MULTINATIONAL ENTERPRISES

and

FOREIGN DIRECT INVESTMENTS

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ABBREVIATIONS

Names of Organizations

UNCTAD: United Nations Conference on Trade and Development

U.N. : United Nations

OECD: Organization for Economic Cooperation and Development

EEC: European Economic Community

CSTD: Committee on Science and Technology for Development

UNCSTD: U.N. Conference on Science and Technology for Development

ACAST: U.N. Advisory Committee for the Application

Other Abbreviations

DC: Developed Country

LDC: Less Developed Country (Developing Countries)

R & D: Research and Development

MNE : Multinational Entreprise

MNC : Multinational Corporation (=MNE)

FDI: Foreign Direct Investment

INTRODUCTION

Until the 1.th century, the common concept of economic activity between the independent nations had meant import-export activities of national entrepreneurs. David Ricardo was the first scholar to account for such activities within a theoretical framework based on comparative advantage doctrine. Ricardo's international trade simply meant that different countries had different natural and physical endowments. Thus, if each country produced commodities with greatest comparative advantage, the global welfare and world's total output would be maximized. Ricardo's basic assumptions were:

1- Complete free trade of commodities:

2- Immobility of the factors of production e.g. no immigration; and

3- No foreign direct investments.

Although the second constraint on factor immobility was relaxed in further advanced stages of the theory by Hechscher-Ohlin, (Samuelson, and others), the theory was still inadequate to give a full account of the current business realities of the 20th century particularly of the activities of emerging Multinational Enterprises (MNEs). International division of production and distribution was being reshaped by the MNEs but the international trade theory was incapable of providing a satisfactory account for the foreign direct operations. Since their emergence, MNEs have been one the few principal institutions effecting, more or less, the formation and outcome of all kinds of economic relations, the other being the state.

The nature and magnitude of foreign direct investments (FDIs) of Multinational Enterprises, and their impacts on both the host and home countries has been one of the frequently discussed subjects by economists since 1950s. Especially in 1950s and 1960s, the term MNE was often used as synonymous with the US-based enterprises or US imperialism. Lately, however, the approach towards MNEs seems to have shifted in favor of the FDIs. Even the socialist countries like Soviet Union and Republic of China try to attract foreign direct investment through various measures. Actually, nowadays nobody seems to dispute the potential fruits to be gained from FDIs of MNEs.

The empirical evidence on the global economic performance since World War II indicates that the gap, in general, in the economic and technological fields between the few so-called Developed Countries (DCs) and the plenty Developing or Less Developed Countries (LDCs) has been continuously widening. Neither the popular import-biased economic growth strategy of 1950s and 1960s nor the highly praised export-biased growth models have been fully successful in transforming a LDC

from the cadres of less development into the levels of welfare prevailing in Western industrialized countries.

Development is a relative concept. Population of LDCs constitutes about 70 percent of world's population while their total production accounts for only 20 percent. The respective figures for DCs are 30 percent and 80 percent. LDCs are not homogeneous and display more differences than similarities. Some of them are relatively richer, like Libya, while some have highly developed public sector, like Turkey and Algeria. Some countries, like South Korea and Singapore, have developed a rather strong and competitive industrial sector and are referred to as the Newly Industrialized Countries (NICs). Countries like India, Thailand, Mexico and Egypt have a rich national history but each are at the different levels of development. Developing countries, in general, have enormous natural and human resources but lack the sufficient productive capacities of their own to make the best use of these endowments.

In order to reach their targeted development goals, some countries had placed heavy emphasis on inward-oriented growth strategies, while some encouraged the outward-oriented economic growth models. Whatever the strategy of economic development, all LDCs were in short supply of essential elements of development such as skilled manpower, infrastructure, organizational ability, foreign currency, capital and appropriate technology for the output of contemporary complex commodities. On the other hand, in a rapidly and continuously advancing technological environment, consumers' preferences both in developed and developing countries were shifting towards more sophisticated and technologically complex products, especially in electronics industry. In order to meet the development targets and to cope with the growing demand for technologically advanced commodities, the LDCs faced two with alternatives: either encouraging indigenous research and development (R&D) or importing the already existing and tried advance technology from DCs. Given the high costs and risks, among other reasons, of producing indigenous technologies, it appeared to be more rational to many LCD decision-makers and planners to rely on the transfer of technology from industrialized countries, particularly through FDIs of MNEs. The commonsense would find the argument for engaging scarce resources of LDCs to produce something that already exists in other countries (DCs) rather irrational. Consequently, the flow of capital and technology began to flow to LDCs, sometimes to take advantage of export-promotion policies and sometimes to enjoy monopoly / oligopoly rights behind high tariff and non-tariff barriers under import-substitution policies.

Technology being the "key to the progress of mankind" (83:p.41) is expected to pave the way to economic development and narrow the gap between the developed

and developing countries, if it could be transferred through proper channels, such as patent-license agreements or foreign direct investments. The key role in the transfer of technology was expected to be played by the MNEs, given the characteristics of free-market enterprise economies in terms of property relations and ownership rights. Transfer of technology, especially trough FDIs, accelerated after the World War II. The major technology exporters were, naturally, the MNEs of DCs, primarily of the U.S., while the major technology importing countries were again the DCs due to their stable and large markets with relatively higher purchase-power as well as more or lest identical consumer tastes. In contrast to the common belief by non-layman, the shares of flow of FDIs to LDCs was/is considerably lower, but growing rapidly.

Technology transfer has many positive impacts on the economy of technology importing countries. Accesses to new technological know- how, addition to domestic productive capacity, generating employment are just a few. Regarding the inadequacy of essential factors of development such as physical/financial capital, foreign currency, infrastructure, high-level man-power, etc., FDIs were expected to fill in the gap, to some extent, at least, and make significant contributions to the development of national economies of LDCs. But it was soon to be discovered that the technology market contained many imperfections. Various factors were restricting the full-utilization of the transferred technology in host countries. Besides its indisputable benefits to the importing country, the FDI also had some adverse impacts on important issues such as income distribution, employment generation and foreign currency reserves. There were even claims that the costs by far outweighed the benefits generated by investment or even the "non-transfer" of technology implying that the host country had no positive benefits in terms of having access to the advanced know-how in spite of far reaching incentives and facilities provided for the foreign investors. (For a more detailed discussion, see Chapter-III).

CHAPTER - I: MULTINATIONAL ENTERPRISE AND FOREIGN INVESTMENTS

I-1: Definition of MNE

Since 1950s, there has been an unprecedented acceleration in the foreign operations of MNEs. Some MNEs have more financial and/or physical assets than some of the independent nations. General Motors, Unilever, IBM are just a few of such giant business corporations. Some of them employ more employees than the entire working-force of some nation states. And the trend in their worldwide accumulation of assets indicates steady growth, thus perpetuating their dominant role on global issues. Some scholars express concern over this new global division of labor generated by the giant business corporations. For instance, according to Sunkel {48:pp.692-702} the period since then has been characterized by denationalization and subsidiarization of industrial development in LDCs. These new powerful economic agents of global business transactions with their enormous technological, financial and organizational potentialities have been given various names, such as, Multinational Corporations by J.J. Servan-Schreiber, Multinational Enterprise by T.G. Parry, International Firm by S.J. Rubin. Accordingly, the definitions of the terms also indicated more or less some diversity.

> According to Parry, "**we can define the form of enterprise that characterizes the stereotype MNE as that corporate structure where operations are in two or more countries on such a scale that growth and success depend on more than one nation, and where decisions are made on the basis of global alternatives**."{55:}

Parry's definition, though it seems compact, is incomplete, for he fails to reflect on the importance of ownership and the ultimate liability to the shareholders of parent company, irrespective of the magnitude and frequency of operations in foreign countries. A practicing lawyer of corporations, S.J. Rubin, defines what he refers to as the International Firm, as "**a business organization that has its roots in one country and operations of various sorts in another**." {39:p.181} In this definition, there seems to be a contradiction. Because, Rubin's business organization, although international by name, is practically a national firm for it has its roots in one country only. Therefore, it is international only in terms of its operations.

Vernon asserts that the MNE is an institution, which tries "**to carry out its activities on an international scale as though there were no national**

boundaries, on the basis of a common strategy directed from a corporate center."{21:p.46} J. Maisonrouge has a similar approach to the issue and emphasizes the multinationality of its operations. For him, a MNE is a business organization which;

> "**(a) operates in many countries;**
> **(b) carries out research, development and manufacturing in those countries; (c) has a multinational management; and**
> **(d) has multinational stock ownership**." {21:p.46}

According to Magdoff-Sweezy, the new powerful economic agent of global economic relations is:

> "**….. multinational in the sense that it operates in a number of nations with the purpose of maximizing the profits not of the individual units on a nation- by-nation basis but of the group as a whole. In particular, ownership and control are located in one nation, not dispersed throughout the corporate system**." {44:p.3}

In a similar approach, Baran-Sweezy claim that the giant business corporations are characterized by the following features:

1. "**(1) Control rests in the hands of management, that is to say, the board of directors plus the chief executive officers. Outside interests are often (but not always) represented on the board to facilitate the harmonization of the internets and policies of the corporation with those of customers, suppliers, bankers, etc.**

2. **Management is a self-perpetuating group. Responsibility to the body of stockholders is for all practical purposes a dead letter. Each generation of managers recruits its own successors and trains, grooms, and promotes them according to its own standards and values.**

3. **Each corporation aims at and normally achieves financial independence through the internal generation of funds which remain at the disposal of management**." {9:pp.28-29}

As pointed out above, some authorities emphasize the degree of foreign operations in their definitions of MNE, while some focus on the distribution of ownership and control of the headquarters. Left-wing scholars attribute an essential role to the control and ownership of business corporations. Management seems to be of secondary importance, for hiring of local personnel to top-level management positions in subsidiaries is considered having "**absolutely nothing to do with sharing-control, which remains undivided in the parent company**."

{44:p.5} On the other hand, in the definitions of MNE by right-wing authorities, the emphasis seems to be on the distribution of investments across the nations, e.g. multinationality of operations.

Multinational implies the consistence of "many" nations. Thus, the term Multinational Enterprise or Corporation gives the impression of being owned by many nations. Enterprises such as ABB and Unilever fit this definition because of their ownership structure by more than one nation, though their ownership is limited to two nations only. The rest, overwhelming majority of MNEs, are owned by one single nation. Although the subsidiaries are legal citizens of several nations, subject to the laws of host country, in practice, they all are owned and controlled by one management center located in the home country of MNE. Their ultimate objectives and operations are subject to the approval and Internets of the headquarters and occasionally the home-country state as well. Hit not the primary goal of headquarter top management to maximize the total benefits of the subsidiaries to host nation or region, but to maximize the profits of the corporation subject to global internets and opportunities. In fact, even home country national policies and internets are of lesser importance for the corporate management. In short, management of the MNEs are not concerned with the development targets of individual nation-states, regions, or territories. Circumstances and country-specific economic policies of nations determine the outcome of relations with MNEs.

In this study, the large business corporations of modern age, operating also in foreign countries will be referred to as the Multinational Enterprise (MNE) simply because of its common usage by many authorities. The term MNE is not chosen to be used "in a propagandistic and apologetic sense" as Magdoff-Sweezy suggest.

The MNE in this study is assumed to have production centers in at least two or more countries with the ultimate goal to maximize the profits of the parent firm on the basis of global opportunities.

One of its main characteristics is that it has a nationality or a home (firms like ABB, Unilever and Royal Dutch are exceptions) in which the private internets of share-holders have absolute priority in determining the extent and nature of global trans- actions. In fact, an important feature of the MNE that significantly contributed to the consolidation of its dominant position in international markets is the "centralized decision-making" with respect to the global opportunities to maximize profits of the parent company. Thus, the nationality of a firm plays an important role in the nature and development of global economic relations. "**Consider a firm with operations in Canada and the United States, suppose that the Canadian activities become unprofitable and it is decided to liquidate**

the enterprise the place where the capital will be transferred to will be influenced not only by profit considerations but by nationality." {31:p.223} Thus, the ownership structure of the MNE displays an important feature influencing global economic decisions of MNEs.

Hymer points out:

> "There are at least three senses in which a firm has a nationality. First it has a legal nationality, and this determines the legal limitations on its behavior. a firm also has nationality because most of its share-holders reside in a certain nation, and, what is more important, is committed to pay dividends in a certain currency. Last and probably least, the managers of a firm have a nationality, and this may affect their allegiance and the firm's behavior." {31:p.29}

In spite of the existence of some MNEs of developing country origin, the leading and largest MNEs have their roots, in terms of legal nationality and the nationality of shareholders in industrialized countries. Their technical, managerial and organizational superiority is indisputable. As to the nationality of managers, the MNEs tend to appoint increasingly more local personnel to top management positions for its obvious advantages. But key decisions are still subject to the approval of the parent firm or the board of directors consisting largely of foreign nationals.

The Source of Global Wealth?

Some authorities claim that the MNEs with their enormous technical managerial and financial capabilities are (becoming) an indispensable source of wealth of nations. According to G.W. Ball: "**The structure of a multinational corporation is a modern concept designed to meet the requirements of modern age**." {39:p.87} G. Meier praises the MNE as "**a unit of integration in the world economy**." {48:p.392} Hymer-Rowthorn go a step further and claim that the nation-state is outmoded, and analogously the national sovereignty.

> "**Whatever the force of technology, it is clear that the growth of Multinational Corporations, by itself, tends to weaken the nation- state. Multinational Corporations render ineffective many traditional policy instruments, the capacity to tax, to restrict credit, to plan investment, etc., because of their international flexibility.**" {39:p.88}

Are the MNEs indeed becoming an indispensable source of wealth of nations? Are the internets of MNEs fully compatible with the internets of host-countries? For J.J. Servan-Schreiber the answer was obvious:

> "**a country (continent) without its own multinational corporations will become a colony. If Europe does not create corporate capitals to match the American giants it will be reduced to playing a secondary, colonial role, not just in the economic sphere, but in the political, social and cultural spheres as well**." {39:pp.58-59}

Servan-Schreiber may be right in hit analysis of economic, political, social and cultural dependence on other countries (continents), but quite mistaken on Europe's economic capabilities.

> "**The problem of colonialism is not really a European problem since European business, despite Servan-Schreiber's analysis, is strong, not weak. Colonialism is the problem of the less-developed countries, where both state enterprise and private capital are very weak and are in no way a match for the powerful business organization of the advanced world. In the coming competition between European and U.S. corporations, the markets of the third-world will be an important battleground**." {39:p.91}

Flow of Funds Through FDIs

In general, the flow of funds from MNEs to developing countries take three forms:

(1) export-credits;
(2) Portfolio investments; and
(3) Foreign direct investments.

Export credits are granted to make it possible to purchase the necessary commodities on credit terms. Essentially being tied, the export credits are not always in line with the economic policy of recipient country. Portfolio investments are loan capital borrowed via bond issues on international capital markets or loans granted by various finance institutes. In essence, they are untied, and do not involve any form of control or ownership of the enterprise. The portfolio investor is mainly interested in maximizing hit profits by investing in areas where expected returns are highest. FDI, on the other hand, involves the setting up of a manufacturing plant and the control of it. There is no commonly accepted definition of control, for its definition is vague, arbitrary and subjective.

> **"The fund's Balance of Payments Manual defines foreign direct investment as investment made to acquire a lasting interest in a foreign enterprise with the purpose of having an effective voice in its management. Many countries set a minimum proportion of foreign ownership of the voting stock (generally between 1 to 2 percent) as evidence of direct investment» sometimes several percentages are set, depending on how dispersed foreign ownership is**." {32:p.28}

In the U.S. the Department of Commerce

> "…. **considers a foreign enterprise to be American-controlled if it is wholly owned, as in the case of a branch plant, or if 2 percent of the equity is held by an American or group of affiliated Americans, or if 5 percent of the equity is held by Americans even though no single group has 25 percent**." {31:p.1}

> "**In principle**", says the IMF report, "**foreign direct investment flows include all funds provided by the direct investor, either directly or through affiliates. This includes equity capital, reinvested earnings, and net borrowing from the direct investor or its affiliates. Third-party loans guaranteed by the direct investor are not included, even though the investor assumes a potential liability and the loan might not have been possible without the existence of the direct investment in the subsidiary by the parent company**." {32:p.28}

I-2: Types of International Investments

Foreign direct investments display various characteristics depending on the host-country economic policy and intentions of the foreign investor. Some foreign investments are undertaken to secure the steady supply of raw materials, while some may strictly aim to exploit the cheap labor services or invest in service sector. If the foreign investor plant to service the market locally rather than by exports, it would set up a local production center. With respect to the differentiality of motives of foreign investors, we can classify and study the "International Investments", as distinct from FDIs, in four major groups:

1- Commodity Market oriented international investments;

   a-) Inward (Local-market) oriented;

   b-) Outward oriented, including off-shore FDIs.

2- Service oriented international investments, (in banking, insurance, tourism, trade, etc.);

3- Primary sector oriented international investments (in extractive industries, plantations.) and,

4- Portfolio investments.

Commodity Market Oriented International Investments (e.g. FDIs)

Tariff and non-tariff trade restrictions and regulations within nations as well as within customs unions such as the EEC (European Economic Community) tend to provide attractive premises for foreign investments. With the imposition of, or an increase in the tariff or non-tariff barriers in a country, the foreign companies face the risk of loosing market shares that were previously being serviced by exports. To protect its market share, the foreign firm may respond with direct investment. In other words, the foreign enterprise moves in to restore / secure its sales and earnings.

Tariff and non-tariff trade restrictions may even attract new direct investment from other foreign enterprises without previous commercial commitment to the market. A study by OECD indicated that the MNEs preferred import-barriers to financial incentives to consider investment in a foreign country. {2:p.59}

> "**In a survey of British corporate investment in Australia, Hogan found that 53 % of the companies in hit sample which were established in**

> **Australia during the fifties mentioned import controls or tariffs as a 'very important' motive foe establishment**." {39:p.298}

National Foreign Trade Council in the U.S.A. {21:p.68} indicated similar preference in the findings of a survey.

In some cases, transportation costs constitute a large portion of the total costs of a commodity, thus reducing the competitiveness in international markets. In order to eliminate the transportation costs across countries, the enterprise may respond with a direct investment, hence survive the competition of local suppliers, given the adequate demand for the commodity.

> "**A survey by the Emergency Committee for American Trade of seventy-four U.S. corporations shows that 57 percent of the respondents considered market demands the most important reason for the foreign investment decision**." {21:p.74}

Another demand related factor inducing direct investment is the expected market growth in a potential host-country. To keep pace with the rapidly growing markets, such as that of the EEC, direct investment would be rational behavior. A survey of British direct investments in Australia indicated long-term market growth as the secondary major motive, after tariff and non-tariff restrictions. {39:p.298}

> "**Looking at American corporate investment", Brash found that "expected market growth was the prime reason for investment given by 54 % of the companies studied, and one of the main reasons for investment given by no lest than 8* percent**." {39:p.298}

C.V. Vaitsos (1974) describes the product life-cycle theory developed by Vernon as defensive strategy response aimed to survive competition from imitators, or as a result of trade barriers and regulations imposed by the host-country. {85:pp.10-12} According to the product life cycle model, during the early stages of a new technology (commodity) the market is characterized by inelastic demand relative to the potential demand, and bulk of the production is aimed for the home market. There are few, if not only one, producers, thus enabling the technology owner to make monopoly profits. In the subsequent phase characterized by growth, demand for the new technology grows rapidly and becomes increasingly better accepted. In the mature phase, the technology and the tastes are assumed to be standardized. As the domestic plant capacity exhausts, the owner of the technology moves into other countries to set up new plants, given sufficient demand and other inducements. As long as there is unutilized domestic plant capacity; the technology owner would be reluctant to move production abroad, unless conditions, for

example tariffs, require the otherwise. Reflecting on product cycle theory, Hymer-Rowthorn pointed out that;

> "**Europe's exports of manufactures to the United States are about equal to its imports from the United States, but direct investment by European corporations in the United States is much smaller than United States direct investment in Europe. The theory of the product cycle (from innovation to exports to foreign investment) seems to apply more closely to the experience of U.S. corporations**." {39:p.77, footnote:14}

Things have changed, however, since Hymer-Rowthorn published their findings. The trend in 1980s indicated a higher rate of direct investment in the U.S.A., hence making her the largest recipient of foreign direct investments around the world.

