

Transnational Corporations and Management Division
Department of Economic and Social Development

World Investment Report 1992

Transnational Corporations as Engines of Growth



United Nations New York, 1992

Chapter II

THE RELATIVE IMPORTANCE OF THE ACTIVITIES OF TRANSNATIONAL CORPORATIONS

A. In the world economy

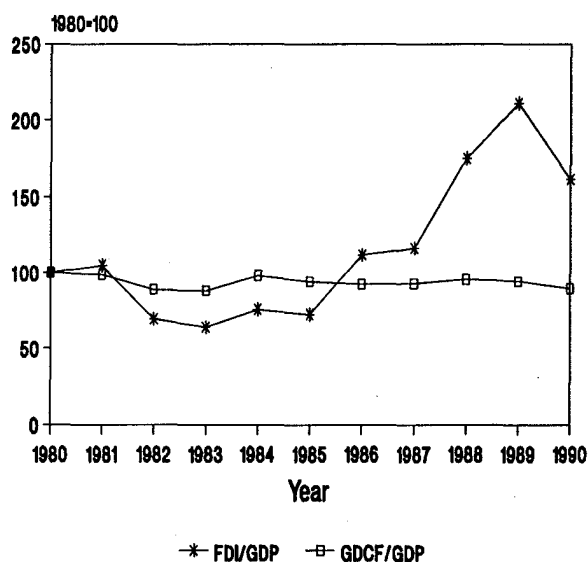
1. Foreign direct investment, domestic investment and output

During the 1980s, world-wide FDI flows grew faster than world-wide domestic investment and domestic output and, to the extent that greenfield investments followed the same trend, output by foreign firms has contributed an increasing share to that output. Foreign direct investment, domestic output and domestic investment grew at similar rates throughout the 1970s. During the early 1980s, the rate of growth of FDI began to diverge from that of domestic output and domestic investment and since 1985 the rate of growth of FDI has accelerated, outpacing that of the other two (chapter I, figure I.1). During the period 1985-1990, global FDI grew almost four times as fast as domestic output and more than twice as fast as domestic investment (annex table 4). In spite of the fact that FDI flows grew faster in developed than in developing countries, flows to developing countries increased more than twice as fast as domestic investment and domestic output between 1985 and 1990 (annex table 5). To a large extent, the rapid growth of FDI represents the growth of international mergers-and-acquisitions, especially among developed countries. However, mergers-and-acquisitions activity would not be reflected in domestic investment (gross domestic capital formation) in so far as the change in ownership does not lead to an

addition in the existing stock of capital. The fact that only greenfield investments or additions to the capital stock attributed to international mergers and acquisitions are included in domestic capital formation could explain the divergence between the growth of FDI and the growth of domestic investment during that period. Given that international mergers-and-acquisitions activity grew rapidly during the second half of the 1980s—a phenomenon which was reflected more in the growth of FDI than in the growth of domestic investment—it could be possible that this activity did not usually lead to an increase in the stock of capital.

The ratio of combined FDI inflows to domestic output (gross domestic product) for the six largest host economies of the 1980s (which together accounted for 65 per cent of global inflows during that period) grew faster than the corresponding ratio of domestic investment to domestic output for the second half of the 1980s, except 1990 (figure II.1). The share of that output contributed by FDI (to the extent that it represents additions to the existing stock of capital) increased, while the share contributed by domestic investment decreased during that period, underlining the rising importance of FDI in the growth of domestic output. Although the ratio of FDI to domestic output is low in comparison to the ratio of domestic investment to domestic output, its value is increasing owing to the faster growth of FDI in these countries, which seems to have outpaced the growth of domestic investment during the late 1980s.

Figure II.1. The importance of foreign direct investment and domestic investment in domestic output for the six largest host countries,^a 1980-1990



Sources: International Monetary Fund, balance-of-payments tape, retrieved in December 1991; and United Nations, Department of Economic and Social Development, data base on major economic indicators showing historical development trends.

