also need to take account of the *pushing elements* of FDI in China (that is, motives of TNCs for choosing China). As granting preferential treatments to TNCs is common in many developing countries, especially economies in transition, why have so many TNCs chosen to go

to China rather than to other countries? There must be some features distinguishing China from other economies in pushing TNCs to invest in China. As widely understood, these seem to be a combination of the large size of the Chinese economy with the fast GDP growth and the progressive opening-up of domestic markets. It is essential to integrate both economic factors and institutional factors in interpreting the FDI legends in China. As institutional barriers are gradually phased out, it becomes more important to define the respective locational advantages of the Chinese economy in attracting different kinds of foreign investment.

The institutional deficiencies in the Chinese economy have led to corporate inefficiency and preferential treatment extended to foreign investors. As the author rightly points out, China chose to rely heavily on FDI for its privatization process. It was perhaps a necessary or unavoidable option, given the political and economic constraints that the Government of China and the state-owned enterprises faced in the 1980s and 1990s. Due to the preferential treatment given to foreign affiliates, however, this has produced distortions in the economy over time. The use of FDI as a financing source for privatization or interregional capital mobility is not a problem *per se*. The issue is the distortionary effects of preferential policies on domestic firms and less-favoured regions.

The further development of the Chinese economy demands a rule-based open competitive market environment for all firms, domestic and foreign alike. As China progressively complies with its World Trade Organization commitments further to open up its markets, it is important to remove preferential treatments for foreign investors so that domestic entrepreneurs can compete on an equal basis. It is, therefore, desirable that China should adopt a strategy that allows removal of distortions created by FDI and a reduction of its reliance on foreign affiliates for stimulating economic growth. At the same time, China needs to complement this “*FDI exit strategy*” with an active “*domestic investment promotion strategy*”, broadening the market entry opportunities for domestic non-state-owned enterprises and improving their market environment.

If the goals in attracting FDI are to introduce advanced technology, to improve management and to expand overseas markets, a direct measurement of success in attaining these goals will be the following results: more and more spin-offs of foreign affiliates prove capable of competing with existing foreign affiliates and further expansion in the global markets realized. Perhaps the author can enlighten us on these issues in his future research.

Selling China delivers its key messages by combining well-documented data, solid econometric analyses and first-hand interviews. Beginning with a story on daily life in Beijing by *Times* reporter Elizabeth Rosenthal, the book ends with an argumentation on Deng Xiaoping's well-known remark "It does not matter whether the cat is white or black, as long as it catches mice". The author provides numerous tables and case studies, presenting various interesting details to support the arguments outlined above. For readers who wish quickly to gain insights into the FDI experience in China, or for serious scholars who have a sustained interest in reviewing the exact nature and impacts of FDI in China, this work is a book to be read for its rigour and entertainment.

Yong Zhang

United Nations Conference on Trade and Development
Geneva, Switzerland

JUST PUBLISHED

International Investment Instruments: A Compendium, Volumes XI and XII

(Sales Nos. E.04.II.D.9 and E.04.II.D.10)(\$60 each)

http://www.unctad.org/en/docs/dite4volxi_en.pdf (Vol. XI)

http://www.unctad.org/en/docs/dite4volxii_en.pdf (Vol. XII)

Initiated in 1996, the series of *International Investment Instruments: A Compendium* contains a collection of international instruments relating to FDI and TNCs. The need for such a collection has increased in recent years as bilateral, regional, interregional and multilateral instruments dealing with various aspects of FDI have proliferated. The core of the *Compendium* consists of legally binding international instruments, mainly multilateral conventions, regional agreements, and bilateral treaties that have entered into force. In addition, a number of “soft law” documents, such as guidelines, declarations and resolutions adopted by intergovernmental bodies, have been included since these instruments also play a role in the elaboration of an international framework for FDI. The most recent volumes, XI and XII, published in 2003, are structured as follows: Volume XI consists of three parts (additional multilateral instruments; additional interregional and regional instruments; and investment-related provisions in free trade, economic integration and cooperation agreements). Volume XII consists of two parts (investment-related provisions of additional free trade, economic integration and cooperation agreements; and additional prototype bilateral investment treaties). Within each of these subdivisions, the instruments are reproduced in chronological order, except for the sections dedicated to prototype instruments. The Compendium reproduces the legal texts as they stand, with the only exceptions being the boxes added to each instrument explaining the context, such as the date of adoption and date of entry into force and, where appropriate, signatory countries.