According to UNCTAD {76:p.19}, one of the motives encouraging direct investment is the home country real-wage level. Profit- maximizing behavior of the enterprises prerequisite the free flow of the factors of production, both capital and labor, in order to operate at optimum level with respect to global opportunities.

There are, however, various restrictions on the mobility of factors of production, especially on the mobility of labor-power across nations. The labor-market imperfections raise the real-wage level of technology producing nations, hence affecting the competitiveness. In response, the MNE may spill over production to other countries where real-wage rate is lower.

The importance of wage-level competitiveness in relation to foreign investments, in general, appears to be overrated by UNCTAD. The bulk of the foreign investments take place in the high wage industrialized countries rather than in low-wage developing areas. Findings of a survey by the Emergency Committee for American Trade of 74 U.S.-based corporations seem to support this view. The survey found that only 5 percent of the companies "**considered labor cost advantages as the primary cause of investing abroad**." {21:p.74} Labor cost advantage is more likely to be of major importance for the "off-shore" investments or so called "runaway shops".

Other motives of relatively minor importance but leading to Foreign direct investment might be summarized as;

1) to have access to local skilled foreign man-power»
2) taxation policy of the home country of enterprise»and

3) home country restrictions and regulations (for example, Indian government's foreign exchange constraints).

The determinants of FDI will be analyzed extensively in Chapter-IÉ and will be one of the major aspects of this study, and the reader ought to keep in mind that when we refer to FDI, we strictly mean local investment with the purpose to manufacture commodities.

Offshore FDIs

Labor-power oriented foreign investments find the most fruitful economic climate in countries where real-wages are cheap and, preferably, trade union activities are restricted. The size of the domestic market and demand in the host-country are unimportant as the production is aimed primarily for the market of home country of foreign investor or for third countries or both. As the UNCTAD report points out;

> "**it is already a common practice for a number of transnational corporations of developed countries to send raw materials or components to certain developing countries for labor-intensive assembling or processing. The products so manufactured are then re-imported into the industrialized countries or exported elsewhere for assembling, finishing or final sale.**" {70:p.4}

In the beginning of 1970s, Zimmerman (1973) had accused the U.S. company RCA of closing down its years old two big plants in Cincinnati-Ohio and Memphis-Tennessee, following a 11 weeks-strike, to Taiwan to take advantage of cheap labor-power where wages were 14 cent an hour and strikes were illegal under the dictatorship of Chiang Kai-shek. {90:p.2} As the president of Admiral International stated, the assembly of complete color TV sets on Taiwan quotes Zimmerman; "… **won't affect pricing stateside, but it should improve the company's profit structure**." {90:p.4} As a result of off-shore production (or "Runaway" shops, as he calls them), says Zimmerman, "**95 % of all radios and tape recorders, 50 % of black-and-white TV's, and 95 % of the baseball gloves sold under American brand names are made abroad**." {90:p.4} in early 1970s. In a relevant study, G.K. Helleiner found that "**value added per employee in U.S. based assembly operations in lest developed countries averages only about $ 2,700 as against an average in U.S. manufacturing industry of over $ 14,000**." {29:p.31} in 1973.

Reflecting on the U.S. economic and trade policy, Bergsten-Horst-Moran (1978) found that two specific aspects directly encouraged the foreign investments in developing countries by the U.S.-based MNEs.

> "**One permitting duty-free importation of the final products made abroad from American-made components (sections 806.30 and 8077of the Tariff Code) encourages assembly operations in other countries. The original target was aircraft produced in Europe with American components, but the industries most affected now are electronics and toy making in Mexico and the Far East. Second is the system of generalized preference, in force since January 1, 1976, which provides duty-free importation for many manufactured and semi manufactured products for at least ten years and thus encourages foreign direct investment in those sectors in eligible countries**." {10:p.357}

The most eligible countries, as expected, were to be found in the Far East.

Frame asserts;

> "… **the advanced country firms can use their overseas operations in ways that would be untenable at home. Foe example, the overseas facilities may be employed to meet orders in boom times. Once the boom is over, plants may be closed and indigenous workers laid off until the arrival of the next boom**." (23:p.90)

Another case which might result with the lay-off of workers and closure of plant could arise when the foreign investor moves its plant back to home country, or a third country, for the production of, say labor-intensive, components and/or assembly tasks by industrial robots. As long as the plant is kept in operation, the benefits accruing to the host-country would be in terms of employment generation and increased foreign currency / government revenues (minus grants and concessions).

Service Oriented International Investments

Service sectors covert activities ranging from tourism, insurance, banking, advertising to consultancy, trading, etc. Investments in this sector, especially in tourism and finance, can sometimes make up a significant percentage of total foreign investments in a given host-country. Tourism sector in Spain and Greece, for example, make considerable contributions to the development of national economy. But, since the focus of this study is on the transfer of technology through direct investment, we shall ignore the consideration of service sector activities in our discussions below.

Primary Sector Oriented Investments:

There seems to be two main factors inducing the enterprises to engage in primary sector activities. The main one is the desire to secure the flow of essential inputs to production centers, thus avoiding (pre-empting) shortages. Artificial shortages of such materials beyond the control of production centers may raise the price of inputs, and eventually of final product, thus jeopardizing the competitiveness and profitability of enterprises using these inputs. To prevent the emergence of such beyond control, the enterprise as the production center may move in and set up or take over a production plant, thus securing the steady supplies of inputs.

Unilever's involvement in raw-material production represents a typical case in support of this view. As Wilson pointed out:

> "**The nature of the raw materials required by the soap maker made him (Lever) peculiarly conscious of the importance of foreign supplies. And the quality of Sunlight, depending as it did on imported vegetable oils, made Lever from the beginning alive to the problems of raw materials. Round about the turn of the century, the fear of being 'squeezed for these materials by the merchants and brokers became almost an obsession with him, and in the projects for winning raw materials that followed there was probably a large element of defensive strategy**." {45:p.465}

And the other factor inducing foreign investment in raw material production seems to be the case where natural resources require on-site processing. In such cases, the MNE is expected to set up a production plant as the source of natural resource. It is also likely that a small country MNE may invest abroad in primary sector primarily to service the third country markets. But, since no manufacturing of commodities is involved, international investments in primary sector, by definition, is not a FDI, thus beyond our interest in this study.

Portfolio Investments

A portfolio investment is loan capital that takes place when an inter-national financial institute or foreign government lends money via bond issues at the disposal of an entrepreneur, whether be it private or state, or enterprise or institution. As distinct from the foreign direct investor, the portfolio investor has no control or ownership rights over assets disposable. In other words, a portfolio

investor does not possess any legal right to interfere in decision-making process of how resources are allocated. Portfolio investments via bonds are usually long-term and carry a fixed interest rate. Portfolio investments are, too, beyond the scope of this study on manufacturing subsidiaries.

I-3: Review of Foreign Direct Investments

MNEs have become a decisive economic factor in the global relations and as such affect the outcome and formation of almost all major global economic events, not to mention the political and cultural ones. Their activities influence the redistribution of global income, division of labor and the flow of commodities across the nations. For most of the developing countries, MNEs are an indispensable source of technical, financial and managerial flows. And the developing countries, in a sense, compete with each other to attract more foreign investment through various generous incentives. How did these mighty economic agents of contemporary world emerged. Could the tendency toward domination by MNEs and universal interdependence be avoided?

FDIs in 19th Century.

British overseas investments in early 1800 in the extractive industries and in railroad construction in colonial settlements were the forerunners of international investments by large corporations. Foreign investment in plantations constituted another field of interest. Other major capital exporting countries were France, Germany and the Netherlands. Much of the capital invested was within the imperial settlements with the main purpose to secure the flow of raw materials and finished commodities from and to colonies. One of the major initial investments was the construction of Panama Railroad in 1849 for $ 5 million by a U.S. firm. {21:P.19} Cockerill of Belgium, however, put up the first foreign manufacturing plant, in Prussia in 1815. {24:p.3}

The large continental corporations of the time spread rapidly their foreign activities and;

> "**no fewer than 37 of them owned one or more foreign manufacturing subsidiaries by 1914. Enterprises active in chemicals and electrical equipment had achieved a particularly impressive spread of foreign manufacturing activities German companies were particularly prominent in this early outward movement» indeed, according to some estimates,**

> **German foreign manufacturing investments alone considerably exceeded those of American enterprises on the eve of World War I**." {24:pp.8-10}

Prior to WW I trade restrictions and regulations had paved the way for subsidiary establishment in various European countries. German firms like Hoechst, Bayer, Siemens, Mannesmann, Swiss companies like Nestle, Ciba, Geigy, and Benelux firms like Cockerill and Unilever had responded to trade barriers with setting up production plants in France, United Kingdom, Russia, Italy, etc. Of the 167 subsidiaries established prior to 1914, 122 were established in Western Europe and North America, 27 in Eastern Europe, 10 in Greece, Spain, Portugal, Turkey, Israel, 2 in Latin America and 6 in Asia and Africa. {24:p.106, Table 5.1} In the absence trade restrictions/regulations much of the foreign production would not had been undertaken. Instead, the flow of commodities across the countries would have increased substantially. FDI made significant contributions to the domestic capital formation in many countries. In the U.S., for example, by 1914 "**direct foreign investments of $ 2.65 billion comprised 7 percent of the United States Gross National Product**." {21:p.20}

Table I-1 displays the year of establishment of some subsidiaries in various European countries and the U.S.A. as well as the investing firm. The common characteristic of all countries was the trade restrictions imposed one way or another, which in response led to FDI.

Table: I-1 Circumstances Related to Establishment of Foreign Manufacturing Facilities by Large Continental European Firms: Selected Cases, Prior to World War I

Parent firm	Date	Product
Subsidiary Establishments in France:		
Hoechst	1881	Synthetic dyes
Bayer	1883	Synthetic dyes
Agfa	ca: 1895	Synthetic dyes
Geigy	ca: 1895	Synthetic dyes
Siemens	1879	Electrical eq.
Subsidiary Establishments in the U.K.		
Ciba	1909	Aniline oil, trinitrotoluene & intermediaries.
Mannesmann	1899	Seamless steel tubes
Subsidiary Establishments in Germany:		
Unilever (V.D.Bergh & Jurgens' predecessors)	1888	Margarine
Brown, Boveri	1898	Steam turbines
Subsidiary Establishments in Russia:		
Hoechst	1878	Aniline dyes
BASF	1878	Aniline dyes
Agfa	1888	Aniline dyes
Ciba	1899	Aniline dyes
Cockerill	1885	Steel plate, ships
Siemens	1880	Cables, telegraph apparatus

Source: Quoted from {24:p.87, Table 4.5}

FDIs in Post-WW I Period

Trade barriers before the World War I had stimulated much FDI by enterprises. Protective measures had increased in all industrial countries, and continued in the post-WW I period. During the War years, 1914-1919, FDI had fallen sharply, but recovered slightly in 1920s. During the recession years of 1930s, FDIs by U.K. and Continental enterprises showed a decline while those of the U.S. enterprises continued to flower, until the advent of WW II.

Division of international markets by cartels or other forms of arrangements had become a common practice. Some enterprises had made arrangements to share the markets, while some had agreed to stay out of each other's product-line, and

others had agreed to operate though a network of Jointly owned subsidiaries. {see 86: }

Following the troubled recession years of 1930s; "**U.S. direct investments abroad increased sharply after W× II, from 7.2 billions of dollars in 1946 to 22.1 billions of dollars in 1956**." {31:p.3}, around triple increase in 10 years. MNEs were steadily increasing their influence in the global business transactions and emerging as the core of a new international division of labor and production. European based MNEs were following the U.S. firms footsteps in international markets but the latter's' leadership and dominance was indisputable.

FDIs in 1950s and 1960s

The growing dominance of the MNEs, especially of U.S. based ones, continued in 1950s and 1960s. Often the term MNE was used as a synonymous to U.S. enterprise operating abroad, while the role of British and other Continental enterprises was reduced to secondary importance.

> "**In the 1960s MNC private direct investments represented about one-fifth of the total flow of recourses to LDCs. Moreover, this flow increased at an annual average rate of 9 percent. Thus the stock of foreign private investment increased faster than the GNĞ of most poor countries**."[64:p.343]

Newfarmer and Mueller (1975) found that in Mexico "**of the 100 largest firms, 61 were foreign» of the 300 largest, 150 were foreign. Foreign subsidiaries were on average much larger than local private firms, but smaller than public sector enterprises**." {in 41:pp.38-39} And of the total GNP, MNEs accounted for 18 percent in 1962 and 23 percent in 1970. [see 41:] In Brazil, of the 500 largest firms 158 were foreign owned. Data on Argentina supplied by Sourouille (1976) indicated "**foreign firms contributed some 30 percent of total manufacturing output in 1970**." {41:p.39}

> "**European and Japanese investors established 254 new subsidiaries (for a total of 529) in the Third World between 1946 and 1959 (about one-sixth of the 1549 subsidiaries they subsequently established from 1959 to 1970). Between 1945 and 1955, 525 new American subsidiaries (for a total of 1,062) were established in Asia, Africa, South America, and the Middle East (many more than the Europeans and Japanese but lest than half of the 1,324 created in the subsequent decade**." {10:pp.370-1}

Meanwhile;

> "… **the book value of American investment in Europe jumped from $ 4.15 billion at the end of 1957 to $ 24.52 billion in 1970, or about 600 percent. By the mid-1960s, the European invasion by American multinationals gave rise in Europe to three concerns: the threat of technological dependence, the fear of industrial dominance, and the prospect of loosing control over national economic planning.**"{10:p.405}

Table:I-2 shows that the foreign affiliate sales constituted around 80 percent of total sales of U.S-based MNEs in early 1970s.

In 1950s, the U.S. based enterprises enjoyed an undisputed and unchallenged leadership position in the international investments. But the European and Japanese enterprises have been closing the technological gap with their U.S. counterparts steadily. "**For example, while the United States had an average annual rate of labor-productivity growth in manufacturing of 2.7 percent in the period 1960-1975, Japan's was 9.7 percent, West Germany's was 5.7 percent, France's was 5.6 percent, and Britain's was 3.8 percent. Allied to those differential rates of productivity growth, difference in unit labor cost between the United States, Japan, and West Germany were narrowing. One consequence of this convergence was that non-U.S. multinationals were growing more rapidly than were U.S. ones, and the dominance of U.S. multinationals 'declined consistently over the decade 1963-1972'**." {25:p.8} Table I-3 supports this view. While 46 % of the total number of subsidiaries of U.S. firms was established between 1956-1964, the most aggressive expansion period of subsidiaries of the European firms was between 1965-1970 according to the data as of January-1971. 67 % of French, 55 % of Dutch, 53 % of German and 47% U.K. based firms' subsidiaries were established during this 5-years period.

Table I-2: Sales by Majority-Owned Foreign Affiliates as a Share of Total Foreign Sales of American Multinationals (1966-73)

Foreign Market (billions of dollars)

Year	Total	Exports from United States	Foreign affiliate sales	Foreign affiliate share (%)
1966	127.1	29.3	97.8	77.0
1967	139.2	30.7	108.5	78.0
1968	154.4	33.6	120.8	78.2
1969	170.7	36.4	134.3	78.7
1970	197.8	41.9	155.9	78.8
1971	227.2	42.8	184.4	81.2
1972	261.1	48.8	212.3	81.3
1973	361.8	70.3	291.5	80.6

Source: Survey of Current Business, Vol.55-56 [10:p.8,Table:1-1]

Table I-3 Percentage of Foreign Manufacturing Subsidiaries Established in Various Periods by Large U.S. & European Companies
(US data as of January 1, 1968; all other ata as of January 1, 1971)

	Period						**Total number of**
Country of parent	Before 1914	1914-1929	1930-1945	1946-1955	1956-1964	1965-1970	**subsidiaries established** (=100 %)
U.S.A.	3 %	8 %	11 %	14 %	46 %	18 %	9,127
U.K.	2	6	5	10	30	47	2,530
Germany	6	9	3	8	21	53	1,024
France	2	3	4	7	18	67	457
Italy	2	4	5	18	34	37	123
Bel & Lux	8	15	4	8	12	53	311
Netherlands*	3	11	4	6	21	55	455
Sweden	3	19	10	11	16	41	209
Switzerland	12	13	9	9	19	38	458

Notes: * Excludes Unilever.
Total percentages may not add 100 due to rounding.
Source: Comparative MNE Project, in {24:p.94, Table 4.9}

By the end of 1960s, Japanese FDIs were still relatively insignificant in comparison to U.S. and European based FDIs. Accumulated total number of U.S. based foreign

manufacturing subsidiaries was 4,836, of the U.K. based subsidiaries 2,529, of Continental based ones 3,023, while the corresponding number was only 521 for Japan based subsidiaries. {see 24:p.10, Table I-2} Most of the Japanese subsidiaries were located in Far East Asian countries.

Trend in 1970s

Foreign investment trend continued in the 1970s.

> "**The U.N. had estimated that the affiliates of all industrial MNE's in the world economy in 1976 accounted for some $ 670 billion of sales (excluding intra-firm sales)..... Further, the stock of direct investment abroad of the developed market economies, commonly associated with the trend of MNE operations, grew from $ 105 billion in 1967, to $ 259 billion in 1975, and to an estimated $ 287 billion in 1976**." {55:p.2}

Todaro, acknowledging the dominant position of MNEs in international affairs, pointed out that nearly 200 of MNEs;

> "**have subsidiaries in 20 or more countries. Eight of the ten largest are based in the United States while U.S. firms exercise control over 30 percent of all foreign affiliates. Britain, Germany, and France, together with the United States, control over 75 percent of all MNC affiliates.**" {64:p.342-3}

The bulk of these foreign investments have gone to industrialized countries, while around 35 percent of the total foreign direct investments have been undertaken in developing countries in 1960s and 1970s. (see Table I-4) Following the OPEC oil crises in early 1970s,the share of developing countries of total foreign capital stock fell to its minimum level ever, 6 percent only in 1974, but recovered again the following year and reached its peak, 49 percent in 1975. The major factors influencing the flow of foreign direct investment primarily to DCs are;

(a) relatively high incomes;

(b) economic and political stability;

(c) transportation costs; and

(d) the specific trade policies prevailing in those countries.