^a Australia, France, the Netherlands, Spain, the United Kingdom and the United States.

2. Foreign direct investment, trade, technology and sales

During the second half of the 1980s, FDI flows grew faster than other key international flows, namely, trade and technology (annex tables 4 and 5). The link between FDI, trade and technology flows implies that the growth of FDI is increasingly related to the growth of the other two types of flows.¹ For

example, it is estimated that intra-firm transactions in royalties and licence fees (which include mostly receipts for the use of trademarks, processes, techniques, copyrights and patents) between firms related by ownership account for over 80 per cent of the total value of these transactions (chapter VI, table VI.10). Intra-firm trade between TNCs is also substantial, accounting for an estimated 25 per cent of world-wide trade, although it is substantially higher for individual countries (see chapter VIII, section B). To a certain extent, therefore, the growth of royalties and licence fees and trade is associated with the growth of FDI.

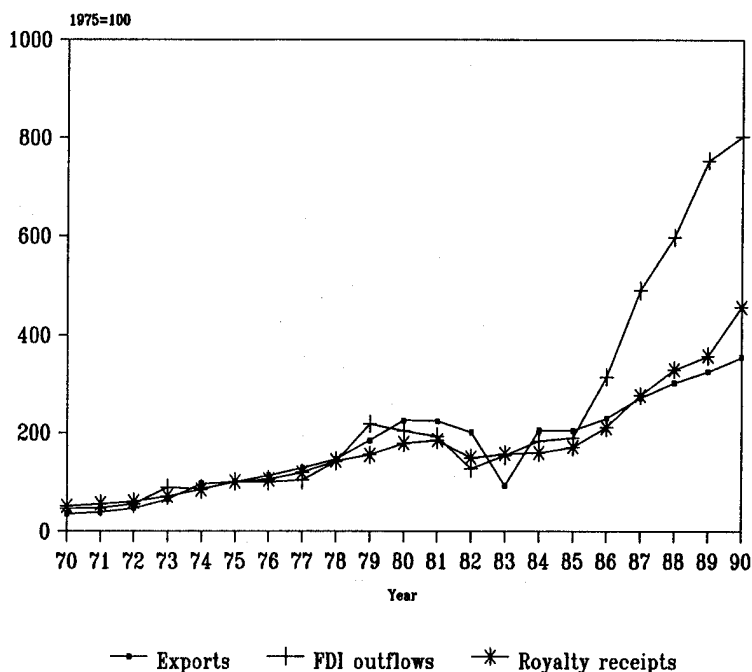
While global FDI outflows, receipts of royalties and fees and exports grew at similar rates throughout the early and mid-1970s, those rates of growth began to diverge during the 1980s (figure II.2). Since 1985, FDI outflows grew

about one-and-a-half times faster than receipts of royalties and fees and about two-and-a-half times faster than exports. To a certain extent, the growth of receipts of royalties and fees reflected the rapid growth of FDI flows. The divergence between the rates of growth of FDI and exports, in spite of the link between FDI and trade, suggests the possible existence of time lags or the influence of exchange rates on exports.

For developing countries overall, technology flows may also be approximated by payments of royalties and licence fees (paid mostly to developed countries), by imports of capital goods and by technical cooperation grants from developed countries (annex table 5). For those countries, the growth of FDI inflows was also nearly two times higher than that of the above indicators of technology flows and almost one-and-a-half times higher than that of all imports. In other words, FDI is growing faster than either trade or technology flows for developing countries, although not at the same pace as for developed countries.