United Nations Centre on Transnational Corporations (UNCTC): a historical collection and recollection by former UNCTC staff

<http://unctc.unctad.org/html/index.html>

This unique on-line resource base collects and disseminates all information related to the historical memory of the United Nations Centre on Transnational Corporations (1974-1992), which was the predecessor of UNCTAD's Division on Investment, Technology and Enterprise Development, in particular on its activities, documents and publications, and information on its former staff members. When the General Assembly formally created the Commission on Transnational Corporations and the Centre as its secretariat, it defined their goals as to further the understanding of the political, economic, social, and legal effects of TNC activity, especially in developing countries; to secure international arrangements that promote the positive contributions of TNCs to national development goals and world economic growth while controlling and eliminating their negative effects; and to strengthen the negotiating capacity of host countries, in particular the developing countries, in their dealings with TNCs. The Centre had three divisions. The Information Analysis Division was responsible for the systematic collection and analysis of information relative to TNCs at the aggregate and enterprise levels, relevant national and regional legislation and policies as well as bibliographic data, and for the dissemination of the above information on a continuing basis through publications and reports and other means as may be requested by Governments. The Policy Analysis Division was responsible for work related to the formulation of a Code of Conduct and other international arrangements and agreements and agreements concerning TNCs, such as illicit payments in international commercial transactions, and conducted research on economic, legal, social, and political matters related to TNCs. The Advisory Services provided advisory services and information to requesting Governments on matters concerning foreign investment policies and institutional arrangements, as well as an evaluation of investment proposals and agreements.

It also backstopped work in preparation for negotiations, organized training workshops on the above and on matters pertaining to negotiations with TNCs and the monitoring of their activities.

Books on FDI and TNCs received since December 2003

- Baldwin, Robert E. and L. Alan Winters, ed., *Challenges to Globalization: Analyzing the Economics* (Chicago: University of Chicago Press, 2004), 560 pages.
- D'Costa, Anthony and E. Sridharan, *India in the Global Software Industry: Innovation, Firm Strategies and Development* (Basingstoke and New York: Palgrave Macmillan, 2004), 320 pages.
- Huang, Yasheng, *Selling China: Foreign Direct Investment During the Reform Era* (Cambridge and New York: Cambridge University Press, 2003), 383 pages.
- Milward, Bob, *Globalisation? Internationalisation and Monopoly Capitalism* (Cheltenham and Northampton, MA: Edward Elgar, 2003), viii+198 pages.
- Moran, Theodore H., ed., *International Political Risk Management: The Brave New World* (Washington: World Bank, 2004), xi+238 pages.
- Organisation for Economic Co-operation and Development (OECD), *Foreign Direct Investment and the Environment: Lessons from the Mining Sector* (Paris: OECD, 2002), 227 pages.
- Seid, Sherif H., *Global Regulation of Foreign Direct Investment* (Aldershot: Ashgate, 2002), xx+254 pages.
- Tseng, Wanda and Markus Rodlauer, ed., *China: Competing in the Global Economy* (Washington: International Monetary Fund, 2003), xiii+222 pages.