I-4: Foreign Capital Movements (Gross) 1960-1979 (Million $)

Years	U.S.A. I	Western Europe II	Industrialized Countries III	Developing Countries IV	World Total V	% IV/V
1960	315	749	2,150	1,806	3,956	46
1961	311	1,573	2,815	1,839	4,654	39
1962	346	1,598	2,790	1,469	4,259	35
1963	231	1,819	2,836	1,659	4,495	38
1964	322	2,255	3,412	1,819	5,231	35
1965	415	2,652	4,227	2,488	6,715	37
1966	425	2,878	4,504	2,159	6,663	33
1967	698	2,893	4,791	2,103	6,894	30
1968	807	2,646	4,735	2,900	7,635	38
1969	1,263	3,300	5,928	2,804	8,732	32
1970	1,464	4,200	7,522	3,689	11,211	33
1971	367	4,892	7,523	3,307	10,830	31
1972	949	5,925	8,702	4,234	12,936	33
1973	2,800	8,054	11,688	4,719	16,407	29
1974	4,760	9,962	16,695	1,123	18,088	6
1975	2,603	7,244	11,153	10,494	21,647	49
1976	4,347	5,611	10,791	7,824	18,615	42
1977	3,338	8,972	13,851	9,500	23,351	40
1978	7,900	10,470	20,978	11,154	32,132	35
1979	9,730	9,403	22,098	13,491	35,589	38
				Average		35

Source: United Nations Center of Transnational Corporations, and the Group of Thirty. [in 12:p.3, Table: 1]

FDI in 1980s

Net flows of direct foreign investment in developing countries soared from around $ 3 billions a year in early 1970s to around 10 billions a year in 1980s.

> "**The growth of net direct investment flows to non-oil developing countries after the first oil price increase was still, on average, around 3 percent per annum in real terms through the 1970s, compared with an average annual real growth rate of around 5 percent for the combined gross domestic product (GDP) of these countries. This 3 percent growth was about 1/2 a percent a year lest than the growth in real gross direct investment inflows into industrial countries, although the average growth in industrial countries' combined GDP, at around 3 percent, was lower than that of developing countries**." {32:p.3}

The stock of foreign capital, growing at an average rate of 11.3 percent a year, rose from $ 47 billion in 1973 to $ 141 billion in 1983, or by 300 percent in 10 years. Meanwhile, the stock of foreign capital as percentage of exports of commodities and services declined from 41.5 percent to 31.7 percent, in respective years. (see Table I-5)

> "**Much of this investment is concentrated in a small number of countries that have large domestic markets, are rich in natural resources, or have significant advantages as a base for export-oriented production. Five countries (Brazil, South Africa, Mexico, Singapore and Malaysia) accounted for almost half of the stock of direct investment in non-oil developing countries at the end of 1983. However, some other countries that also have large domestic markets (such as India and Turkey), or that have successfully pursued an export-oriented development strategy (such as Korea), were much lest reliant on direct investment. Countries that had small domestic markets and that lacked substantial natural resources or an export-oriented manufacturing base (including many in Africa) were often relatively unsuccessful in attracting direct investment**." {32:p.4}

MNEs of LDCs

The main characteristics of contemporary giant business firms are their financial strength, technological superiority, access to highly skilled manpower and the structure of organization. MNEs are predominantly of developed country origin and are large by size. In each country, the largest enterprises seem to account for the major part of FDIs. Of the U.S. based FDIs, for instance, around 70-80 percent are undertaken by 187 enterprises in 1970s. 165 MNEs of U.K origin accounted for more than 80 percent of FDI.

Table I-5: Non-oil Developing Countries: External Liabilities

1973, 1983

	Stock of Liabilities[a]		Average Annual Growth Rate
	1973	1983	1973-83
	(in billions of US $)		(in percent)
Foreign direct investment **	47.0	140.9	11.6
Total external debt ***	130.1	685.5	18.1
(As percent of exports of goods and services)			
Foreign direct investment	41.5	31.7	
Total external debt	115.4	154.4	

Sources: OECD, Development Cooperation, and Geographical Distribution of Financial Flows to Lest Developed Countries; IMF, World Economic Outlook, 1984. {32:p.5}

* End-of-year

** Book value; net of disinvestments and nationalization

*** Excluding reserve-related credits

In Federal Germany, 82 firms accounted for more than 70 percent of FDI, while the 9 largest accounted for 37 percent of total FDIs originating from that country in 1970s. {see 87:p.181-2} Regarding their technological and non-technological superiority and the market imperfections, there seems to be no challenge originating from the developing countries to the dominant position of developed country MNEs, in the near future at least. But the international activities of some of the LDC-based enterprises tend to be expanding gradually, particularly in other developing countries.

> "**In Asia, the Middle East, Latin America, and parts of Africa a number of local firms are moving abroad to establish manufacturing plants in other developing countries. Indian companies have subsidiaries in Sri Lanka, Malaysia, and Kenya. Argentine firms have established production facilities in Brazil, Chile, and Uruguay. Countries, such as Indonesia, find themselves hosting subsidiaries of companies headquartered in the Philippines Korea, Taiwan, Singapore, and Hong Kong. In a list of the 441 largest non-financial firms in Latin America, Brazilian firms are listed as owned in Argentina. In Indonesia, investments approved by the Foreign Investment Board since 1967 contain a significant number of investments from other developing countries**."{1-e:p. 133}

And in Thailand "**of the 360 foreign firms granted promotion status between 1966 and 1973, 93 were from Taiwan, 10 from Malaysia, 5 from Hong Kong, 15 from India, and 16 from Singapore**."{1-e:p. 134} South Korea's foreign direct investments was worth of $ 25 million in 1970, and $ 386 million in 1983, of which about $ 239 million was invested in DCs and $ 147 million in LDCs, or 62 percent and 38 percent, respectively. {19:pp.530-1,Tables A3 & A5} And the combined foreign direct investments of developing countries reached to $ 6,162 million in 1983. {19:p.190, Table B1} However, not all of these international activities are always "truly" of developing country origin, as it may seem on the paper. It has been frequently observed that some MNEs of DC-origin undertake investments in LDCs through their subsidiaries in developing countries, or move their headquarters to countries where they get generous tax-incentives.

I-4: Distribution of FDIs by Country of Origin

There seems to be no correlation between the mere size of geographical area ¯ population of the home country and the size or numbers of MNEs. Switzerland and Sweden, for instance, are much smaller than India or Brazil in terms of land and population. But it is the former countries that have a lot more and huge MNEs possessing most advanced technologies and operating in a number of countries around the world. Switzerland's foreign direct capital stock as a proportion of the GNP was estimated to be 41 percent in 1982, followed by Netherlands, 28.5 percent, and the U.K., 19.5 percent. (see Table I-6) By standards of industrial development, Seychelles is a developing country, but she ranks the fourth place among the countries most dependent on foreign investment, preceding countries like U.S., Sweden and Federal Germany. The only logical explanation of this situation is that the MNEs use Seychelles as their base for investments in other countries most likely for generous financial incentives.

Table I-6: Countries Most Dependent on Outward Investment in 198² as Indicated by Foreign Direct Capital Stock as a Proportion of GNP.

	Country	%
1	Switzerland	41.0
2	Netherlands	28.5
3	U.K.	19.5
4	Seychelles	17.2
5	Canada	9.6
6	S. Africa	8.9
7	Sweden	7.5
8	U.S.A.	7.2
9	Hong Kong	6.9
10	W. Germany	6.0

Source: IRM Directory of Statistics of International Investment and Production; {19:p.816,Table:B-13}

Before the World War I, the U.K. and the Continental European MNEs were the dominant economic agents of global business activities. But, since the World War II, the undisputed leading home-country of FDIs has been the U.S. Table:I-7 shows that as of January, 1971, 4,246 manufacturing subsidiaries, or 42.8 percent of total manufacturing subsidiaries were of U.S. origin. Other traditional competitors, the U.K. and Federal Germany, had 22.9 respective ¸ percent of the total. Not even the total number of Continental European foreign manufacturing subsidiaries could come close to that of the U.S. figure.

I-7: Foreign Manufacturing Subsidiaries of Large Industrial Enterprises, Classified by Country of Parent Company,

January 1, 1971
(187 US Multinational Companies as of January 1, 1968)

Parent Country	Number of Subsidiaries in Operation	Percentage Share
United States	4,246	42.8
United Kingdom	2,269	22.9
Belgium & Luxembourg	276	2.8 %
France	429	4.3
West Germany	792	8.0
Italy	133	1.3
Netherlands	429	4.3
Sweden	171	1.7
Switzerland	397	4.0
Sub-Total Continental Europe	2,627	26.4 %
Japan	483	4.9
Canada	201	2.0
Other	100	1.0
Grand Total	9,926	100.0

Source: Comparative Multinational Enterprise Project {24:p.12, Table: 1-3}

Since 1965, the European and Japanese competitors have increasingly undermined the U.S.'s position as the principal source of foreign direct investment. Table I-8 shows a drastic increase in the percentage of foreign manufacturing subsidiaries established or acquired by European enterprises. By the end of 1970, countries like U.K., Federal Germany, Netherlands, Belgium and Luxembourg had established or acquired around 50 percent of their total foreign manufacturing subsidiaries between 1965-1970. According to data on Table I-9, the book value of the total stock of foreign direct investment increased from $ 108,200 millions in 1967 to $ 165,000 millions in 1971, or by about 53 percent. Meanwhile, the share of total stock of the U.S., the U.K., and Australia declined by a few percentages, while that of Continental European countries increased slightly, and that of Japan doubled. However, as per capita value of the stock of FDI, Switzerland exceeded the other industrialized countries by a good margin, more than 100 percent.

Table I-8: Percentage of Foreign Manufacturing Subsidiaries Established in Various Periods by Large American, British and Continental European Countries.
(US data as of January 1, 1968;
all other data as of January 1, 1971)

Country of parent	Period Before 1914	1914-1929	1930-1945	1946-1955	1956-1964	1965-1970	Total number of subsidiaries established (= 100 %)
United States	3	8	11	14	46	18	9,127
United Kingdom	2	6	5	10	30	47	2,530
Germany	6	9	3	8	21	53	1,024
France	2	3	4	7	18	67	457
Italy	2	4	5	18	34	37	123
Bel & Lux	8	15	4	8	12	53	311
Netherlands*	3	11	4	6	21	55	455
Sweden	3	19	10	11	16	41	209
Switzerland	12	13	9	9	19	38	458

Source: Comparative Multinational Enterprise Project {24:p.94, Table 4.9}
* Excludes Unilever
Total percentages may not add to 100 due to rounding.

Table I-9: Distribution of Stock of Foreign Direct Investment, Home Country, 1967 and 1971

	Book value (millions of $)		Share of total (percent)		
Home country	1967	1971 a	1967	1971	Per capita value, 1971 (dollars)
United States	59,486	86,001	55.0	52.0	415
United Kingdom	17,521	24,019	16.2	14.5	422
France	6,000	9,540	5.5	5.8	186
Germany	3,015	7,276	2.8	4.4	119
Switzerland	4,250	6,790	3.9	4.1	1,070
Canada	3,728	5,930	3.4	3.6	275
Japan	1,458	4,480	1.3	2.7	43
Netherlands	2,250	3,580	2.1	2.2	272
Sweden	1,514 b	3,450 c	1.4	2.1	425
Italy	2,110	3,350	1.9	2.0	62
Belgium	2,040	3,250	0.4	2.0	335
Australia	380	610	1.9	0.4	48
Portugal	200	320	0.2	0.2	33
Denmark	190	310	0.2	0.2	63
Norway	60	90	0.0	0.0	23
Austria	30	40	0.0	0.0	5
Other	4,000	6,000	3.7	3.6	...
Total	108,200	165,000	100.0	100.0	...

Sources: United Nations, ST/ECA/190, 1973; World Bank Atlas, 1973 {10:p.15, Table: 1-5}

a. Except for United States, United Kingdom, Germany, Japan,& Sweden, 1971 figures are estimates derived by applying the average 1966-71 growth rate of the U.S., the U.K. and Germany.

b. 1965 current price for assets of majority-owned manufacturing subsidiaries.

c. 1970 current price for assets of majority-owned manufacturing subsidiaries.

Table I-10: Stock of Direct Investment Abroad of Developed Market Economies, by Major Country of Origin, 1971 - 1975

	Billions of $, End of:			Percentage Distribution		
Country of origin	1971	1973	1975	1971	1973	1975
United States	82.8	101.3	124.2	52.3	51.0	47.8
United Kingdom	23.7	26.9	30.8	15.0	13.5	11.9
Germany,Fed.Rep.of	7.3	11.9	16.0	4.6	6.0	6.2
Japan	4.4	10.3	15.9	2.8	5.2	6.1
Switzerland	9.5	11.1	16.9	6.0	5.6	6.5
France	7.3	8.8	11.1	4.6	4.4	4.3
Canada	6.5	7.8	10.5	4.1	3.9	4.1
Netherlands	4.0	5.5	8.5	2.5	2.8	3.2
Sweden	2.4	3.0	4.4	1.5	1.5	1.7
Belgium-Luxembourg	2.4	2.7	3.2	1.5	1.4	1.2
Italy	3.0	3.2	3.3	1.9	1.6	1.3
Total above	153.3	192.5	243.8	96.8	96.9	94.3
All other (est.)	5.1	6.3	15.1	3.2	3.1	5.7
Grand Total	158.4	198.8	258.9	100.0	100.0	100.0

Source: U.N. Commission on Transnational Corporations, Transnational Corporations in World Development: a Re-examination (U.N. Economic and Social Council, E/C. 10/38, March 1978) p.236

The percentage share of the total stock of FDI of the U.S. and the U.K., two largest sources of FDI, continued to decrease between the years 1971 and 1975. (see Table I-10) Meanwhile, Federal Germany and Japan based international direct investments increased their share of the total. By 1975, the U.S. was still the major source of FDIs, accounting for about 50 percent of the total stock but the others were catching up gradually. Especially in the developed areas, Federal Germany and Japan increased their share substantially, by 17.1 and 20.6 percent respectively, between 1970-82. (see Table I-11) The annual growth rate of FDI in developing countries by U.S. based enterprises and other traditional sources such as the U.K., France, Netherlands and Belgium, remained below 10 percent.

Table I-11: Industrial Countries: Stock of Foreign Direct Investment in Developing Countries, 1970, 1982

	1970	1982	Average annual growth rate 1970-82
	(in billions of U.S. $)		
Australia	0.3	1.5	14.4
Belgium	0.8	2.1	8.4
Canada	1.7	4.5	8.5
France	3.8	9.6	8.0
Germany,Fed.Rep.of	1.9	12.6	17.1
Italy	1.2	3.8	10.1
Japan	1.2	11.4*	20.6
Netherlands	2.2	5.3	7.6
Sweden	0.3	1.4	13.7
Switzerland	0.9	3.4	11.7
United Kingdom	5.9	15.8	8.6
United States	22.3	68.6	9.8
Other industrial countries **	0.2	1.1	15.3
Total	42.7	141.1	10.5

Sources: OECD, Investing in Developing Countries, 1983, and Development Cooperation, 1983 {32:p.43, Table:A-3}
Note: This table uses end-of-year figures
ª:Excludes official support for private investment estimated at over $ 6 billion)
**: Austria, Denmark, Finland, New Zealand, and Norway.

As mentioned in Chapter I-3 above, there is a small but gradually growing international activities by the enterprises originating from developing countries. "**If South Africa is excluded, the total recorded outflow of direct investment from non-oil developing countries amounted to an average of $ 640 million a year during 1980-82, compared with $ 120 million a year during 1973-75**." {32:p.5} The actual amount of FDI is assumed to be higher as many developing countries like Hong Kong, Singapore, Argentina were not included in these estimates for the lack of data. (see Table: I-12) Covering a more extensive area, J.Dunning-J.Cantwell {19:} estimated the percentage share of the developing country stock of FDI at 2.9 percent in 1975 and 2.7 percent in 1983. (see Table I-13) Annual average growth rate of the foreign investment stock of developing countries was estimated as percent between 1975-83, while the corresponding estimate for developed countries reached 9.8 percent. The highest annual average growth rates were observed in the U.K., 19 percent, and in Japan, 18.³ percent, exceeding the U.S.-based FDI's annual growth rate by around 3.5 times during the same period.

Table I-12: Non-oil Developing Countries: Net Recorded Foreign Direct Investment Abroad, 1973-82
(In millions of U.S. dollars)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Non-oil developing countries*	146	228	270	335	333	520	338	1425	1039	856
Of which:										
Brazil	37	59	112	183	146	125	195	369	208	371
Colombia	1	6	5	12	21	38	23	109	53	32
Israel	0	0	-1	6	6	6	1	-8	83	69
Korea	2	14	4	6	21	28	19	13	43	146
Philippines	1	0	1	6	17	30	126	222	71	177
South Africa	50	114	121	32	68	259	11	756	647	-5

Source: IMF, Balance of Payments Yearbook, various issues {32:p.43, Table: A-4}

Note: This table shows the capital movements resulting from the overseas direct investment activities of residents of non-oil developing countries. Positive data imply a net accumulation of overseas direct investment by residents, while negative figures imply a net repatriation.

*: Many non-oil developing countries (including Hong Kong and Singapore) do not report data on direct investment outflows

Due to the faster growth rate of FDIs of other countries, the percentage share of U.S. FDIs in total foreign capital stock had been reduced from around 50 percent in early 1970t to 44.2 percent in 1975, and to 38.4 percent in 1983. (see Table I-14) But the U.K still continues its leading position by a good margin to the second ranking U.K., and Japan in the third place. Between 1975-83 the share of foreign capital stock of Switzerland, Netherlands, France, Sweden, and Australia decreased by some percentages while that of the U.K., Federal Germany, Canada, Italy, Belgium, Hong Kong, and Brazil improved slightly, and that of Japan more than doubled.

Table I-13: World Stock of Outward Direct Investment by Region

	Percentage Distribution 1975	1983	Annual Average Growth Rate 1975-83
All Countries	100.0	100.0	9.7
Developed Areas	97.1	97.3	9.8
Europe	42.0	42.2	9.8
EEC	31.7	33.4	10.5
Other Europe	10.4	8.8	7.6
Switzerland	8.0	6.9	7.7
North America	48.0	43.2	8.4
U.S.A.	44.3	38.4	7.8
Other DCs	7.1	11.9	17.1
Developing Areas	2.9	2.7	6.0
Africa	n.a.	0.1	n.a.
Asia & Pacific	n.a.	1.6	n.a.
L.America & Carib.	n.a.	0.9	n.a.
Australasia	n.a.	0.03	n.a.

Source: J.Dunning - J.Cantwell, 1987; p.817, Table: B 15

Geographical Distribution of Subsidiaries

Geographical distribution of foreign direct investments indicates some divergences according to the origin of parent company. Franko (1976) points out that "Continental enterprises had long located a majority of their foreign subsidiaries in Europe prior to World War I, almost 90 % of the subsidiaries of Continental enterprises were located in Europe, including the United Kingdom. In the inter-war period, this percentage remained above 70. Not until the late 1950's and early 1960's did the number of new foreign plants located outside of developed Europe exceed those within. Then, after 1965, Europe once again became the focus for approximately 60 % of the foreign subsidiaries set up or acquired by continental firms." {24:p.81ı Table I-15 demonstrates that, except for the U.K., and Italy, the principal area for setting up or acquiring a manufacturing plant for European and U.S. investors has been the developed Europe. For Japan, the principle area for foreign direct investment was Asia and Oceania, while for Italy it was Latin America, by the end of 1970. However, the U.S. has been acquiring considerable amount of foreign direct investment from both, Europe and Japan in 1980s.