Since FDI data measure investment and not the value of output, they tend to underestimate the extent of the activities of TNCs (see box II.1). Using FDI as a proxy for international production and

Figure II.2. Investment outflows, exports and royalty and fees receipts, 1970-1990



Sources: International Monetary Fund, *Direction of Trade Statistics Yearbook*, various issues; International Monetary Fund, balance-of-payments tape, retrieved in December 1991 and January 1992; OECD estimates; and Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992).

comparing it with other measures of serving international markets, such as trade, could therefore lead to misleading conclusions. Global sales of foreign affiliates in host countries are an alternative indicator of the activities of TNCs, and are better suited for comparisons with trade flows. Estimates of world-wide sales have been obtained by extrapolation, using sales of foreign affiliates abroad of TNCs based in the Federal Republic of Germany, Japan and the United States (three of the largest outward investors) and the share of those countries in world-wide outward FDI stock.² According to this method of estimation, world-wide sales of foreign affiliates in 1989 were \$4.4 trillion, compared to world exports of \$2.5 trillion, including world exports of commercial services and excluding intra-firm trade (table II.1). Global sales of affiliates are considerably more important than exports in delivering goods and services to markets world-wide, which underlines the importance of TNCs in structuring international economic relations. Actual data for three of the five largest home countries for which time-series data are available confirm the overall pattern, namely, that sales by foreign affiliates are considerably more important than total exports, by a factor of about 2 to 5 (table II.2). Global sales of affiliates of TNCs from the United States are higher than those of the Federal Republic of Germany and Japan because of the longer history of that country as an outward investor, reflected by the size of its FDI stock abroad. Beyond that, however, the pat-

Box II.1. Imperfections of foreign-direct-investment data

Foreign direct investment is the most commonly used measure of the activities of TNCs. It is, however, an imperfect measure since:

- It does not capture non-equity linkages of TNCs, such as contractual arrangements and turnkey agreements, which account for a substantial part of the activities of these corporations in certain industries (for example, the hotel industry). Non-equity forms of involvement of TNCs, though not easily quantifiable, may be more widespread as a form of conducting business in developing than in developed countries.
- It underestimates the amount of FDI since reinvested earnings are unavailable for several home countries—some of which are significant outward investors—and, hence, are not included in total flows. As such, investment flows underestimate the extent of foreign involvement by TNCs in host countries.
- It underestimates the total amount of investment by foreign affiliates in so far as it does not include capital that is raised in the host country (locally-raised capital is frequently used to finance international mergers-and-acquisition, as well as greenfield investments). The exclusion of domestically-raised capital has more serious repercussions in the estimation of FDI in developed than in developing countries because mergers-and-acquisitions activity is concentrated in the former and financial markets in the latter are not highly developed. The implication of this is that the share of developing countries in world investment flows may be overestimated.

Since comparable FDI data that include estimates of locally-raised capital and non-equity forms are not available, FDI flows and stocks are commonly used as the main indicators of the importance of the activities of TNCs. Foreign-direct-investment flows, however, greatly underestimate the full extent of TNC activity, not counting such other activities of TNCs as transfer of technology, trade and human resource development (see Part Two).

tern diverges, with the ratio falling in the United States and increasing in the Federal Republic of Germany and Japan during the late 1980s. The rise in that ratio for the latter countries reflects, in part, the appreciation of their currencies *vis-à-vis* the dollar since 1985.

Global sales of affiliates have grown at an annual average rate of 15 per cent since the mid-1980s, significantly above their growth during the first half of the 1980s. The rapid growth of sales in recent years concurs with the growth of FDI. Nevertheless, the ratio of global sales to exports has remained fairly constant, since exports grew at similar rates. This reflects in part the declining ratio of sales to exports for the United States during the 1980s, which is largely the result of a resurgence of exports from that country during the second half of the 1980s, owing to, in particular, a depreciation of the dollar exchange rate, higher economic growth abroad (especially in Western Europe) and stronger demand for United States capital goods, which account for a considerable share of its exports.³

3. Foreign direct investment and capital flows

By the end of the decade, FDI had become the principal source of private foreign capital for the major-

Table II.1. Estimated worldwide sales of foreign affiliates and total exports, 1982-1989, and average annual growth rates 1982-1984 and 1985-1989