Press materials on FDI issued in February and March 2004
(Please visit <http://www.unctad.org/press> for details)

Title	Date	Document symbol	http:
<i>Press releases and information notes</i>			
UNCTAD Meeting on the Role of Regional Integration Groupings in International Trade, Investment and Human Resources	10.03.2004	UNCTAD/PRESS/IN/2004/007/Rev.1	http://www.unctad.org/Templates/webflyer.asp?docid=4662&intItemID=1634&lang=1
<i>E-briefs</i>			
FDI Inflows to Ireland on the Rise in 2002	19.02.2004	UNCTAD/PRESS/EB/2004/006	http://www.unctad.org/Templates/webflyer.asp?docid=4461&intItemID=1634&lang=1
FDI Down in Three Latin American Economies	05.03.2004	UNCTAD/PRESS/EB/2004/007	http://www.unctad.org/Templates/webflyer.asp?docid=4494&intItemID=1634&lang=1



GUIDELINES FOR CONTRIBUTORS

I. Manuscript preparation

Authors are requested to submit three (3) copies of their manuscript in English, with a signed statement that the text (or parts thereof) has not been published or submitted for publication elsewhere, to:

The Editor, *Transnational Corporations*
UNCTAD
Division on Investment, Technology
and Enterprise Development
Room E-10054
Palais des Nations
CH-1211 Geneva 10
Switzerland
Tel: (41) 22 907 5707
Fax: (41) 22 907 0498
E-mail: Karl.Sauvant@UNCTAD.org

Articles should, normally, not exceed 30 double-spaced pages (12,000 words). All articles should have an abstract not exceeding 150 words. Research notes should be between 10 and 15 double-spaced pages. Book reviews should be around 1,500 words, unless they are review essays, in which case they may be the length of an article. Footnotes should be placed at the bottom of the page they refer to. An alphabetical list of references should appear at the end of the manuscript. Appendices, tables and figures should be on separate sheets of paper and placed at the end of the manuscript.

Manuscripts should be word-processed (or typewritten) and double-spaced (including references) with wide margins. Pages should be numbered consecutively. The first page of the manuscript should contain: (i) title; (ii) name(s) and institutional affiliation(s) of the author(s); and (iii) mailing address, e-mail address, telephone and facsimile numbers of the author (or primary author, if more than one).

Authors should provide a diskette of manuscripts only when accepted for publication. The diskette should be labelled with the title of the article, the name(s) of the author(s) and the software used (e.g. WordPerfect, Microsoft Word, etc.).

Transnational Corporations has the copyright for all published articles. Authors may reuse published manuscripts with due acknowledgement. The editor does not accept responsibility for damage or loss of manuscripts or diskettes submitted.

II. Style guide

A. **Quotations** should be double-spaced. Long quotations should also be indented. A copy of the page(s) of the original source of the quotation, as well as a copy of the cover page of that source, should be provided.

B. **Footnotes** should be numbered consecutively throughout the text with Arabic-numeral superscripts. Footnotes should not be used for citing references; these should be placed in the text. Important substantive comments should be integrated in the text itself rather than placed in footnotes.

C. **Figures** (charts, graphs, illustrations, etc.) should have headers, subheaders, labels and full sources. Footnotes to figures should be preceded by lowercase letters and should appear after the sources. Figures should be numbered consecutively. The position of figures in the text should be indicated as follows:

Put figure 1 here

D. **Tables** should have headers, subheaders, column headers and full sources. Table headers should indicate the year(s) of the data, if applicable. The unavailability of data should be indicated by two dots (..). If data are zero or negligible, this should be indicated by a dash (-). Footnotes to

tables should be preceded by lower case letters and should appear after the sources. Tables should be numbered consecutively. The position of tables in the text should be indicated as follows:

Put table 1 here

E. **Abbreviations** should be avoided whenever possible, except for FDI (foreign direct investment) and TNCs (transnational corporations).

F. **Bibliographical references** in the text should appear as: “John Dunning (1979) reported that ...”, or “This finding has been widely supported in the literature (Cantwell, 1991, p. 19)”. The author(s) should ensure that there is a strict correspondence between names and years appearing in the text and those appearing in the list of references.

All citations in the list of references should be complete. Names of journals should not be abbreviated. The following are examples for most citations:

Bhagwati, Jagdish (1988). *Protectionism* (Cambridge, MA: MIT Press).