Table I-14: 15 Largest Outward Investors, by Size of Foreign Direct Capital Stock. 1975 and 1983 (US $ m)

		1975	% Distribution	1983	% Distribution
1	U.S.A.	124,050.0	44.2	226,962.0	38.4
2	U.K.	37,001.7	13.2	88,543.2	15.0
3	Japan	15,941.0	5.7	61,276.0	10.4
4	Switzerland	22,442.7	8.0	40,532.2	6.9
5	Netherlands	19,922.3	7.1	39,120.9	6.6
6	W. Germany	14,353.8	5.1	38,934.6	6.6
7	Canada	10,356.2	3.7	28,795.4	4.9
8	France	10,607.5	3.8	17,242.3	2.9
9	Italy	3,298.7	1.2	8,495.3	1.4
10	Sweden	4,670.4	1.7	6,761.4	1.1
11	South Africa	2,867.3	1.0	5,679.7	1.0
12	Belgium	3,038.4	0.4	4,211.0	0.7
13	Australia	1,108.8	1.1	2,997.9	0.5
14	Hong Kong	N.S.A.	-	2,540.0	0.4
15	Brazil	279.0	0.1	2,010.0	0.3
	Other Countries	10,197.8	3.6	17,469.8	2.9
	TOTAL	280,135.6	100.0	591,572.4	100.0

Source: J.Dunning- J.Cantwell(1987),IRM Directory of Statistics of International Investment and Production. p.813, Table: B 10

Data on Table I-16 displays the geographical distribution of foreign direct capital stock according to the geographical origin in 1975 and 1982. One striking feature of this data is that European foreign direct capital stock in developed areas seems to have exceeded the corresponding figure for the U.S. by a good margin in 1982. In developing areas, however, the U.S. based foreign direct capital stock was still slightly ahead of Europeans. Though the developed countries altogether increased their foreign capital stock in both developed and developing areas between 1975-1982, the European and the Japanese growth rates seem to have risen faster than that of U.S. Another striking feature of the Table I-16 is the drastic increase in the foreign direct capital stock of developing countries in both, developed and developing areas, in spite of the lack of data for some regions.

The book value of the foreign capital stock of developing areas increased from $ 22 millions to $ 1,091 millions in developed areas, around 50 times, between 1975-1982, and from $ 27.6 millions to $ 927.4 millions in developing areas, around 33 times, in respective years.

TableI-15: Geographical Distribution of Foreign Manufacturing Subsidiaries of Large American, British, European and Japanese Firms: Percentage in Main Areas of the World

(UK data as of Jan.1,1968» all other data as of Jan.1,1971)

National base of parent enterprises	Geographical Region of Subsidiary's Country: U.S.& Canada	Developed Europe	LDC* Europe	Latin America	Asia & Oceania	Africa & M.East	Total no. 100 %
United States .	13	35	4	27	15	7	4,246
United Kingdom	13	26	3	6	27	25	2,265
Japan	5	1	2	18	65	9	479
Germany	10	42	11	18	10	10	788
France	7	38	13	17	6	19	425
Italy	6	27	18	33	5	10	129
Belgium & Lux.	21	53	9	5	1	11	272
The Netherlands	23	51	3	9	9	5	425
Sweden	4	65	3	14	9	4	167
Switzerland	10	57	7	14	8	4	393

Source: Comparative Multinational Enterprise Project, {24:p.80, Table: 4.2}

* Less developed Europe includes Spain, Portugal, Greece & Turkey

Not surprisingly, the book value of the developed area foreign capital stock is much larger than that of developing areas, both in terms of capital stock as percentage of the GNP, and in terms of capital stock per head in U.S. dollars. (see Table I-17) What might seem as surprise for some, however, is the significance of foreign direct investments to certain countries, especially to Switzerland, the Netherlands, and Seychelles. The foreign capital stock of Swiss corporations consist 41 percent of the Swiss GNP, or $ 6,512 foreign investment per capita, and both figures are the highest of their kind around the world. The Netherlands came in the second place with her foreign capital stock equal to 28.5 percent of the GNP, or $ 2,776 foreign capital stock per head. The foreign capital stock of the leading country of international investments, the U.S., was 7.2 percent of the GNP, lower than the developed area average of 7.6 percent.

Table: I-16 Geographical Distribution of Outward Foreign Direct Capital Stock, 1975,1982 (in %) (US $ m)

	Developed Countries		Developing Countries	
	1975	1982	1975	1982
Developed Areas	$ 176,748.8	$ 420,720.3	$ 57,033.0	$ 139,103.8
Europe	% 36.8	% 47.1	% 30.2	% 35.9
EEC	36.6	36.6	29.9	30.0
Other Europe	0.2	10.5	0.3	5.9
North America	58.8	45.5	53.3	41.5
U.S.A.	54.4	39.9	48.8	38.7
Other DCs	4.2	7.3	16.4	22.5
Developing Areas	$ 22.0	$ 1,091.0	$ 27.6	$ 927.4
Africa (except S.Africa)	% n.a.	% n.a.	% n.a.	% n.a.
Asia & Pacific (ex.Japan or M.E.)	100.0	92.6	100.0	85.1
L.America & Caribbean	n.a.	1.5	n.a.	13.7
Middle East	n.a.	n.a.	n.a.	n.a.
Australasia	n.a.	5.8	n.a.	1.1

Source: J.Dunning - J.Cantwell, 1987, IRM Directory of Statistics of International Investment and Production.(derived from Tables B4-B5, pp.797-801

Note: Other European estimates for 1975 do not include countries like Austria, Finland, Portugal, Sweden, Switzerland, and Yugoslavia. And other DCs estimates for 1975 do not include South Africa.

Table:I-17 Indicators of the Significance of Outward Foreign Direct Capital Stock to Various Selected Economies,1982

	Capital stock as % of GNP	Capital stock per head (U.S. $)
Developed Areas	7.6	792.8
Europe	9.1	874.4
EEC	8.9	953.1
Other Europe	10.0	665.3
North America	7.5	971.6
Other Developed Countries	4.9	375.5
Selected DCs:		
Switzerland	41.0	6,512.5
Netherlands	28.5	2,776.9
United Kingdom	19.5	1,551.2
United States	7.2	956.0
Japan	4.7	448.6
Developing Areas	0.7	5.5
Africa (except S.Africa)	1.1	10.2
Asia & Pacific (except Japan and Middle East)	0.9	3.7
L.America & Caribbean	0.5	8.1
Middle East	n.a.	n.a.
Australasia	2.4	22.7
Selected LDCs:		
Singapore	4.0	484.3
Seychelles	17.2	385.9
Hong Kong	6.9	350.0

Source: J.Dunning - J.Cantwell, 1987, IRM Directory of Statistics of International Investment and Production. Derived from Table: B6, pp.802-804

Another apparently surprising outcome of the Table I-17 is the significance of foreign capital stock to the economy of Seychelles, a developing country by various yardsticks. But her foreign capital stock represents around 17 percent of the GNP, a figure much higher than the European or North American averages.

Seychelles must be an attractive country for MNEs to be used as headquarters for foreign direct investment because of, most likely, various financial incentives. It is also interesting to note that the per capita foreign capital stock of Singapore, $ 484 in 1982, was higher than that of Japan, $ 448.

Table I-1, Foreign Manufacturing Subsidiaries of 391 MNEs,

Classified by Ownership Patterns *

Country and ownership patterns	180 US-based enterprises No.	%	135 Europe & U.K.-based enterprises No.	%	61 Japan-based enterprises No.	%	All 391 enterprises in sample*** No.	%
In All Countries								
Total subsidia.	5,727	100.0	4,661	100.0	562	100.0	9,601	100.0
Wholly owned **	3,730	65.1	2,278	48.9	34	6.0	4,907	51.1
Majority-owned	1,223	21.4	1,320	28.3	74	13.2	2,177	22.7
Minority-owned	723	12.6	712	15.3	431	76.7	1,537	16.0
Unknown	51	0.9	351	7.5	23	4.1	980	10.2
IN INDUSTRIALIZED COUNTRIES								
Total Subsidia.	3,603	100.0	3,207	100.0	46	100.0	6,060	100.0
Wholly owned	2,612	72.5	1,788	55.7	6	13.0	3,634	60.0
Majority-owned	657	18.2	802	25.0	8	17.4	1,260	20.8
Minority-owned	302	8.4	404	12.6	30	65.2	626	10.3
Unknown	32	0.9	213	6.6	2	4.3	540	8.9
IN DEVELOPING COUNTRIES								
Total subsidia.	2,124	100.0	1,454	100.0	516	100.0	3,541	100.0
Wholly-owned	1,118	52.6	490	33.7	28	5.4	1,273	36.0
Majority-owned	566	26.6	518	35.6	66	12.8	917	25.9
Minority-owned	421	19.8	308	21.2	401	77.7	911	25.7
Unknown	19	0.9	138	9.5	21	4.1	440	12.4

Source: Harvard Multinational Enterprise Project {86:p.34, Table:4}

*: Data for US-based enterprises are provisional, as of 1975; others are final, as of 1970.

**: Subsidiaries of which the immediate parent in the system owns 95 % or more are classified as wholly owned; 50 % 0r more, as majority-owned; 5 to 49 % as minority owned.

***: Includes 15 MNEs based elsewhere than in U.S, Europe and the U.K. or Japan.

And finally a few words about the distribution of ownership of subsidiaries. As shown in Table I-18, the U.S.-based enterprises had a clear preference for whole or majority-ownership of their foreign manufacturing subsidiaries in 1975. European enterprises pursued a similar approach to the ownership matter as the U.S.-based enterprises. However, all MNEs seem to have been compelled to accept minority-ownership positions, around 20 percent, due to the specific economic policies and preferences of developing countries. Japan-based enterprises, on the other hand, in contrast to the U.S.-based or European-based enterprises, seem to

have settled easily for minority-ownership in about 3/4 of their foreign manufacturing subsidiaries in developing countries.

I-5 Distribution of FDIs by Recipient Countries

Foreign direct investments were initiated in the early 18th century by the European enterprises, primarily by U.K.-based ones. These initial investments were mainly in railway construction, plantations, or in extractive industries. Along with the FDIs, considerable amount of capital was exported as portfolio investments or foreign credit. Europe was the major recipient region of exported foreign capital, 27 percent of the total in 1913, including the portfolio investments and credits.{87:Table:1} South America was the second largest recipient region with its 19 percent, followed by the U.S., 15 percent.

Prior to World War I, Europe including eastern and southern parts together with the U.S. was hosting 157 subsidiaries of a total of 167 owned by 85 largest continental European enterprises. (see Table I-19) Europe and the U.S.A. continued to be the most attractive regions for foreign investors throughout the interwar period. After the World War II, the continental European enterprises indicated a growing interest for the Latin American, Asian and African regions. By the end of 1960s, these three regions were hosting about 27 percent, compared to a mere 4.7 percent prior to WW I, of foreign manufacturing subsidiaries of the 85 largest continental European enterprises.

Table I-19: Number of Manufacturing Subsidiaries Formed and Acquired in Developed and Less Developed Regions in Various Period by the 85 Largest Continental European Enterprises.

	Region of Subsidiary Location					
	Developed		Less Developed			
Period	Europe & N.America	Eastern Europe	Europe*	Latin America	Asia & Africa	Total Number
Prior to 1914	122	27	10	2	6	167
1914 - 1919	36	5	6	3	1	51
1920 - 1929	162	27	22	15	23	249
1930 - 1938	69	8	10	16	9	112
1939 - 1945	25	2	8	4	5	44
1946 - 1952	62	-	14	30	23	129
1953 - 1955	60	-	16	23	18	117
1956 - 1958	69	-	9	27	26	131
1959 - 1961	128	-	14	30	60	232
1962 - 1964	120	-	34	30	45	229
1965 - 1967	346	-	39	76	71	532
1968 - 1970	659	4**	86	130	151	1,030

Source: Comparative Multinational Enterprise Project {24:p.106, Table: 5-1}
* : Greece, Portugal, Spain, Turkey, Israel.
** : Joint-venture subsidiaries in Yugoslavia.

Table I-20 demonstrates the distribution of 15 largest recipients of foreign direct investment in 1975 and 1983. In 1975, Canada was the largest recipient country of FDI hosting 14.9 percent of the total global foreign capital stock, followed by the U.S. with her 11.2 percent. Eight years later in 1983, the U.S. and Canada switched the places. The value of the foreign capital stock hosted by the U.S. was $ 137,061 millions, or 25.4 percent of the world total. Canada, as the second largest host-country, hosted around 11 percent of the total foreign capital stock with a book value of $ 59,924 millions, followed closely by the U.K., 9.7 percent and $ 52,700 millions, respectively.

Table I-20: 15 Largest Inward Investors
By Size of Foreign Direct Capital Stock
1975 and 1983 (U.S. $ m.)

		1975	% Distribution	1983	% Distribution
1	U.S.A.	27,662.0	11.2	137,061.0	25.4
2	Canada	36,785.7	14.9	59,924.5	11.1
3	U.K.	24,490.4	9.9	52,700.3	9.7
4	W.Germany	23,075.2	9.4	29,587.3	5.5
5	Brazil	6,890.0	2.8	23,200.0	4.3
6	South Africa	8,544.5	3.5	21,041.1	3.9
7	Saudi Arabia	650.0	0.3	16,940.0	3.1
8	Netherlands	9,812.9	4.0	16,924.5	3.1
9	Australia	8,846.2	3.6	16,138.2	3.0
10	Mexico	4,800.0	1.9	14,898.2	2.8
11	France	9,497.3	3.9	13,426.1	2.5
12	Belgium	4,176.8	1.7	9,085.2	1.7
13	Malaysia	2,300.0	0.9	8,075.1	1.5
14	Switzerland	4,084.0	1.7	8,029.4	1.5
15	Italy	9,113.5	3.7	7,320.3	1.4
Other Countries		65,938.8	26.7	106,193.6	19.6
TOTAL		246,667.3	100.0	540,544.8	100.0

Source: J.Dunning - J.Cantwell, 1987, IRM Directory of Statistics of International Investment and Production. p.814, Table B11

Distribution by Region

Table I-21 displays data on the recipient regions and some selected countries for the years 1975 and 1983. Developed areas hosted about 75 percent of total global foreign capital stock and more or less, retained this percentage in 1983. Meanwhile, the share of Europe declined from 40 percent of the total in 1975 to 29 percent in 1983, while that of North America increased from 2 percent to 36 percent, in respective years. The proportion of the developing countries' foreign capital stock remained the same between 1975-1983, but that of Malaysia increased from 0.9 percent to 1.5 percent, of Brazil from 2.، percent to 4.3 percent, of Mexico from 2 percent to 2.7 percent, and of Saudi Arabia from 0.2 percent to 3 percent.

Table I-21: Total Foreign Direct Capital Stock
1975-83 (US $ M) (in %)

	1975		1983	
Developed Areas	183,399	% 75.5	401,084	% 74.2
Europe	98,710	40.6	159,696	29.5
EEC	85,555	35.2	138,308	25.5
Other Europe	13,155	5.4	21,387	3.9
North America	64,447	26.5	196,985	36.4
Other DCs	20,241	8.3	44,403	8.2
Developing Areas	59,439	24.4	139,460	25.8
Africa (except South Africa)	15,445	6.3	19,271	3.5
Asia & Pacific (except Japan or M.East)	13,039	5.3	28,120	5.2
L.America & Caribbean	29,386	12.1	73,246	13.5
Middle East:				
Saudi Arabia	650	0.2	16,940	3.0
Australasia	918	0.3	1,881	0.3
Selected LDCs:				
Malaysia	2,300	0.9	8,075	1.5
Brazil	6,890	2.8	23,200	4.3
Mexico	4,800	2.0	14,898	2.7

Source: J.Dunning - J.Cantwell, 1987, op. cit.Derived from Table B1, pp.790-792

Annual average growth rate of the various regions' foreign capital stock between 1975-83 is demonstrated on Table I-22. Developed as well as developing areas experienced an annual average growth rate of inward direct investment at around 10.3 percent, which also represents the average for all countries. Regarding individual areas, EEC's annual growth rate of inward direct investment was the lowest, 6.2 percent, and of North America's the highest, 15 percent, among the developed areas. The U.S. accounted for the highest average growth rate, 22 percent, while Federal Germany's growth rate was the lowest, 3.2 percent, on the country base among developed nations. In developing areas, the average annual growth rate of inward foreign investment decreased by 1 percent in Africa between 1975-83, while it increased by around 10 percent in other regions, except for the Middle East. Middle East estimate covered data only from Saudi Arabia where the annual average growth rate, 50 percent, was highest of all countries concerned. Countries like Philippines, Malaysia, Hong Kong, Brazil, Argentina and Mexico also experienced relatively high growth rates of inward investment averaging around 1¶ percent. The trend in Nigeria was the reverse, where the foreign capital stock decreased sharply, by 9.7 percent, between 1975-83.

Table I-22: World Stock of Inward Direct Investment by Region
(US $ m)

	% Distribution 1975	% Distribution 1983	Annual Average Growth Rate 1975-83
All Countries	100.0	100.0	10.3
Developed Areas	74.4	74.2	10.3
EEC	34.7	25.5	6.2
Other Europe	5.3	4.0	6.3
North America	26.1	36.4	15.0
Other DCs	8.2	8.2	10.3
Selected DCs:			
Federal Germany	9.4	5.5	3.2
U.S.A.	11.2	25.3	22.1
Developing Areas	25.6	25.8	10.4
Africa	7.8	3.6	-1.0
Asia & Pacific	5.3	5.2	10.1
L. America & Caribbean	11.9	13.6	12.1
Middle East	0.3	3.1	50.3
Australasia	0.4	0.3	9.4
Selected LDCs:			
Nigeria	3.0	0.7	-9.7
Malaysia	0.9	1.5	17.0
Hong Kong	0.5	0.9	17.5
Philippines	0.2	0.4	19.3
Brazil	2.8	4.3	16.4
Mexico	1.9	2.8	15.2
Argentina	0.9	1.3	15.5
Saudi Arabia	0.3	3.1	50.3

Source: J.Dunning - J.Cantwell, 1987, op. cit.p.818, Table: B16

Regarding the facts that the U.S. is the host of largest amount of foreign direct investment and that its annual average growth rate was highest among the developed nations, one might get deceiving conclusions about the significance of foreign capital to national economy. Although U.S. is the largest source and recipient of FDI, foreign capital stock represents a small proportion of the GNP of U.S. According to Table I-23, Panama ranks the top of the list of countries most dependent on inward investment in 1982, with a foreign capital stock constituting 144.4 percent of the GNP.

Table I-23: Countries Most Dependent on Inward Investment in 1982
As Indicated by Foreign Direct Capital Stock As a
Proportion of GNP.

	Country	%	Capital Stock Per Head (US $)
1	Panama	144.4	2,653.8
2	Liberia	113.5	453.0
3	Trinidad & Tobago	80.8	2,980.5
4	Papua New Guinea	60.7	415.0
5	Guyana	47.3	212.6
6	Botswana	42.5	342.0
7	Fiji	41.5	556.5
8	Zimbabwe	40.7	259.1
9	Malawi	39.6	59.8
10	Gabon	36.9	948.1

Source: J.Dunning - J.Cantwell, 1987, op. cit.p.802 and p.816, Tables: B 6 and B 14

Panama, together with Liberia, seem to be hosting foreign capital stock greater than their GNPs, but these countries' share in the total world stock of foreign capital was rather insignificant, 1 percent and 0.17 percent, respectively, in 1982. {19:pp.790-2, Table: B1}

Significance of Capital Stock to National Economy

On Table: I-24, we can study the significance of foreign capital stock to the economy of some selected host countries and regions. Foreign capital stock hosted in developed areas was, on average, about 5 percent of the GNP, and somewhat higher in developing areas, 8.5 percent of the GNP. Though the proportion of capital stock as percentage of the GNP was around 70 percent higher in developing than in developed areas, the per capita foreign capital stock in developing areas ($ 87.2) was only 18 percent of the corresponding figure for developed areas ($ 483.8). The foreign capital stock as a percentage of the GNP was highest in Canada (19.3 percent) among the developed countries followed by the Netherlands (12.9 percent), and Australia (10.2 percent). The corresponding figure for the largest recipient of foreign direct investment, the U.S., was only 4.1 percent of the GNP. In terms of foreign capital stock per capita, Trinidad & Tobago ranked highest of all countries ($ 2,980), followed by Panama ($ 2,653), (see Table: I-23), and Canada ($ 2,285).