Year	Sales ^a	Exports ^b	Ratio of sales to exports
	(Trillions of dollars)		
1982	2.4	1.5	1.6
1983	2.3	1.3	1.7
1984	2.5	1.4	1.7
1985	2.5	1.4	1.8
1986	2.9	1.7	1.7
1987	3.5	2.0	1.7
1988	4.2	2.4	1.8
1989 ^c	4.4	2.5	1.8
Average annual growth rates	1982-1984	1985-1989	
	Sales	Exports	
	3	15	
	-2	15	

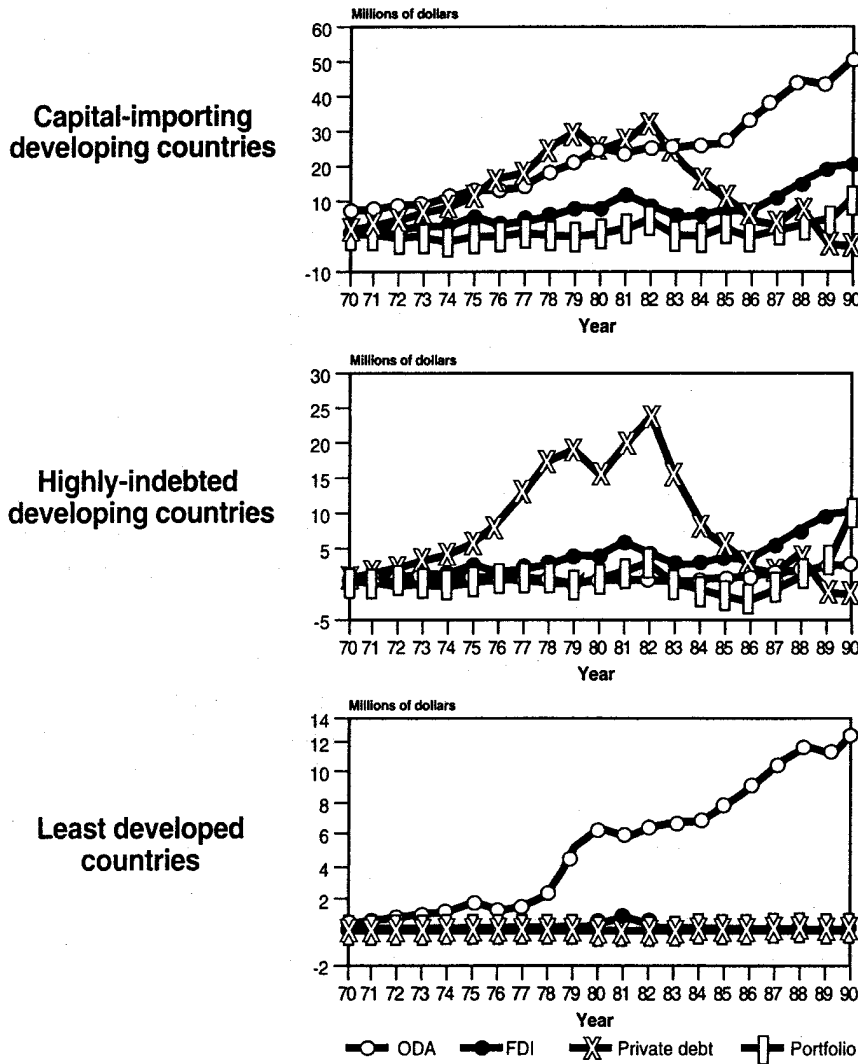
Sources: International Monetary Fund, *Direction of Trade Statistics Yearbook, 1988* and General Agreement on Tariffs and Trade, *International Trade 1990/91*, vol. II; Jeffrey H. Lowe and Raymond J. Mataloni, Jr., "U.S. direct investment abroad: 1989 benchmark survey results", *Survey of Current Business*, vol. 71, No. 10 (October 1991), p. 29; Ministry of International Trade and Industry, *Wagakuni Kigyo no Kaigai Jigyo Katsudo* and *Kaigai Jigyo Katsudo Kihon Chosa: Kaigai Toshi Tokei Soran*, various issues; Deutsche Bundesbank, *Statistische Beihefte der Monatsberichte*, various issues; and United States, Department of Commerce, Bureau of Economic Analysis, *U.S. Direct Investment Abroad: Operations of U.S. Parent Companies and their Foreign Affiliates*, various issues.