Cantwell, John (1991). “A survey of theories of international production”, in Christos N. Pitelis and Roger Sugden, eds., *The Nature of the Transnational Firm* (London: Routledge), pp. 16-63.

Dunning, John H. (1979). “Explaining changing patterns of international production: in defence of the eclectic theory”, *Oxford Bulletin of Economics and Statistics*, 41 (November), pp. 269-295.

United Nations Centre on Transnational Corporations (1991). *World Investment Report 1991: The Triad in Foreign Direct Investment*. Sales No. E.91.II.A.12.

All manuscripts accepted for publication will be edited to ensure conformity with United Nations practice.

READERSHIP SURVEY

Dear Reader,

We believe that *Transnational Corporations*, already in its twelfth year of publication, has established itself as an important channel for policy-oriented academic research on issues relating to transnational corporations (TNCs) and foreign direct investment (FDI). But we would like to know what **you** think of the journal. To this end, we are carrying out a readership survey. And, as a special incentive, every respondent will receive an UNCTAD publication on TNCs! Please fill in the attached questionnaire and send it to:

Readership Survey: *Transnational Corporations*
Karl P. Sauvant
Editor
UNCTAD, Room E-10054
Palais des Nations
CH-1211 Geneva 10
Switzerland
Fax: (41) 22 907 0498
(E-mail: Karl.Sauvant@UNCTAD.org)

Please do take the time to complete the questionnaire and return it to the above-mentioned address. Your comments are important to us and will help us to improve the quality of *Transnational Corporations*. We look forward to hearing from you.

Sincerely yours,



Karl P. Sauvant
Editor

Transnational Corporations

TRANSNATIONAL CORPORATIONS

Questionnaire

1. Name and address of respondent (optional):

2. In which country are you based?

3. Which of the following best describes your area of work?

Government	<input type="checkbox"/>	Public enterprise	<input type="checkbox"/>
Private enterprise	<input type="checkbox"/>	Academic or research	<input type="checkbox"/>
Non-profit organization	<input type="checkbox"/>	Library	<input type="checkbox"/>
Media	<input type="checkbox"/>	Other (specify)	<input type="checkbox"/>

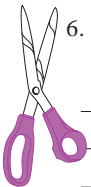
4. What is your overall assessment of the contents of *Transnational Corporations*?

Excellent	<input type="checkbox"/>	Adequate	<input type="checkbox"/>
Good	<input type="checkbox"/>	Poor	<input type="checkbox"/>

5. How useful is *Transnational Corporations* to your work?

Very useful Of some use Irrelevant

6. Please indicate the three things you liked most about *Transnational Corporations*:

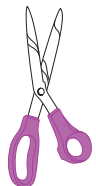


7. Please indicate the three things you liked least about *Transnational Corporations*:

8. Please suggest areas for improvement:

9. Are you a subscriber? Yes No

If not, would you like to become one (\$45 per year)? Yes No
Please use the subscription form on p. 139).



I wish to subscribe to *Transnational Corporations*

Name _____
Title _____
Organization _____
Address _____
Country _____

Subscription rates for *Transnational Corporations* (3 issues per year)

1 year US\$45 (single issue: US\$20)

Payment enclosed

Charge my Visa Master Card American Express

Account No. _____ Expiry Date _____

United Nations Publications

Sales Section
Room DC2-853
2 UN Plaza
New York, N.Y. 10017
United States
Tel: +1 212 963 8302
Fax: +1 212 963 3484
E-mail: publications@un.org

Sales Section
United Nation Office
Palais des Nations
CH-1211 Geneva 10
Switzerland
Tel: +41 22 917 2615
Fax: +41 22 917 0027
E-mail: unpubli@unog.ch

Is our mailing information correct?

Let us know of any changes that might affect your receipt of *Transnational Corporations*. Please fill in the new information.

Name _____
Title _____
Organization _____
Address _____
Country _____



GE.04- Printed in Switzerland
February 2004 - 3,765

UNCTAD/ITE/IIT/2004/5 (Vol. 13, No. 2)