Table I-24 Indicators of the Significance of Inward Foreign Direct Capital Stock to Various National Economies 1982

	Capital Stock As % of GNP	Capital Stock Per Head (US $)
Developed Areas	5.0	483.8
Europe	5.4	445.4
EEC	5.8	639.6
Netherlands	12.9	1,256.1
Other Europe	3.9	150.3
Switzerland	8.1	1,294.1
North America	5.4	705.0
Canada	19.3	2,285.3
U.S.A.	4.1	537.3
Other Developed Countries	3.0	228.4
Australia	10.2	1,051.2
Developing Areas	8.5	87.2
Africa (except S.Africa)	17.2	69.9
Asia & Pacific (except Japan or Middle East)	4.1	16.8
Hong Kong	16.5	832.3
Singapore	7.1	869.9
Latin America & Caribbean	11.5	195.6
Brazil	11.3	170.6
Mexico	7.0	150.8
Middle East: Saudi Arabia	8.7	1,328.7
Australasia	0.6	514.8

Source: J.Dunning - J.Cantwell, 1987, op.cit.pp.802-804, Table B 6

Table: I-25: Geographical Distribution of Inward Foreign Direct Capital Stock, 1975-1982 (in %) (US $ m)

	Developed Countries		Developing Countries	
	1975	1982	1975	1982
Developed Areas	$ 147,549	$ 338,454	$ 8,656	$ 32,811
Europe	% 51.3	% 42.2	% 49.4	% 28.3
EEC	48.0	38.3	48.2	26.8
Other Europe	3.3	3.9	1.2	1.5
North America	41.1	47.4	42.6	62.3
U.S.A.	16.6	31.1	35.8	58.7
Other Developed Countries	7.4	10.3	7.8	9.2
Developing Areas	$ 34,836	$ 105,530	$ 3,837	$ 23,369
Africa (except South Africa)	% 20.5	% 15.7	% 6.7	% 11.3
Asia & Pacific (except Japan or M. East)	20.6	20.1	38.8	21.2
Latin America & Caribbean	57.0	57.8	53.4	32.7
Middle East:				
Saudi Arabia	n.a.	5.0	n.a.	34.6
Australasia	1.7	1.3	1.0	0.05
TOTAL	$ 182,385	$ 443,984	$ 12,493	$ 56,181

Source: J.Dunning - J.Cantwell, 1987, op. cit. Derived from Tables: B 4 & B 5, pp. 797-801

Table I-25 compares the geographical distribution of the foreign capital stock in 1975 and 1982. From 1975 to 1982, we observe from the Table around 10 percent fall in the foreign capital stock of Europe and of the EEC in the developed areas, and around 20 percent fall in the developing areas. Meanwhile, North America increased its foreign capital stock from 41 percent to 47 percent in developed areas, and from 4² percent to 6² percent in the developing regions. Developing areas' foreign investment increased about 5 times in developed regions, and about 7 times in developing regions. From 1975 to 1982, the foreign direct capital stock of Africa in developed areas decreased from 20.5 percent to 15.7 percent, while that of other developing regions remained more or lest at the same level. As to the foreign capital stock in developing areas owned by other developing areas, Africa almost doubled her share from 6.7 percent to 11.3 percent, while the shares of Asia & Pacific as well as Latin America & Caribbean fell considerably, by around 17 percent and 21 percent in respective regions.

I-6: Distribution of FDIs by Sectors

Major industrialized countries of the 19th century were European countries. Circumstances such as the lack of natural resources, ever increasing industrial innovations and accumulation of capital had induced the enterprises to search for new outlets for investments. Most profitable fields for foreign direct investment were railroad construction, extractive industries and plantations.

Prior to World War I, the largest continental European enterprises had already established or acquired 48 foreign plants in extractive industries. {24:p.47, Table:3.1} The major recipient area of foreign investments was Europe prior to WW I, and the major capital exporting countries were the U.K., France and Germany, while the U.S.-based foreign investments were rather insignificant in comparison to European-based enterprises, but they were growing steadily.

Since the end of World War II, the investments in manufacturing subsidiaries operating in foreign countries increased substantially. U.S.-based enterprises appeared most frequently in chemical and drugs sector (29 percent of total), and in food and tobacco sector (14 percent of total) in 1968. (see Table I-26) U.K.-based firms were mainly engaged in the same sectors (21 and 25 percent, respectively of the total) as the U.S.-based ones.

Japanese foreign manufacturing subsidiaries, on the other hand, were mainly engaged in textile sector (28 percent of total) and in electrical sector, while almost half of the total Germany-based subsidiaries were operating in the chemical and drugs sector (46 percent of total), followed by the electrical sector. An interesting outcome of the data on Table I-2 is that the MNEs in general, were most frequently active chemical and electrical sectors, while the subsidiaries of U.S.-, U.K.- and Swiss-based enterprises were also heavily engaged in food and tobacco sector.

The MNEs manufacturing in 7 or more countries "**made an especially frequent appearance in chemical and electrical sectors. Quite unlike Continental Enterprises, however, many American multinationals were also found in the food, fabricated metal products and non-electrical machinery industries**." {24:p.15}

Table I-27 shows the sectoral distribution of foreign capital stock owned by 4 major industrial countries in the developing areas. Foreign capital stock of each home country in the extractive industries fell drastically between 1967 and 1980, while the share of manufacturing increased, except for Federal Germany. "Direct

investment in agriculture, which accounted for only 6 percent of the stock of all foreign direct investment in developing countries in 1967, has become even less important.

Table:I-26 Percent of Foreign Manufacturing Subsidiaries of U.S., British, Japanese and Continental European MNEs Active in Various Industries,as of Jan.1,1971 (US as of Jan.1,1968)

	National Base of Parent Enterprises									
Industry group	US	UK	Japan	Ger-many	France	Italy	Bel& Lux	Hol.	Sweden	Switzer-land
Food & Tobacco	14	25	5	-	-	-	2	-**	-	21
Text.& Apparel	3	4	28	-	2	5	-	3	-	-
Wood,paper & Furn.	5	6	3	2	-	-	7	-	13	-
Chemicals & Drugs	29	21	8	46	24	20	25	32	14	40
Petroleum Ref.	6	3***	-	-	10	12	6	10***	-	-
Rubber & Tyres	3	2	3	2	4	10	-	-	-	-
Primary Metals	3	8	9	7	11	3	15	2	6	4
Fabric. Metals	5	4	8	8	5	8	12	3	1	7
Non-elect.Mach.	10	4	6	4	2	3	4	3	26	11
Electrical #	10	11	17	18	10	21	9	34	25	12
Transport	6	5	8	6	9	17	-	-	8	-
Instruments	2	-	-	3	-	-	2	3	-	2
Other	6	5	4	2	21	2	17	8	6	-
Total Percent	100	100	100	100	100	100	100	100	100	100
Total Number	3756	2160	438	666	376	101	253	410	157	371

Source: Comparative Multinational Enterprise Project {24:p.78,Table:4.1}

* Column totals may not add to 100 due to rounding

** Unilever is counted in the UK column, reallocation to 'company parent' Holland would increase this number significantly.

*** Royal Dutch-Shell is counted as Dutch in this tabulation.

- Indicates 1 % or less.

Includes office equipment and computers.

The declining relative importance of direct investment in extractive industries was partly due to the effort of some governments to increase domestic control of natural resources, either through the nationalization of existing foreign owned-assets or through regulations restricting the entry of new foreign capital into the sector. For example, since 1967 a large number of countries (including most of the major oil exporting countries, as well as Bolivia and Peru) have partially or completely nationalized the local assets of foreign oil companies.

Table: I-27 Four Industrial Countries: Composition of Foreign Direct Investment Stock in Developing Countries. 1967, 1980 (in percent)

	1967 *			1980 **		
	Mining & Petroleum	Manu-facturing	Other***	Mining & Petroleum	Manu-facturing	Other***
United States	49.6	27.1	23.3	26.4	34.5	39.1
United Kingdom	12.5 ****	34.0	53.5	2.8****	54.4	42.8
Germany,Fed.Rep.of	7.5	85.0	7.5	3.9	72.4	23.7
Japan	44.4	33.6	22.0	24.0	42.7	33.3

Sources: OECD; U.S. Department of Commerce; Ministry of International Trade and Industry and Economic Survey of Japan; Deutsche Bundesbank. {32:p.44, Table: A-5}
*: 1969 for Japan
**: 1978 for the U.K.
***: Mainly services, but also agriculture, public utilities, transport, and construction.
****: Excludes investment in petroleum sector.

Much of the increased foreign direct investment in manufacturing in developing countries was undertaken primarily to service growing local markets and was often made in response to trade restrictions imposed as part of a strategy of inward oriented industrialization. This was especially true of investment in a number of Latin American countries, though not in some Asian countries...The services sector has attracted a growing proportion of direct investment, much of it concentrated in finance, insurance, trade, and tourism." {32:p.6}

Developed areas hosted around four-fifth of all foreign capital stock in 1975, while the developing areas acquired little lest than 20 percent. The most attractive area for primary sector direct investments was North America with its 40 percent of total, and of investments in secondary and tertiary sectors, Europe acquired the largest portion. In developing areas, the most attractive regions for investments in primary sector were Latin America and Africa, and for other sectors, mainly Latin America. (see Table I-28) In 1982, we observe a shift in the trend of foreign direct investments in favor of the developing areas, where all sectors increased their share by some percentages of total investments. North America continued to be the largest recipient region of primary sector investments, followed by Europe and Latin America. As far as the tertiary sector foreign investments were concerned, Europe received the largest portion of total, 34.3 percent, with North America in the second place, 28.8 percent, and Latin America and Caribbean in the third place, 17.1 percent. In tertiary sector investments in 1982, North America ranked the top of the list again with almost half of total foreign investments, 45

percent, thus changing places with Europe, which had received around 47 percent of total and ranked as number one of the list in 1975. On the country base, the U.S. acquired more foreign direct investment than any other country in all sectors. In developing areas, L atin American and Caribbean countries were the most preferred countries for investment outlets in all sectors.

Table: I-28 Sectoral Distribution of Foreign Direct Capital Stock

Inward Investment, 1975, 1982 (US $ m) (in %)						
	1975			1982		
	Primary	Secondary	Tertiary	Primary	Secondary	Tertiary
TOTAL	$ 44,838	$ 99,851	$ 56,141	$ 96,830	$ 228,310	$ 168,672
Developed Areas	%77.6	% 80.0	% 86.7	% 72.4	% 71.5	% 83.6
Europe	28.1	48.1	47.3	26.7	34.3	31.0
EEC	27.9	43.5	43.0	26.1	31.0	27.8
Other Europe	0.2	4.6	4.3	0.6	3.3	3.2
North America	44.5	27.1	30.9	40.2	28.8	45.0
Canada	26.8	15.7	16.0	19.0	9.5	9.5
U.S.A.	17.7	11.3	14.9	21.2	19.3	35.5
Other DCs	5.0	4.7	8.4	5.4	8.8	7.4
Japan	0.5	1.0	0.5	0.5	1.1	0.6
Developing A.	% 22.3	% 20.0	% 13.3	% 27.5	% 28.0	% 16.3
Africa (except S.Africa)	9.3	2.6	2.2	6.9	1.6	1.5
Asia & Pacific (except Japan or M.East)	2.4	4.4	4.1	3.0	5.1	5.4
Latin America & Caribbean	9.3	12.8	6.8	14.4	17.1	8.7
Middle East:						
Saudi Arabia	n.a.	n.a.	n.a.	3.2	4.1	0.4
Australasia	1.2	0.03	0.1	0.01	0.03	0.2
	100.0	100.0	100.0	100.0	100.0	100.0

Source: J.Dunning - J.Cantwell, 1987, op. cit. Derived from Tables B2 & B3, pp.793-796.

Table: I-29 Sectoral Distribution of Foreign Direct Capital Stock

Outward Investment, 1975, 1982, (US $) (in %)

	1975			1982		
	Primary	Secondary	Tertiary	Primary	Secondary	Tertiary
TOTAL	$ 60,696	$ 108,726	$ 67,695	$ 132,903	$ 215,410	$ 164,698
Developed Areas	%100.0	% 99.9	% 99.9	% 99.5	% 99.4	% 99.5
Europe	34.7	38.5	33.5	38.1	43.1	37.8
EEC	34.6	38.3	33.1	37.3	41.0	34.4
Other Europe	0.1	0.2	0.4	0.8	2.1	3.4
North America	57.1	56.2	57.0	53.3	48.0	45.6
Canada	3.6	4.8	4.3	5.8	6.0	4.3
U.S.A.	53.5	51.4	52.7	47.5	42.0	41.3
Other DCs	8.0	5.3	9.5	8.1	8.3	16.5
Japan	7.7	4.9	8.7	7.7	7.8	15.7
Developing Areas	% N.A.	0.1	0.1	0.5	0.6	0.5
Africa (except S.Africa)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Asia & Pacific (except Japan or M.E.	n.a.	n.a.	n.a.	0.4	0.5	0.4
Latin America & Caribbean	n.a.	0.1	0.1	0.1	0.1	0.1
Middle East	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Australasia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	100.0	100.0	100.0	100.0	100.0	100.0

Source: J.Dunning - J.Cantwell, 1987, op.cit. Derived from Tables B2 & B3, pp.793-796.

Table I-29 shows the sectoral distribution of direct investments classified by the source of origin. The share of developing areas of total outward investments was rather insignificant both in 1975 and 1982, though it had increased slightly by 1982. Consequently, the developed areas accounted for almost all of outward investments. North America, especially the U.S.A., was the largest single source of primary sector direct investments in years, 1975 and 1982, followed by EEC-countries. Also for the secondary and tertiary sector investments, the U.S.A. accounted for the major part of investments in respective years. But by 1982, Europe and other DC-based enterprises had increased their shares of total foreign investments in both secondary and tertiary sectors, thus closing the gap with North America. The share of the U.S.-based investments in the total foreign investments fell by percent in the primary sector, and around 10 percent in the secondary and tertiary sectors between 1975-1982. Meanwhile, Europe and other

developing areas had increased their shares. Especially, Japan-based foreign investments' growth rate in secondary and tertiary sectors was rather impressive.

CHAPTER - II THEORIES OF FOREIGN DIRECT INVESTMENTS

The rise of the giant, globally operating MNEs have played a critical role in the rapid expansion of international trade and capital flows. For some, like H.G. Johnson for example, the MNEs are an indispensable source of wealth, and the international division of labor as such is inevitable and contribute to the maximization of global welfare. Any argument against the new international division of labor, claims Johnson, must be either "**arguments directed at the maximization of something other than the privately consumable flow of goods and services, or arguments that produce the policy of restriction on inward private foreign investments as second-best (possibly third-best) policy with an uncertain effect on the achievement of the desired economic aim."** {39:p.47} Another dedicated proponent of the new division of labor, G.W. Ball, claims that the profit-maximizing goal of the MNEs is vital for the benefit of mankind in the new economic world order. According to Ball, the structure of the new economic order is shaped by the rise of MNEs and the latter is a response to meet the requirements of a new era. As a consequence, "the nation-state is a very old fashioned idea and badly adopted to serve the needs of our present complex world." {39:}. Maybe so, but the substitution of nation-states by a "superior" form of organization seems utopian, in the near future, at least.

Certainly, not all authorities are dedicated proponents of foreign investments. Some even suggest that the cons of foreign investments outweigh the pros. O.Sunkel, for instance, claims, "Until about the middle of the 50s, the nature of the external contributions to industrial development was such that it contributed to the development of a national manufacturing sector in our economies (in LDCs). Since then, however, a period of denationalization and of 'subsidiarization' of industrial development has ensued." {48:pp.692-702} as a result of international operations of MNEs. In a similar fashion, having a rather critical view of the MNEs, Magdoff-Sweezy postulate that the main purpose of foreign operations is to control the markets for their own security and profits.

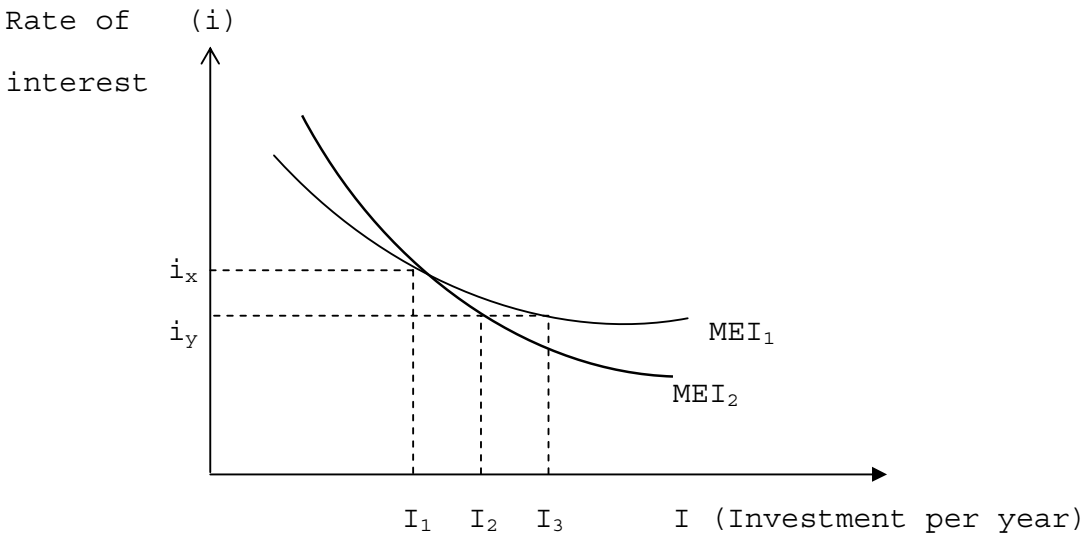
Irrespective of the various conflicting views, international operations of MNEs continue to expand all over the world including the non-market-oriented economies of socialist countries. As Todaro pointed out, the purpose of international operations of MNEs is "far from charitable. In many instances, they have little to do with the development aspirations of the countries in which they operate." {64:p.342} So, what are the driving forces for MNEs to carry their business

transactions to foreign countries around the world? In the following sub-chapters, we will study various approaches to the issue.

II-1 Keynesian Approach

Keynes' theory in the General Theory was developed in response to the prevailing conditions in 1930s, the worldwide recession and substantial unemployment. The main emphasis of the General Theory was how to solve the unemployment problem and to secure the continued growth. It did not account for the FDIs by MNEs but assumed that the exogenous factors, mainly the "animal spirits", could explain the nature and rate of investments. As long as the rate of return (r) on investment exceeded the interest rate (i), there would be incentives to invest.

Figure II-1: Marginal Efficiency of Investment (MEI)



FigureII-1 displays a hypothetical case of Marginal Efficiency of Investment (MEI). The flatter the MEI-curve, the greater investment is expected to take place following a fall in the rate of interest. If we assume that MEI., and MEI represent the marginal efficiency curves of investment, the lower the interest rate, the more investment will take place with a flatter curve, MEI, ceteris

paribus. While this might resemble the reality within a nation, especially in DCs, allowing for the proper influence of "animal spirits", it does not give an account of the foreign operations of MNEs.