a World-wide estimates of sales by foreign affiliates of home-based TNCs were calculated by extrapolating the sales of foreign affiliates of TNCs from the Federal Republic of Germany, Japan and the United States on the basis of the relative importance of these countries in world-wide FDI outward stock.

b World-wide exports have been adjusted to exclude intra-firm trade, estimated by applying the share of intra-firm trade by TNC affiliates in total exports from the United States to world-wide exports.

c Preliminary estimates extrapolating the sales of foreign affiliates of TNCs from the Federal Republic of Germany and the United States on the same basis as that described in (a).

Figure II.3. Investment flows, debt from private sources^a, official development assistance^b and portfolio investment for 93 capital importing developing countries, heavily indebted developing countries^c and least developed countries, 1970-1990



Sources: World Bank, world-debt-tables-data tape, retrieved in January 1992; International Monetary Fund, balance-of-payments tape, retrieved in December 1991 and January 1992; OECD estimates; Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992), and OECD, *Development Co-operation Report*, various years.

a Net disbursements of public and publicly guaranteed debt, excluding debt owed to official creditors.

b Official development assistance to all developing countries, excluding countries in the Middle East.

c Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, Yugoslavia.

corporate equity component of those investments. The stock market crash of October 1987 had a temporary adverse effect on the growth of portfolio flows, while FDI flows, responding more to long-term motives, have been less affected.

Although securities markets in developing countries have traditionally played a small role in attracting foreign capital, the inclusion of portfolio investment in capital flows from private sources reduces the relative importance of FDI in total private capital flows, especially during the second half of the 1980s. The rapid growth of portfolio investment to developing countries during that period (though fluctuating more than that of FDI flows) occurred particularly in East, South and South-East Asia, aided by the growth of bond issues in some Latin American countries. The rise of portfolio investment can be attributed to the removal of many restrictions on foreign participation in securities markets and the easing of exchange controls on the part of many developing countries. Eventually, the opening of securities markets to foreign investors can also lead to higher FDI flows, as investors accumulate more sizeable shares of investment in domestic firms.

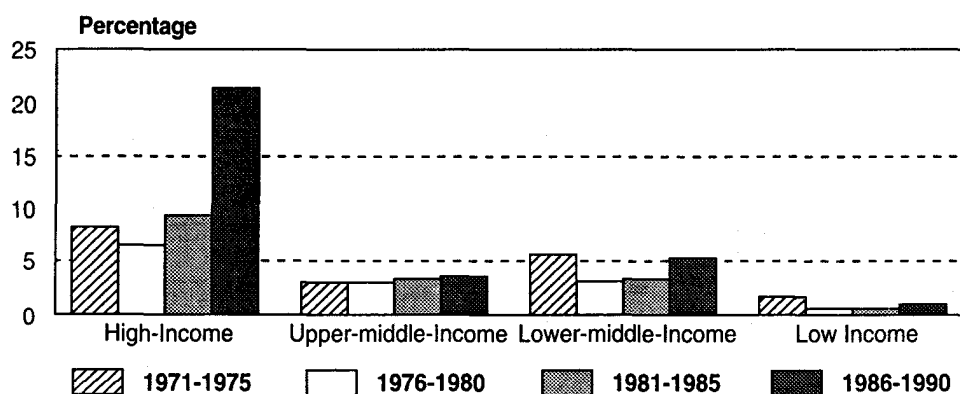
For developing countries, the share of FDI in total financial flows during the 1990s will depend on a number of factors, foremost among which is, of course, the growth of FDI inflows themselves. But flows of private credit to those countries will also be important (as they recover from the effects of the debt crisis), as will be the continuing liberalization of financial markets and exchange control regulations (which is likely to encourage further the flow of portfolio, as well as direct investment). Competition for ODA is likely to increase as Central and Eastern European countries attempt to reintegrate themselves into the world economy, thus increasing the importance of FDI for developing countries as a source of capital.

B. In host countries

Reflecting the growing importance of FDI in the world economy, the activities of TNCs are becoming increasingly important to the economies of individual host countries. Specifically, the share of total exports, sales and assets accounted for by foreign affiliates in a number of host countries is not only sizeable, but, at least for a sample of countries, has been increasing over time. The ratio of FDI flows to domestic investment (GDCF), an indicator of the significance of FDI in domestic capital formation, has risen for most developed and developing countries (figure II.4 and table II.3). Moreover, the ratio of FDI stock to domestic output (GDP), an indicator of the importance of those investments in relation to the size of the economy of host countries has also been rising over time. In this section, the importance of TNCs in individual host countries will be examined, with particular attention being paid to regional differences and to differences arising in these indicators according to the level of development of host countries.

Since the mid-1970s, FDI has been more significant in the domestic investment of developing rather than that of developed countries, as indicated by the higher ratio of FDI flows to gross domestic capital formation⁶ in the former (figure II.4 and annex table 6). During the second half of the 1980s, however,

Figure II.5. The ratio of investment inflows to gross domestic capital formation for developing countries by income group, annual average, 1971-1975, 1976-1980, 1981-1985, 1986-1989^a



Sources: International Monetary Fund, balance-of-payments tape, retrieved in December 1991; OECD estimates; Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992); United Nations, Department of Economic and Social Development, database on major economic indicators showing historical development trends; and World Bank, *World Development Report, 1991* (New York, Oxford University Press, 1991).

a For some countries, data for individual years might be missing; in those cases, ratios have been estimated only on the basis of those years for which data are available.

b Over \$10,000 1989 GNP per capita.

c \$1,500-\$9,999 1989 GNP per capita.

d \$500-\$1,4999 1989 GNP per capita.

e Less than \$499 1989 GNP per capita.

The importance of FDI in relation to domestic capital formation becomes more pronounced when compared to the component of that formation attributed to the private sector. This is not surprising, given that, in a number of countries, public investment accounts for a substantial share of total domestic investment. On the other hand, FDI is usually, though not exclusively, concentrated in the private sector. Excluding residential investment from total domestic investment of host countries further boosts the importance of FDI in their economy.

The ratio of FDI stock to domestic output (gross domestic product), another indicator of the importance of these investments in host countries, shows significant increases for many developed and developing countries (annex table 7; see also table II.4). This ratio rose significantly during the 1980s for most developed countries, more than doubling in some cases (for example, Portugal and the United States) but, in some cases, starting from lower values compared to corresponding ratios for developing countries. For the latter, that ratio also increased substantially, particularly for countries in East, South and South-East Asia (for example, Singapore and Indonesia). Considering that domestic output grew rapidly in that region during the 1980s, the increasing significance of FDI there suggests a link between the two.

On the sectoral level, the relative importance of FDI for countries represented in annex table 7 has been consistently greater in manufacturing than in the services sector and, with few exceptions, in the extractive sector. Thus, despite the large FDI inflows in services during the 1980s, FDI in this sector still lags behind that in manufacturing in terms of relative importance for host countries. This discrepancy may, however, narrow or even disappear during the 1990s, if services remain the largest sector in FDI outflows of major home countries and new capital-intensive services industries, such as telecommunication, transportation and public utilities, as well as banking in a number of developing countries are privatized and being opened to FDI.