One of the key concepts of General Theory is the Marginal Efficiency of Capital (MEC), e.g. expected profit rate from investment. As long as MEC is greater than the interest rate (i), i.e., MEC >i, than investment will take place. If we adapt this postulate to international direct investments, FDI will continue while the expected profit rate (MEC) abroad exceeds the interest rate. Empirical evidence show that the actual profit rate is greater in LDCs than in DCs. Accordingly, a greater portion of FDIs should flow into the developing nations. But, in practice, the major share of FDIs are undertaken in developed countries» a paradox of Keynesian theory.

II-2: Neo-Classical Approach

The Classical theory was developed by Ricardo and based on the comparative advantage of production. Different countries had different natural and physical endowments. If each country engaged in the production of commodities in which she had the greatest comparative advantage, the global output would be maximized and all countries would benefit from it. In this theory, Ricardo had assumed the complete freedom of trade of commodities, but complete immobility of the factors of production. Since the export of capital is constrained by assumption, there was no room for foreign direct investments.

Hechscher-Ohlin and Samuelson further developed Ricardo's Classical model of static comparative advantage theory with the introduction of mobility of factors of production. Basic assumptions of the model were:

a) Full competition of commodities;

b) Complete mobility of the factors of production;

c) The same production functions in all countries; and

d) No transportation costs.

"**Mundell (1957), using the Heckscher-Ohlin-Samuelson model asserted the proposition that trade and capital movements are substitutes for each other and that the equalization of factor-price ratios implies the equalization of commodity-price ratios**." {18:p.305}

After the introductions of improvements, the scholars renamed it the Neo-classical theory. The Neo-classical school adapted further modifications into the model by incorporating the technological advances and imperfect competition.

> "**One of the major implications of general equilibrium theory is that any imperfections in the goods, factor or consumption markets will inevitably lead to some reduction in social welfare. Such imperfections may be;**
>
> **a) in the factor market such as trade union which raises the money wages of some workers above their marginal value product;**
>
> **b) a government tax on capital which prevents equality between the rate of return and marginal physical product of capital,**
>
> **c) an externality in either the product or consumption market in which there is a divergence between the private and social costs, for example in pricing pollution or knowledge.**
>
> **These examples of market failure prevent the efficient allocation and consumption of goods and factors in terms the general equilibrium model of the neo-classical economic theory**." {59:p.24}

Hicks, a prominent scholar of the Neo-classical theory, asserted that the nation-states with various interventionist policies are the main obstacles of development and "**if there were no nations the absorption of the whole human race into the ranks of the developed would be relatively simple**." {13:p.26}

In spite of the incorporation of the possibility of market imperfections in recent economic models, the Neo-classical school, in principle, considers all restrictions and intervention in the market as ill-conceived and second- or third-best economic policies, preventing the optimum utility and maximum welfare. The basic critical assumptions of the Neo-classical model are:

1- Perfect competition;
2- CRTS (Constant Returns to Scale);
3- Mobility of the factors of production;
4- No restrictions/intervention in the market by the state;
5- Ease of entry;
6- No producer is big enough to influence the market price (no price-leader);
7- No uncertainty (correct foresight) of future events;
8- Full-employment of the factors of production; and
9- All savings are invested (I=S), i.e., no distinction is made between investment and the liquidity preference.

In such an ideal world as in the Neo-classical model, each country would be expected to specialize in the production of commodities in which she has the greatest comparative advantage. Regarding the mobility of the factors of production, both capital and labor would move to the sectors and countries where relative returns are higher. As a result, along with the full-employment of production factors, a globally optimum equilibrium state of commodity production and maximum global welfare would be achieved. In view of the subject of this study, it would imply that foreign direct investments (movement of capital to other countries) aim to take advantage of the comparative costs. Every restriction/intervention in the market is considered ill conceived and would deviate the economy from its optimum path or equilibrium.

Harrod-Domar growth model assumes that the foreign investments fill in the resource (capital) gap between locally mobilized resources and the "desired" or "planned" level of these resources.

To set an example, assume a developing country and let;

g' = desired rate of growth,

s' = desired rate of savings, and

k = actual capital/output ratio.

In equilibrium position, g' should equal s'/k. Further assume that g'= 8 percent, k = 3 percent, and the actual rate of saving, s= 15 percent. In order to reach the targeted ¸ percent growth rate, s must increase to 24 percent of the GNP (s'= g'* k >> 8 * 3 = 24 %)

There is a gap of 9 percent, which can be filled in by foreign direct investments. But this gap could also be filled in by port- folio investments or by loans from abroad. Therefore, Harrod-Domar's model does not seem to provide a satisfactory account of FDIs.

Reflecting on the motives for direct investments, Parry (1980) asserts that»

> "**The classical theory of international capital flows, an extenuation of classical investment theory across national boundaries, explains both the basis for and the effects of these capital flows in terms of the marginal rate of return on capital in alternate uses. Capital will move between countries in response to international interest-rate differentials, and the effects of such flows are associated with the resulting optimum global allocation of capital**." {55:p.57}

To clarify hit assertion, Parry assumes two countries with two different rates of return on capital. Country-A is the home country of investor, and Country-B the recipient country. (see Figure II-2) Other critical assumptions of the model are;

1- Full-employment;

2- No taxation;

3- CRTS;

4- Perfect competition;

5- No external economies;

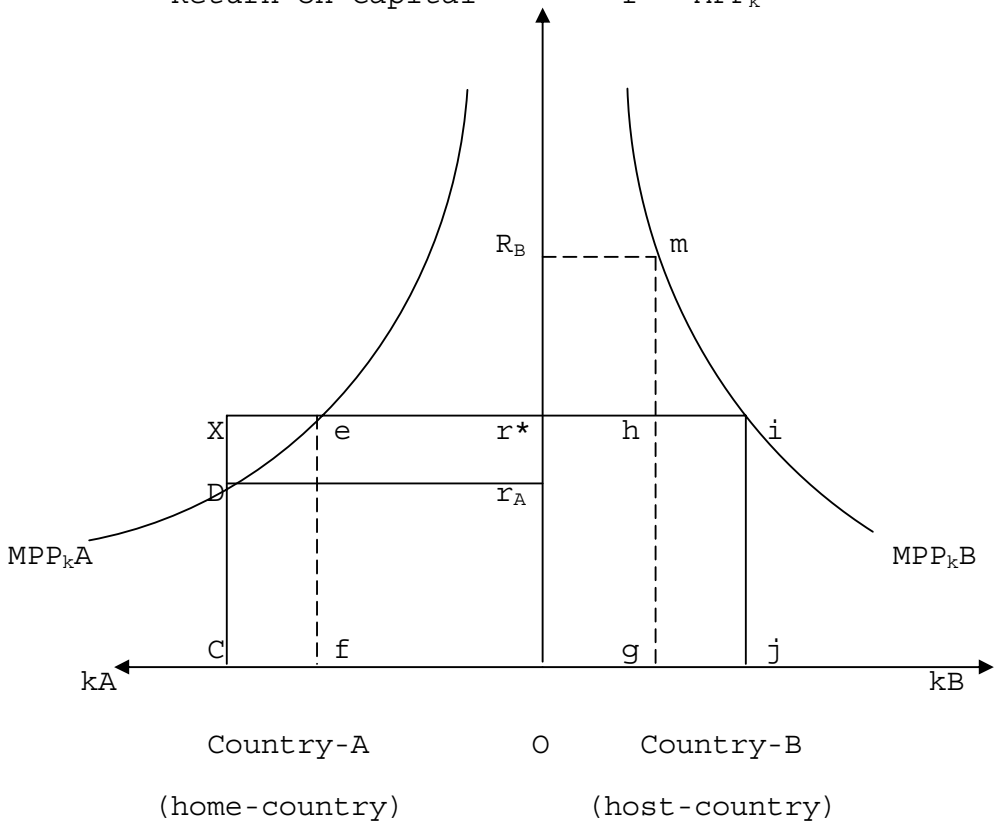
6- Size of the labor force is independent of the stock of foreign capital in the country;

7- Stock of domestic capital is independent of the stock of foreign capital in the country;

8- Foreign investment has no effect on the host country's t.o.t.

9- Foreign investment has no effect on the host country's balance of payments.

Figure: II-2 Foreign Investment and Equalization of Return on Capital



Let r denote the Rate of Return on Capital (interest rate), MPPk the Marginal Physical Product of Capital, kA+kB the Stock of Capital in respective countries, Oc+Og the initial Stock of Capital in respective countries before capital flow, and rA+rB the initial Interest Rates in respective countries. Following the flow of capital from Country-A to Country-B, i.e., foreign direct investment, the domestically produced output falls by the amount of **cdef** in Country-A and rises by **gmij** in Country-B while the rate of return rises in Country-A and falls in Country-B, until it is stabilized at equilibrium rate, r*, for both countries. As a result of the capital flow (foreign direct investment) Country-A's net gain is the area "dxe", and Country-B's net gain is "hmi". Both countries benefit from the direct investment.

One of the critical assumptions of the Neo-classical theory is the assumption of perfect competition in all markets free of any intervention ¯ restriction. Recently, however, this assumption has been relaxed. As Parry asserts,

> "**The contemporary treatment of the foreign direct investment associated with the MNE sharply contrasts with the earlier treatment of capital flows in terms of international interest-rate differentials. International investment associated with the operations of the MNE is more properly treated within a framework of market imperfections and distortions**." {55:p.57}

The notion of perfect competition is not, by any means, excluded from the economic models. But competition in terms of product design and in marketing/servicing fields seems to have replaced the traditional price competition theory.

The introduction of imperfect competition into the Neo-classical model seems as a step forward in explanations of foreign direct investments by Neo-classical scholars. But for Brown; {1978}

> "**The incorporation into neo-classical economic thought of the possibility of imperfect competition did not, however, lead to any change in belief in the pacific and non-expansionary nature of the system." {13:p.33ı According to Adler, "in a multi-country, multi-commodity world, comparative cost theories do not seem to explain trade flows very well, much lest PFI, except perhaps in natural-resource-based industries**." {1:p.42}

Reflecting on the static comparative advantage, Dunning (1973) claimed

> "**there is no room for the MNE at all. With completely free movement of goods but immobility of factors of production, and with all firms transacting goods and services in a price-taking situation, there is little incentive for international direct investment. In a static model** "he says," **innovations are ignored altogether as production functions are assumed constant and identical (or nearly identical) throughout the world. Where they are introduced, e.g. in a comparative static situation, their benefits are assumed to be instantaneously and freely transferable. Such an assumption is totally unrealistic in a situation where information is costly to produce, is enterprise specific, and is sold under conditions of imperfect competition» where governments both finance the output of new knowledge and impose barriers on its dissemination, e.g. by the patent system, and, hence, affect the patterns of trade and resource allocation**." {18:p.305}

Helleiner (1973), too, is critical of the merits of static comparative advantage model. He asserts that;

> "**No longer can direct investment be analyzed in the classical manner as a flow of extra capital into a country within which all else is held constant, with the static effects evaluated according to the tenets of orthodox marginal productivity analysis. The new approach applied the theory of industrial organization to the activities of large oligopolistik firms who happen to straddle international boundaries. Tariffs, other trade barriers and incentives or disincentives to international capital flows are analogous, in this approach, to transport costs within national-level analysis of such firms' behavior."** {28:p.21}

If we summarize the critics of the static model of comparative advantage there seems to be a consensus on one important aspect» due to its inherent features, the static model appears to be inadequate to explain the direct investments of MNEs.

II-3: Marxist Approach

Marx

Marxist economic thought interprets all aspects of human actions and social behavior as an inter-related whole, and applies an historical materialistic approach to explain the socio-economic relations and development. In other words, there are

always some material or economic forces influencing the individual and social behavior as well as the direction and outcome of socio-economic relations. These economic forces are, by no means, to be treated as the sole driving forces of the socio-economic change. As the matter of fact, socio-economic change is assumed to be the result of the combination of various factors. But historical-materialistic approach always seeks the material roots of socio-economic changes, while acknowledging the impact of various other factors such as ideology, tradition, social values, etc.

Following the materialistic interpretation of history, Marx regarded the present social formation, the capitalist society, as the latest and highest stage of a number of successive social formations. The basic characteristics of each stage are considered to be shaped by the mode of production or the production relations. Under capitalism, Marx asserted, the relationship was between the owners of production forces, e.g. the capitalists, and the owners of labor-power. Capitalists acquire profits as a reward on their investment, while workers receive wages just enough to meet their basic needs for survival and reproduction.

> "**Profit is made and capital accumulated in only one way -out of the labor alienated from the human being who owns and sells it to the owner of capital, at a price that is less than the value of the net product. This is how surplus value is created**." {13:Ch. on Marxist Th. of Imperialism}

The driving force of the capitalist society is the competitive struggle for capital accumulation. a capitalist must either expand or die, there is no other alternative. In order to survive the fierce competition, all capitalists must accumulate capital out of profits. There are three main channels to reduce the costs of production, hence to increase profits;

> "**a- by reducing the cost of each worker, directly through lowering wages or indirectly through cheapening the commodities consumed by workers,**
>
> **b- by reducing the cost of capital equipment through introduction of more efficient machines, through continuous operation and through cheaper or reduced inputs of raw materials and fuels,**
>
> **c- by reducing the time taken by each worker to produce a given output through increased application of machinery to production."** {13:ibid.}

There are assumed to be some limitations to the lowering of wages below a certain rate as well as to the extension of working-hours per day/week. Thus, only the

introduction of cost-saving new production methods seem to offer a sound basis for the realization of higher rates of profit and consequently, capital accumulation. The capitalists are forced to act alike and constantly seek to revolutionize the meant of production, i.e., introduce new technologies, in order to survive. This characteristic of the capitalist social formation makes it "expansionist" by its inherent nature.

Rate of accumulation (e.g. rate of expansion) is assumed to be an exogenous variable in the long run. All other variables such as wage-rate, prices, rate of unemployment, etc., assumed as endogenous factors. As the capital accumulation continues, the rate of profit tends to fall. "The tendency of the rate of profit to fall is bound up with a tendency of the rate of surplus-value to rise, hence with a tendency for the rate of exploitation to rise." {46:Vol.III,p.240} To set an example, let "c" denote constant capital, "v" the variable capital, "s" the surplus value, and "r" the rate of profit. Given the value of variable capital (let v=100) and the rate of surplus value (let s/v= 100 %), the rate of profit (s/c+v) would rise or fall in accordance with the amount of constant capital, "c", as shown below;

if c = 50, v = 100 then r = s/c+v = 100/150 >> r = 66 2/3 %

if c = 100, v = 100 then r = 100/200 >> r = 50 %

if c = 400, v = 100 then r = 100/500 >> r = 20 %

The profit rate would be highest when the amount of constant capital, "c", or the organic composition of capital (c/v) is lowest, and it would be lowest when "c" or "c/v" is highest, with the same rate of surplus value.

> "**In an undeveloped country, in which the former composition of capital is the average, the general rate of profit would ½ 66 2/3 %, while in a country with the latter composition and a much higher stage of development it would = 20 %.**" {46:Vol.III,p.214}

Therefore, according to Marx, to obtain higher profit rates and to assure the flow of necessary inputs of production, the capitalists expand their business activities to underdeveloped regions, e.g. colonies. Colonial investments arising from the competition between rival capitalists for control over the markets and sources of raw materials yield higher rates of profits. The higher profit rate realized in other countries by capitalists, "sent home by them, enter into the equalization of the general rate of profit and thus tend, pro tanto, to raise it." {46:Vol.III,p.238} In other words, the falling rate of profit in developed areas induces the capitalists to search for new outlets for capital accumulation. Investments undertaken in lest developed regions where labor-power is cheap, thus elevates the "general rate of profit" of capitalists.

Lenin

Brown (1978) claims that Marx had insisted "on free trade as the main form of capitalist expansion," {13:Ch.on Capital Export and that this argument was replaced with the thesis of "capital export" to protected areas, by hit followers. Lenin, following the footsteps of Marx, asserted that» "Typical of the old capitalism, when free competition held undivided sway, was the export of goods. Typical of the latest stage of capitalism, when monopolies rule, is the export of capital." {42:p.212} The export of capital stepped up the capital accumulation and accelerated the overall economic development. However, the principle goal of the capitalists was far from raising the standards of living in the host countries, according to Lenin, but to maximize the profits in protected markets. For Lenin, "**both uneven development and a semi-starvation level of existence of the masses are fundamental and inevitable conditions and constitute premises of this mode of production..... The need to export capital arises from the fact that in a few countries capitalism has become 'overripe'**." {42:p.213} He refers to this overripe stage of capitalism as 'imperialism', the highest stage of capitalism, which is characterized by five essential features;

1- The concentration of production and capital, developed to such a high stage that it has created monopolies which play a decisive role in economic life.

2- The merging of bank capital with industrial capital and the creation, on the basis of this 'finance-capital', of a financial oligarchy.

3- The export of capital, as distinguished from the export of commodities, becomes of particularly great importance.

4- International monopoly combines of capitalists are formed which divide up the world.

5- The territorial division of the world by the greatest capitalist powers is completed. {42:}

Lenin treated the foreign direct investments as a meant to exploit the cheap labor-power and the raw materials in colonial markets as well as an opportunity for the finance-capital to spread its activities around the world. "**Colonial possessions alone gives the monopolies complete guarantee against all contingencies in the struggle against competitors**." {42:p.228}

Kemp

Kemp (1967), following hit predecessors, claimed that;

> "**The tendency of capitalist production to develop the scale of production necessitated a search for markets on the part of the industrial capitalists: hence the penetration of those areas which remained chiefly suppliers of raw materials to the world market and their development in a lop-sided fashion characteristic of modern capitalism.**" {38:p.20}

This penetration of underdeveloped countries did not take place;

> "**on a philanthropic or educational program but because they have seen a chance of profitable investment. The effect of their activities on the inhabitants of the areas in which they operate has not been their concern. All-round economic development has not been their aim. They have linked the labor and resources of these areas to the world market, at subordinate segments whose economies have hinged on one or two primary products.**" {38:p.168}

Kemp's study seems to focus on foreign direct investments in developing areas, hence overlooking direct investments and their impacts in developed countries. In addition, he seems to underestimate the contribution made by foreign investments in the manufacturing and service sectors in developing areas. According to Kemp, "**capitalist development, as always, proceeds with great unevenness and is full of contradictions. A key example of this is the present tendency for the per capita incomes of the advanced and the underdeveloped countries to diverge**." {38:p.173} Such great unevenness of development among countries, says Kemp, is "**in large part, the consequence of imperialism currently and in the past**." {38:p.168} Now, he says;

> "**as in Lenin's day, capital export continues to provide an indispensable field for the realization and capitalization of surplus value. Past investment provides a continued meant for the exploitation of labor power on a world scale and contributes its flow of surplus value to the total -thus making possible direct capital formation in the lest developed countries under the ownership and control of the big extra-territorial concerns,**" {38:p.168} e.g. MNEs.