Other indicators of the significance of the activities of TNCs include sales, assets and exports of foreign affiliates located in host countries. From the perspective of host countries, activities of foreign affiliates are important, but perhaps more so in developing than in developed countries (annex table 8). Foreign affiliates in host developing countries play an important role in manufacturing, particularly in electrical and transportation equipment.⁷ Limited as data on sales, assets and exports are, they, too, suggest that, over time, foreign affiliates are assuming a relatively more important role in host economies, developed and developing alike (annex table 9). On the sectoral level, there are some notable differences, with foreign affiliates in the primary sector accounting for a smaller share of total assets and exports, as developing countries assumed control of previously foreign-owned assets in resource-based industries. In contrast, that share for manufacturing—having declined during the 1970s and first half of the 1980s—is again increasing.

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Table II.4. The relative importance of foreign-direct-investment stock in the domestic economy, 1988

<i>Percentage</i>	<i>Economy</i>
Less than 5 per cent	Bangladesh, China, Finland, France, India, Japan, Nepal, Norway, Pakistan, Philippines, Republic of Korea
5.1 to 10 per cent	Austria, Federal Republic of Germany, Indonesia, Italy, Morocco, New Zealand, Nigeria, Portugal, Spain, Sri Lanka, Thailand, United States
10.1 to 15 per cent	South Africa
15.1 to 20 per cent	United Kingdom
Over 20 per cent	Australia, Canada, Fiji, Hong Kong, Malaysia, Netherlands, Papua New Guinea, Singapore

Sources: Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992); United Nations, Department of Economic and Social Development, database on major economic indicators showing historical development trends.

The assessment of the relative importance of FDI to host countries depends, to some extent, on the indicators of the activities of TNCs that are available. Although for some developed and developing countries the extent of foreign involvement in the domestic economy has not changed substantially over the past two decades, for most countries, foreign affiliates appear to have become more significant in their economic activities. Some developing countries with a large foreign presence in their economies in the 1970s experienced a drop in that presence by the mid-to late 1970s resulting, to some extent, from policies aimed at reducing foreign ownership of productive assets. During the late 1980s, however, the values of most of these measures began to increase and, by the end of the 1980s, foreign involvement in the economies of several host countries had risen significantly. In general, differences in the extent of involvement of the TNCs in developed and developing countries are becoming less pronounced as foreign involvement in developed countries is increasing more rapidly than in developing countries. Foreign direct investment is, therefore, becoming more important in relation to world-wide investment, output, trade, technology and capital flows, and TNCs are playing a more important role in the economies of individual countries.

Notes

¹For a discussion of this, see UNCTC, *World Investment Report, 1991: The Triad in Foreign Direct Investment* (United Nations publication, Sales No. E.91.II.A.12), chapter 3.

²Since both exports and sales of foreign affiliates abroad include intra-firm transactions, some double-counting is involved. For example, a product shipped by a parent company to its foreign affiliate and then sold would be included in both exports and sales. This is discussed in DeAnne Julius, *Global Companies and Public Policy* (London, Pinter Publishers, 1990), p. 78. A partial solution is to subtract from exports the share of intra-firm trade by affiliates of TNCs. That share is available for the United States and has been applied to world-wide exports.

³Stephen Cooney, *Can the U.S. Export Drive Continue?* (Washington, D.C., National Association of Manufacturers International Economic Department, December 1991).

⁴Foreign direct investment differs from portfolio investment in that the former involve a lasting interest in firms; for the purpose of data collection, this distinction usually involves an ownership threshold below which all foreign investments are considered as portfolio.

⁵The total market capitalization of equity markets in developing countries is only 6 per cent of that in developed countries, according to one estimate; see Philip Turner, "Capital flows in the 1980s: a survey of major trends", Bank for International Settlements Economic Papers, No. 30 (April 1991), p. 51.

⁶Gross domestic capital formation represents changes in the existing stock of capital and, therefore, it is not, strictly speaking, comparable to foreign direct investment, which may include acquisitions of existing assets.

⁷UNCTC, *World Investment Report 1991: The Triad in Foreign Direct Investment* op. cit. pp. 99-100; and annex tables 8 and 9.