Magdoff-Sweezy

Magdoff-Sweezy seem to share Kemp's opinion on the control of underdeveloped country markets through direct investment and state that;

> "**tariff barriers, patent rights, and other local conditions create circumstances in which the corporate giants find that they can best control the market in a foreign country through investment rather than mere exports. One of the outstanding features of the giant corporation, indeed, is that it has the meant to try to control the market over a large part of the world» and for its own security and profits, it continuously strives to do so**." {44:p.14}

In Magdoff-Sweezy's model, giant corporations with monopoly power dominate the world markets. These monopolistic firms are induced by an "irresistible" drive to carry their operations to new markets. The foreign operations of giant corporations are of vital importance to maintain a stable rate of profit at the headquarters and "**the drive for investment abroad by monopolistic firms is stimulated solely by pressures emanating from the search for investment outlets for surplus funds. For example, capital will move to areas where it is feasible to exploit low wages and other cost advantages**." {44:p.14} When a monopolistic firm invests in another country, the competing firms in the same industry would be expected to follow the suit to get, or to retain a proper share of the market.

Monopolistic firm in Magdoff-Sweezy's model does not imply the complete control of a market by one firm in a given industry. In fact, it is assumed that there are some (few) firms competing with each other in global markets.

> "**It is important to understand that under monopolistic conditions the axiom according to which capital always moves from low-profit to high-profit industries and regions no longer holds. Monopoly by definition impedes the free flow of capital into protected high-profit situations» and, the monopolist sitting inside these bastions is careful not to invest more than the traffic will bear, while seeking outlets elsewhere for hit surplus capital. It is therefore not only possible but probably quite common for capital to move in directions opposite to those indicated by traditional economic theory.**" {44:p.15}

To confirm these statements, Magdoff-Sweezy reflect on a study of the U.S. automobile industry, and say that» "**On the one hand it is one of the most highly monopolized and profitable industries in the United States, and on the other**

hand the Big Three which dominate it are continues and heavy investors in other industries and abroad." {44:p.15}

Baran-Sweezy

In their work titled Monopoly Capital, Baran-Sweezy, like Magdoff-Sweezy, "**use the term 'monopoly to include not only the case of a single seller of a commodity for which there are no substitutes, but also the much more common sense of 'oligopoly', i.e., a few sellers dominating markets."** {9:p.20} As a distinct feature of contemporary capitalism, they say, the ownership of corporation is separated from the management. Self-perpetuating managers control the financially independent giant corporations to reach the targets set by them.

> "**This does not of course mean that each giant corporation operates in isolation, that there are no alliances and alignments, no agreements or groupings. On the contrary, these forms of action -like their opposites, competition and struggle- are of the very essence of monopoly capitalism... In the oil industry, for example, Standard companies are as ready and willing to ally themselves with or fight against non-Standard companies as with or against other Standard companies. It all depends on where the maximum profit lies**." {9:pp.32-33}

The pattern of behavior of the management-controlled, financially independent giant corporations, like the individual capitalists of early capitalism, is dedicated to accumulate capital and to maximize profits. As an inherent feature of monopoly capitalism, however, "**the corporation has a longer time horizon than the individual capitalist, and it is a more rational calculator**," {9:p.58} assert Baran-Sweezy.

On the foreign operations of these rational giant corporations, Baran-Sweezy suggest that "**except possibly for brief periods of abnormally high capital exports from the advanced countries, foreign investment must be looked upon as a method of pumping surplus out of under-developed areas, not as a channel through which surplus is directed into them**." {9:p.110} Empirical evidence of the period between 1870-1913 indicated that Britain's income from foreign investment far exceeded the capital exports. "According to Cairncross't estimates, in the years 1870-1913, net export of capital totaled £ 2.4 billion, while income received from foreign investments came to £ 4.1 billion: capital export was thus only three-fifths of income received." {9:pp.110-1} And the U.S.A. experience showed somewhat similar results in the post World War II era.

> **"Even in cases where substantial sums of capital are exported, subsequent expansion commonly takes place through ploughing back of profits» and the return flow of interest and dividends (not to mention remittances disguised in the form of payment for services and the like) soon repays the original investment many times over -and still continues to pour capital into the coffers of the parent corporation in the United States. It is not surprising, therefore, that while capital does flow out of the country every year, the return flow of investment income is invariably much larger**." {9:pp.111-2}

Official government statistics covering the period between 1950-1963, and comparing the capital outflow and return on investment, excluding the management fees, royalties and various forms of hidden remittances, show that the total net direct investment capital outflow amounted to $ 17,382 millions, while direct investment income reached to $ 29,416 millions. (9:p.112,Table: 2} "**One can only conclude", says Baran-Sweezy, "that foreign investment, far from being an outlet for domestically generated surplus, is a most efficient device for transferring surplus generated abroad to the investing country**". {9:p.112}

As a concrete example, Baran-Sweezy point out the percentage distribution of assets and profits of Standard Oil of New Jersey by regions at of the end of 1958.

> "**While two-thirds of Jersey's assets were located in North America, only one-third of its profits came from that region. Or to put the point differently, Jersey's foreign investments were half as large as its domestic investments but its foreign profits were twice as large as its domestic profits. The indicated profit rate abroad is thus four times the domestic rate**." {9:p.193}

Standard Oil had achieved these results with a small initial export of capital, in contrast to expectations of large amounts and consistent export of capital. The expansion of foreign assets was realized by reinvestment of profits made abroad. In 1962, Standard Oil's;

> "**total profits were $ 841 million. Of this sum, $ 538 million were paid out as dividends to stockholders..... profits from operations in the United States in 1962 were $ 309 million. This figure, it will be seen, is $ 229 million lest than the amount of dividends paid. In other words, approximately 40 percent of dividends paid to stockholders plus whatever net investment was made in the United States during the year were financed from the profits of foreign operations**." {9:p.194}

To conclude, Baran-Sweezy describe the Standard Oil as a "very large and consistent importer of capital." {9:p.194}

Other giant corporations are assumed to act likewise in foreign markets, say Baran-Sweezy and assert that: "What they want is monopolistic control over foreign sources of supply and foreign markets, enabling them to buy and sell on specially privileged terms, to shift orders from one subsidiary to another, to favor this country or that depending on which has the most advantageous tax, labor, and other pollicies -in a word, they want to do business on their own terms and wherever they choose." {9:p.200}

Brown

Brown, like other Marxists, describes the contemporary stage of capitalism as monopoly capitalism in which the giant transnational corporations (=MNEs) are engaged in a worldwide oligopolistik competition to acquire monopolistic positions in relation to markets and sources of supply. Capitalism, due to its inherent features, is assumed to be expansionist.

> "**Direct investment in manufacturing ties satellite economic development more firmly into the world division of labor, operated today by giant transnational companies, than ever the indirect investment in transport and infrastructure did in the nineteenth century. But direct investment at the same time implies sunk capital in large-scale and ever larger-scale plants which become so many 'individual hostages to fortunes in the underdeveloped countries." {13:p.326}**

Foreign investments are "real assets, liable to nationalization, which local staffs are increasingly capable of managing." {13:p.326} In order to maintain their monopolistic positions, the transnational companies attempt "retain in the metropolis some of the machine tool and other capital equipment production, spare parts and technical know-how in research and development." {13:p.326}

Brown believes in the continuing competitive struggle between the giant transnational corporations within an oligopolistik framework. "Oligopolistik competition between giant firms consists of a struggle for take-overs, for monopoly positions in markets, for privileged access to sources of raw materials, accompanied by rationalization and other forms of cost-cutting, if not by direct price-cutting." {13:p.217} He accuses the Neo-Marxists for under-emphasizing the competition between oligopolistik firms and for concentrating their studies on explaining the "rising surplus".

Regarding the surplus, Brown criticizes Baran-Sweezy for failing "**to show in their own tablet for the United States between 1929 and 1963 that there was a marked tendency for the surplus to rise as a proportion of GNP**." {13:p.216} But on the direction of flow of capital under capitalism, Brown does not seem to disagree with Baran-Sweezy. In Britain, he says, the exported capital was financing the investments in colonial settlements. But through the transfer of dividends, royalties, etc., the colonial territories have been transferring the surplus generated to Britain, hence providing finance for investments, e.g. import of capital from colonial settlements in excess of exported capital.

II-4: Contemporary Approaches

R.Z. Aliber

Aliber suggests that a theory of foreign investment must be able to explain;

1- as the primary concern, the benefits of foreign investments overcoming the economic, political and other costs involved with investment;

2- why a substantial part of foreign investments consists of U.S. investments in the post World War II era;

3- why the drug or aluminum industry attract more foreign investment than machine tool or steel industry;

4- why some foreign investments take place through take-overs» i.e., the acquisition of established firms; and

5- cross-country investments, i.e., why foreign firms invest in the U.S.A. in those industries in which the U.S. firms invest abroad. {39:pp.17-8}

The currency boundary theory developed by Aliber postulates that MNEs invest in foreign countries to take advantage of the foreign exchange rates and high-premium currencies, and not because of a firm-specific technological advantage. The theory is based on the "foreign currency premium". "Thus the international role of the U.S. dollar facilitated foreign investment, and may have been supplemented by an overvalued exchange rate." {21:p.45} There are two sorts of currencies;

1- high-premium currencies; and
2- low-premium currencies.

Home countries of the foreign investors are the high-premium currency areas, whereat host countries are characterized by their low-premium currencies, according to Aliber. Other factors inducing direct investment are;

1- the size of the domestic market;

2- the technology possessed by the MNE;

3- the protectionist policies of the host country; and

4- the costs of production in a foreign country.

The theory asserts that the rate of return of a U.S. owned subsidiary, for instance in Federal Germany, would differ from the rate of return of a German firm. To set an example, assume that the rate of return of dollars invested in Germany is 10 percent and the expected depreciation rate of Deutsche Mark is 5 percent. "a rate of return of 10 percent with a currency that devalues by 5 percent is worth 5 percent lest the depreciated value of the assets in other currencies. When they invest, firms will then capitalize their income streams taking account of these uncertainties." {18:p.316} Aliber calls this uncertainty risk the "currency premium". The key aspects of the theory are;

1- capital market relations;

2- currency risks; and

3- preferences to hold certain foreign currencies.

According to the theory, if for example, a U.S. firm takes-over a German manufacturing unit, it is because the U.S. firm (e.g. the high-premium currency firm), has access to cheaper credits.

A critic of the currency boundary theory, J. Dunning claims, "Aliber is not concerned with explaining investment in the same currency area, e.g. U.K. investment in Australia, but only where the assets are in different currencies." {18:p.316} Aliber also seems to fail to explain the foreign investments across countries within the high-premium currency areas, e.g. Swedish investments in Federal Germany and vice versa. Moreover, as Aliber assumes that all foreign investment originates from high-premium currency areas, in hit example in U.S. dollars, the theory cannot account for neither developing country based foreign investments or for the investments with locally borrowed currency in low-premium currency areas.

A currency is normally strong if the economy, e.g. the firms, is strong and competitive in international markets. Therefore, the main criteria for the explanation of international operations of MNEs should be based on the industrial

strength and international competitiveness of the enterprises, rather than the strength of currency.

R. Vernon

The product life-cycle theory developed by Vernon is essentially a defensive strategy. The theory assumes three essential stages of production. The first stage emerges when a new, advanced technology is first introduced in the market. Because of its high price, the demand is expected to be low, and the higher income groups would represent the major consumers. There is also certain degree of uncertainty involved.

In the second phase, the demand for the new product is higher, and the costs of production are reduced, due to economies of scale. The new product is ready to be exported to foreign markets to meet the growing foreign demand. Meanwhile the uncertainty would be reduced, if not eliminated.

In the final stage, e.g. the mature phase, demand for the product both in domestic and international markets continue to grow, while the costs of production are minimized and the product is standardized. But now, there is the risk of imitation and further development of the product by competitors. To protect its foreign markets, the owner of the new advanced product may be induced to invest abroad and thus become international. As a result, foreign investment in product life-cycle theory appears to be a defensive strategy to retain the foreign markets. Depending on the size of the foreign market and the economic policy of host country, the technology owner decides whether to set up a production plant in a foreign country.

Vernon's product life-cycle theory has some deficiencies. First of all, the theory fails to explain foreign investments in sectors such as extractive or service sectors, as well as investments made to take advantage of cheap labor only or of tax concessions. In addition, Vernon's theory fails to explain the developing country investments and cross country investments in the same industries or product lines. Moreover, small country MNEs like those of Sweden or Switzerland plan their production at international level in the initial stages of product development to take advantage of scale economies to be economically efficient. Vernon's theory cannot account for such investments either.

S.H. Hymer

The theory of international oligopoly developed by Hymer in 1960 is based on the assumption that direct investments result from the monopolistic competition of large corporations. Dismissing the interest-rate theory as inadequate to explain control, he looked for other reasons to explain the international investments of MNEs. For Hymer»"The main condition stimulating the direct investment of firms is that a firm must be able to make a higher income stream abroad than it could at home." says Fatemé & et. al. (1976)

Control is the keyword of the theory. There are two main reasons for a MNE to seek control. One reason is that» "it frequently happens that enterprises in different countries compete with each other because they sell in the same market or because some of the firms sell to other firms. If the markets are imperfect, that is, if there is horizontal or bilateral monopoly or oligopoly, some form of collusion will be profitable. One form of collusion is to have the various enterprises owned and controlled by one firm." {31:p.25} The control of the foreign production unit removes competition between enterprises across countries. "In other words, it is profitable to substitute centralized decision making for decentralized decision making." {31:p.37}

"The other main motivation stems from the fact that firms are very unequal in their ability to operate in a particular industry." {31:p.25} The MNe with advantages in a particular activity over other enterprises may find it profitable to exploit these advantages by undertaking the production in other country(-ies).

"The firm's advantage may be that it can acquire factors of production at a lower cost than other firms. Or it may have knowledge or control of a more efficient production function. Or the firm may have better distribution facilities for a differentiated product." {31:p.41} An alternative for the firm to foreign investment is to rent or sell its advantage to other firm(s) in foreign countries. The method of diffusion of the firm specific advantage depends largely on the degree of imperfection in the market for its "advantage".

The firms undertaking production in foreign countries normally possess some firm specific advantage over other firms. Market imperfections such as trade barriers provide the premises for foreign investment, but are not sufficient factors. "Unequal ability of firms", on the other hand, "is a sufficient condition for international operations." {31:p.46} And "the motivation for the investment is not the higher interest rate abroad but the profits that are derived from controlling the enterprise." {31: p.26} a profit maximizing enterprise would be reluctant to license its "advantage", because the licensee would be a potential competitor. "If the firm which possesses the advantages does not license but instead undertakes

the operations itself, there is less difficulty in achieving maximum profits." {31:p.49}

J.Niehans

Foreign investment in Niehans' sense implies that: "Successive stages of production must be separated by national borders" and "integrated in the same firm across national borders." {1-a: p.8} A truly multinational firm, as distinct from binational or trinational firm, must scatter at least one of the stages of production over numerous countries. Swiss companies are typical examples of this case with headquarters in a narrow domestic market and the final-product stage dispersed over many countries.

Niehans calls this situation the "Vertical Specialization of Nations" but fails to make a clear distinction/comparison between vertical and horizontal integration.

Major factors affecting the Vertical Integration are;

1- comparative costs;

2- scale economies;

3- transport costs;

4- state of demand;

5- trade barriers; and

6- exchange risks.

1- Comparative Cost:

In a state of global competitive equilibrium, assuming the absence of scale economies, transport costs, trade barriers, and joint-products, the relative factor endowments and the state of technology determine the production frontiers of various countries based on comparative costs of production. "There is no simple criterion for national specialization." However, "research and development, requiring highly skilled labor, will often be assigned to technologically advanced countries rather than assembling and packaging, which require lower skills." {1-a:p.11}

2- Economies Of Scale:

By assuming the economies of scale, i.e., varying costs at various levels of production, we observe different scale effects at different stages of production, says Niehans. "For example, numerous national or regional markets may each be large enough to support efficient plants as the final stage, while only the world is large enough to support efficient operations as the stage of research or financial management. In other cases, local sources of raw materials like minerals or agricultural products may be subject to diminishing returns and thus internationally scattered, while the efficiency of processing plants requires concentration. {1-a:p.11}

3- Transport costs:

The higher the transport costs, the more likely it would be for the successive stages of production to be separated geographically e.g. internationally. "On the other hand, transportation costs that are sufficiently high for intermediary products can always force two successive stages to the same location." {1-a:p.12}

4- Demand:

Niehans suggests that while it may be economically efficient to produce a given commodity at low level of demand in a single country, it may be more efficient to produce it in many countries at higher levels of demand. "While this situation is true, in principle, even in the absence of scale economies, it may become of decisive importance with increasing returns to scale." {1-a: p.12}

5- Trade Barriers:

"Tariff protection for the finished good at a higher level than for the intermediate good may be a powerful reason for vertical specialization, even though such specialization is socially inefficient. Customs unions, by discriminating against nonmembers, will tend to have the same effect..... Similar considerations apply to non-tariff protection." {1-a:pp.12-3}

6- Exchange Risk:

Fluctuating exchange rates relative to the purchasing-power parity between nations may induce the multinational firms to decentralize production in order to minimize the exchange risk. "The larger the exchange risk, the larger -other things being equal- will be the tendency." {1-a:p.13}

Even in the absence of all sorts of tariff or non-tariff protection and discrimination, some firms would still undertake international operations. But,

"protection is one of the most important determinants of multinationalism. In the absence of protection, therefore, the number and size of multinationals would be much smaller than in the world we live in." {1-a:pp.33-4} In addition, international trade would rise substantially, terms of trade would improve in industrialized countries (real wage/income ratio would rise), foreign direct investments would decline and the technology transfer to developing countries would slow down.

T.G Parry

Parry asserts that the classical theory of international capital flows where "investment will occur up to a point where the marginal rate of return on capital equals the interest rate" {55:p.19} i.e., interest rate differentials alone, cannot give a full account of foreign direct investments. Determinants of FDI are for more complex than the explanations provided by classical theory of international investments. Classical theory does not provide much insight into the issues related to FDI, such as why a subsidiary is established in a particular country.

According to Parry, the primary goal of the MNEs is to maximize the global profits over time. In order to reach this goal, they must allocate the resources optimally. Maximization of profits is subject to the following conditions;

1- "the total global funds available to the MNE from both internal and external sources, and

2- the relative rates of return on alternative uses internationally, both internal and external to the firm, of those investment funds." {55:Ch.3}

To determine the optimum allocation of resources, Parry assumes;

1- "Perfect international mobility of goods (free trade);

2- Perfect international factor-mobility, both real and financial;

3- Perfect knowledge;

4- Internationally identical technology and techniques;

5- Perfect competition; and

6- International equality of company and sales taxes." {55:Ch.3}

Global profits will be maximized, or there will be an optimum allocation of resources, when the marginal returns on investment are the same for all alternative investments. In other words, both internally and externally generated resources will be allocated to the most profitable investments by the firm.

Parry departures from the "optimum" conditions of resource allocation to the "Constrained" optimum allocation by relaxing some of the initial assumptions. First, he relaxes the assumption on the perfect international mobility of goods (free trade) and states that» "Where foreign markets are cut off with the imposition of trade restrictions, including tariff and non-tariff barriers, an international investment response is expected, both a priory and on the basis of considerable empirical evidence." {55:Ch.3} Thus, foreign investments by MNEs appear as a response to trade barriers to acquire or retain a proper market share.

As the next step, Parry relaxes the initial assumption on perfect international mobility of factors. Under constrained optimum conditions, "restrictions on real factor mobility between countries may result in a shortage of various factors of production, at a given price, in an established production center." {55:Ch.3ı As the labor example of this situation, Parry points out the "runaway" industries that invest in other countries to take advantage of the cheap labor force. To counteract this, he recommends the free movement of workers across the countries.

Restrictions on the mobility of natural resources may also lead to foreign investment response. "For example, if there are imperfections or restrictions in the international market for bauxite, then production of alumina may take place at the site of the bauxite deposits, with eventual production of aluminum taking place in other markets." {55:Ch.3} On the restrictions of mobility of financial assets, Parry says that: "With imperfections and distortions in international financial markets, particularly associated with national restrictions on exchange flows, especially profit flows, the MNE's allocation of global investment fund is constrained." {55:Ch.3} The MNE may resort to "transfer pricing" or to intra-firm interest rate on loan to transfer the financial funds from the foreign subsidiary.

Relaxation of the assumptions on perfect knowledge and identical technology brings about the "uncertainty" and "risk" aspects, which may account for some foreign direct investments. For instance, "uncertainty about the security of the long-term supplies of raw materials may lead to a vertical direct-investment response in order to secure ownership of the natural resource and reduce risk. On the other hand, uncertainty over the future ability to maintain

A foothold in a foreign market serviced via exports for various reasons may result in a horizontal direct-investment response by MNE." {55:Ch.3} As to the technology, the likelihood of the lost of returns (the risk of income-loss) on new technology leads to the "internalization" (see footnote) of various functions and packaging of the technology.

The introduction of imperfect competition, allowing for different prices in different markets by different firms, may explain why some foreign investments are undertaken by MNEs. "Departures from perfect competition will also introduce the possibility of economies of scale at the plant level as well as economies of size as the firm or enterprise level. These scale factors can explain the potential for international investment." {55:Ch.3}

Relaxing the initial assumption on international taxes, Parry introduces the possibility of differential tax-rates on foreign investment. "If company tax rates differ as between countries and if resource and profit flows are not constrained, then the enterprise will have an inducement, ceteris paribus, to operate in the low-tax area via direct investment." {55:Ch.3}

A.M. Rugman

Basing hit theory on the commodity and factor market imperfections induced by exogenous factors such as government induced regulation or interventions, Rugman claims that the MNEs use their internal markets as the meant to service foreign markets. "The essence of internalization theory is the recognition of market imperfections which prevent the efficient operation of international trade and investment." {59:p.27} Using its "firm specific advantage in knowledge or other proprietary information" {59:p.22} through the internal market, the MNE expands its international activities.

Rugman defines the internalization as "the process of making a market within a firm. The internal market of the firm substitutes for the missing regular (external) market and solves the problems of allocation and distribution by the use of administrative fiat.

The internal prices (or transfer prices) of the firm lubricate the organization and permit the internal market to function as efficiently as a potential (but unrealized) regular market.

Footnote:

The internalization argument proposes that there are various functions that might be carried out by the market which have been taken over by intra-MNE transfers. Thus, for example, the exercise of control via owned subsidiary operations in several countries is consistent with internalizing various market functions.

Whenever there is a missing market (as in the pricing of inter-mediate products such as knowledge), or when the transaction costs of the regular market are excessive, than there will be a reason for internalization." {59:p.28} The internalization process is the decisive factor of international investments by MNEs and makes them the dominant economic force of world economy. But the core of the problem is the market imperfections. As there are countless market imperfections, there are stronger reasons for internal markets and the operations of MNEs. "The key characteristic of the MNE is that it has a firm specific advantage in knowledge. Therefore, by definition, the MNE is a monopolist." {59:p.61}

There are three possible ways for a MNE to service foreign markets. "First, the firm may simply wish to export to foreign markets. Secondly, the firm may engage in foreign direct investment, that is, set up an overseas subsidiary to produce for a local market. Thirdly, a firm may wish to license to a possible host-country producer. The method of servicing a foreign market may change over time, as the various costs associated with each of these three strategies change." {59:p.26} Market imperfections such as government intervention, taxes and tariffs are of particular relevance in explaining the foreign investments.

Rugman is very critical of market imperfections prevailing in both commodity and factor markets. As a result of these imperfections, he claims, "neither factor price equalization nor goods price equalization has been observed." {59:p.38} The MNe and the foreign investments are the response to exogenous market imperfections in the commodity and factor markets. Imperfections in the intermediate product market such as research, information and knowledge are of particular interest to Rugman.

> "Information is an intermediate product par excellence..... There is no proper market for the sale of information created by the MNE and therefore no price for it..... Instead, the MNE is driven to create an internal market for its own in order to overcome the failure of an external market to emerge for the sale of information. Internalization allows the MNE to solve the appopriability problem by assigning property rights in knowledge to the MNE organization." {59:p.41}

According to Rugman, even the location economics explanations of foreign investments can be regarded as an aspect of internalization process, but "this time in a spatial context. The MNE can save transport costs by setting up an overseas subsidiary rather than relying on exports from the home nation. This spatial cost saving is another example of a firm specific advantage internalized by the MNE." {59:p.48} Rugman seems to believe that the internalization process can explain

most (and probably all) of the reasons for foreign investments. Even the frequently criticized intra-firm transfer pricing is regarded as an outcome of imperfect markets. Rugman claims that» "Such prices are set by administrative decision and have to be respected as the prices necessary to make the MNE function efficiently." {59:p.83} And it is interesting to note that "exogenous market imperfections stem as much from regulations as they do from natural market failure.

As long as governments persist in intervention in the market place there will remain incentives for internalization." {59:p.157} In fact, since the modern world is characterized by a great volume of market imperfections, as Rugman put it, the international operations of MNEs will always be justified, until we get perfectly functioning markets.

The theory of internalization asserts that the "multinationals are efficient if the market imperfections. are assumed to be external to the firm."{59:p.157} But what happens if imperfections are internal to the firm? How to explain foreign investments in relation to internal imperfections? In addition, internalization theory seems to fail to account for investments for defensive purposes (others will invest if I don't approach) and investments to take advantage of scale economies.

As far as scale economies is concerned, a Swiss firm, for example, might have to scatter the production of components of a new product at initial stages because of limited markets and facilities (such as lack of manpower or limited plant capacity). Whereas a U.S-based firms do not need to go abroad, in general, to take advantage of scale economies because of huge domestic markets

L.T. Wells, Jr. (FDIs by Developing Country MNEs)

There are various factors inducing the developing country-based enterprises to invest abroad. Some enterprises with necessary facilities respond to these factors and survive successfully in international markets. In order to survive the international competition, these developing country based enterprises must have some firm specific comparative advantages over domestic enterprises and the developed country based MNEs. Regrettably: "Data are not yet available to provide much empirical evidence about the comparative advantage of LCD investors." {1-e:p.136} One of the major factors inducing LDC-based enterprises to invest abroad is the strict foreign-exchange control exercised by the home country of investor. Developing country entrepreneur may regard the foreign investment as the meant to escape strict foreign currency controls at home and to accumulate foreign

exchange to secure the steady supply of imports, especially in emergency situations.

Foreign investment by Indian enterprises to secure the flow of imports was a common practice. Indian government required "that firms which desire to import earn their own foreign exchange." {1-e:p.136} Thus, some foreign subsidiaries of Indian enterprises were established to provide the needed foreign exchange. Another case inducing foreign investment is the constraints on growth of firms at home imposed by the authorities. Such constraints appear "in the firm of antitrust action, capacity licensing, or policies that discriminate against large enterprises. For the firm faced with such policies, the only possibility for continued growth may be foreign investment." {1-e:p.136} In addition, some developing country firms expand their manufacturing operations in foreign countries because of the limited domestic markets, or simply because they become competitive in international markets and respond to the same kind of market incentives as the developed country based MNEs.

According to Wells, Jr. the developing country enterprises tend to invest in industries or segments where cost competition is severe and the economies of large scale is not a decisive factor. In other words, LDC-based foreign investors tend to enjoy a comparative cost advantage and are economically efficient in small markets. "The data available suggest that most LCD investors operate in industries that have mature technologies. The technology for the products these investors manufacture has become rather standardized in the advanced countries. The technology used in the advanced countries to manufacture these products is usually based on large-scale manufacture for a mast market. When that technology is applied to manufacture for the market of a developing country, costs are usually high since the market is small. The firm that employs the technology used in the advanced countries for production in the developing countries usually finds herself saddled with excess capacity in various stages of the production line.

In such a situation, there is an opportunity for innovation. That opportunity, it appears, is particularly likely to be seized by the developing-country entrepreneur beginning the process that leads to foreign investment. Many of the developing-country investors appear to have gained their initial advantage when they adapted large-scale technologies of the industrialized countries for manufacture at small scale in their home countries."{1-e: p.138} In other words, in many cases the technology of developing country enterprise is of industrialized country origin but adapted to small-scale production. This gives them an edge over the DC-based MNEs, especially in cases where markets are small and not sufficiently attractive for DC-based MNEs.

II-5: Driving Forces Behind the FDIs: Reconsidered

Various theories have been offered, as discussed in preceding sub-chapters, to explain the determinants of foreign investment. While Marxists see an inherent feature in capitalism to expand production and to accumulate more capital (expand or die), the Neo-classical scholars base their arguments on the interest-rate differences between countries, i.e. foreign investment will take place until the marginal rate of return on capital equals the interest rate across countries. The question is» which one of the theories reflect the reality or come close to reality?

Contemporary scholars seem to place more emphasis on various other factors. For example, H.G. Johnson, a prominent proponent of the free flow of resources "views the transfer of knowledge as the crux" {55:p.26ı of foreign direct investments. Vernon's "product life-cycle" model regards the foreign investments mainly as a defensive strategy to survive competition in previous export markets. According to Parry, the oligopolistik advantages of MNE lead to foreign investments, given the market imperfections such as trade restrictions, immobility of labor-force, etc. Aliber, on the other hand, claims that the currency premium is the major determinant of international investments. The question is; which one of the theories displays the reality or comet close to reality?

Perfect Competition and Accumulation

Long before the domination of global economic structure and events by the MNEs, the price-taker firm under competitive capitalism had one sole objective» to make profits. The profits were to be generated by business transactions, e.g. exchange of commodities, between the producers and consumers. If we define the profits as excess value over total costs of production minus total costs of inputs, the rate of profit can be represented as excess value (#) over total production costs (TC), #/C.

Profit making objective is the heart of the matter under capitalism. An entrepreneur is driven by the profit-making motive and invests hit accumulated capital to increase hit cumulative capital stock. To achieve hit purpose, the entrepreneur has constantly to be on alert and take into account the changing environment in technology and consumer tastes, and the potential (counter-) actions of competitors. He must be sensitive and responsive to the signals from the market and keep pace with the technological changes. An entrepreneur ignorant to the changing economic environment, especially to technology and consumer tastes, cannot survive the fierce competitive winds of competitors.

An entrepreneur's primary objective, or the driving motive for his actions, is to make profits. And there seems to be no upper limit to profit making aspirations, although profits below a lower limit may discourage further investments and may even end up with dropping out of the battle field. The upper limit, i.e., maximization of profits is subject to various constraints such as the demand for, and supply of, products, production techniques used, competitor's strength, etc. In Neo-classical models, by assumption all producers have access to the same production methods and no single firm can influence the market price of products, the firms are likely to make profits but unable to push its rate beyond a given limit determined by market conditions.

The practical observations indicate, however, that the assumption of homogeneity of production methods is a fallacy, to say the least. In reality, even under perfect competition where plenty of producers of insignificant size without any effect on the out come of market forces exist, the production method used by entrepreneurs is not homogenous. In other words, the technology used is not the same. In fact, technology has never been a constant nor homogenous variable of economic life. It has always been the most important aspect of economic and social chance. And the entrepreneurs have always been very keen to technological change, whether it is new products or new production methods.

Given the heterogeneity of technology, the rate of return on investment can never be same for all entrepreneurs, either. Some are very responsive to innovations and constantly introduce new methods of production and/or new commodities. Some are lest dynamic and lest responsive to changing environment, and lag behind. The latter group's share and income of the total is bound to decline while the former group's entrepreneurs expand their activities and cumulative capital stock.

Technological change is not the only way to increase the rate of profit and accumulation of capital. Factors as;

1- investment in human capital (education/on the job training);

2- population growth (growing demand, cet. par.);

3- external demand (exports);

4- government's economic policy (especially procurement);

5- organizational improvement; and

6- management's efficiency

can prove to be efficient meant to secure profitability, but only up to a limit, in a static technological environment. Beyond this limit, the above stated factors may prove to be useless. But in a dynamic technological environment where innovations

are constantly being introduced, there seems to be no limits to the growth of firm(s).

One can hardly under-emphasize the importance of technology in the process of development, both as national and company level. Technological improvements are the most efficient means of securing maximum profits. An innovation may introduce a new method minimizing the costs of production with a given quantity of output or maximizing the output with given quantity of inputs, or introduce new commodities thus generating new demand. Therefore, technological changes are the most reliable and efficient weapons of offensive entrepreneurs in the struggle for accumulation. When the technological gap between the firms is not too big, the defensive entrepreneurs follow the offensive ones, or they wither away, in the long run. A firm cannot survive in the long run by just maintaining the status quo.

A distinction is quite useful in economic analysis between the long-term and short-term goals of the economic agents. In the long run, all firms/entrepreneurs strive to maximize the rate of return on investment. In the short-run, however, the firms may pursue other goal(s) than the maximization of profit rate, depending on the circumstances. Major short-run goals are likely to be;

1- acquisition of a targeted market-share;

2- retaining of an already acquired market-share;

3- maximization of sales;

4- compliance with the national economic policy;

5- satisfying the shareholders;

6- keeping a "good company" image; or

7- surviving the strong competitive winds until counter-innovations are introduced.

Driving Forces For The MNE

Under fully competitive models where all firms by assumption were price-takers foreign markets were served by exports from the home country of firm. Export of capital for direct investment was predominantly directed to colonies to set up plantations, to construct railroads or to supply minerals. Already in the first half of 19.th Century the uneven development of national economies was obvious although the technological gap between developed and less-developed nations was not as drastic as in 1980s.

In order to protect the local manufacturers, the countries lagging behind the economic development began to introduce trade restrictions already in 19th century. Actually, some form of protection has always been present in the history of today's developed countries, and even in 1980t Dc economies have not totally abolished all kinds of protective measures, in contrast to the teachings of their prominent economists or textbooks. Anyway, the firms exporting to countries imposing trade restrictions have usually responded by establishing local manufacturing units for the protected local markets. Cockerill of Belgium was the first firm to initiate export of capital in 1815 to manufacture for the local market in a foreign country. Following Cockerel's footsteps, especially the chemical firms rapidly expanded their foreign operations in the second half of 19.th Century.

If one prefers to use narrow-sighted spectacles to see a distant view, one may argue that the firms respond by exporting capital to retain the market share served by exports prior to trade restrictions. Indeed, the retaining of market-share argument seems rather logical to explain the motive behind FDI. But it falls short of a full-fledged account of the action. It would be more realistic and appropriate to describe the foreign direct investment action as a response to retain / maximize the total income streams of the firm. Because the objective of exports was to increase the income and profit-rate of the firm, and not responding to trade-restrictions by FDI would imply lost of profits. In other words, the FDI-response explained as defensive strategy to protect the foreign market share is in fact aimed to retain the profits due abroad. Analogously, a firm may seem to invest because of high transport costs but the real motive, or the driving force, usually is the drive to increase the profit rate of the firm. The same logic is also applicable for other kinds of motives offered by various economists. In short, the ultimate goal and the long-term driving force for expansion is the profit-making motive for the private enterprises.

To conclude, we can assert that the MNE is driven by the some motive as the atomistic price-taking firm of Neo-classical doctrine. The long-run objective is the maximization of profit rate, but the short-run strategy may induce the enterprise to pursue other goals. The major distinction between the price-taker firm and the oligopolistik MNE is that the latter makes its decisions with respect to global opportunities while the former's activities were mainly confined to domestic market.

The main characteristics of a typical MNE tend to be access to a firm specific "advantage", organizational ability and highly skilled manpower. Internally generated and accumulated surpluses provide the basis of its financial strength and independence. It usually originates from industrialized countries and seems to expand its foreign production by exploiting its firm specific advantage, whether it

be knowledge, trade-mark, marketing skills, favorable financial facilities, distribution net, after-sale service, favorable access to inputs of production, etc. But the most effective weapon that a MNE possesses is the technological advantage over other firms. Innovations pave the way for increased profits and a healthy growth. An enterprise without a healthy growth cannot survive in the longer-run. And the best way of securing high-income streams is through the control of production and distribution of commodities around the world.

Professor Mc Fadzean, once the chairman of Royal Dutch Shell group, reflecting on the profit maximization issue, pointed out that if any of the general managers "were to submit a forward program on the basis that it was designed to achieve less than maximum profitability, but enough to keep the shareholders quite and provide capital for expansion, he would be removed from office." {8:p.12} Profit maximization can only be realized through healthy, steady and vigorous growth. As the 1965 annual report of Rockwell-Standard Corporation stated» "a company is just like a human being. When it stops growing, when it can't replenish itself through growth, then it starts to deteriorate." {44:p.10} And growth simply implies the addition of some (undistributed) profits accruing in a given time-span, to the capital in the next time-span through investment, e.g. capital accumulation, after allowance depreciation.

The importance of profit maximization and growth is also emphasized by Business International which stresses that» "International corporations need the freedom to move capital, materials, technology, and technicians whenever and wherever needed to maximize the growth, competitive strength, and profits of the enterprise." {44:p.25} Galbraith argues that maximization of profits is not always the basis for policy-making in companies. The primary concern of the firm may be to avoid maximum profits not to attract new entrants into the market, or to avoid accusation for market abuse as well as the fear of antagonizing trade unions or authorities.

LDCs as Outlets for FDIs

The bulk of international direct investments take place among the developed countries. But this does not imply, by all means, that the share of developing areas of total foreign investments is insignificant or of marginal importance. Developing country markets provide highly profitable outlets for the foreign operations of MNEs. In fact, empirical evidence indicates that the rate of return on investment is greater in developing countries than in developed countries.

Data supplied by Vernon (1971) showed that whilst U.S. companies invested approximately $ 1 billion each year in foreign subsidiaries between 1960-1968, the annual flow of capital from foreign subsidiaries to the parent company amounted to around $2.5 billion during the same years in form of profits, excluding royalties, transfer pricing and interest on intra-firm loans. Erdilek (1982) estimated an annual mean rate of return on foreign investment in Turkish manufacturing sector at around 23 percent between 1970-77. "This figure implies a lest than five-year pay-back period for the parent firm's original imported capital, which is shorter than both the initial and present pay-back period estimates 8 years and 14 years, respectively." {20:p.168}

The foreign operations of MNEs seem to have a stabilizing impact on the global sales and profits. Working with a sample of 233 large U.S. firms, "Cohen explored the year-to-year variation in both earnings and sales around either their mean or their trend over the years 1961-69. Controlling at best he could for the size, diversity, and principal industry of the firm, he found that both earnings and sales fluctuations were reduced by foreign investment. Since economic conditions in different countries do not go up and down in perfect unison, Cohen concluded that foreign investing provided American firms with an effective way of stabilizing their global earnings." {10:p.225}

As the industrialization process goes on, the need of the developing countries for the advanced technology of industrialized nations increases for both embodied (product) and disembodied (production process) technology, given the technological gap. In a free market economic order, the private enterprises appear to be the principle source of technology supply to developing countries.

The cost of foreign investment to the MNE is the income forgone by the amount of exported capital, not by the amount of full investment value as often local financing is involved. But as demonstrated by Erdilek (1982), the return on foreign investment is rather high and often repays the invested capital sooner than the assumed payback period. Therefore, one can easily claim that foreign investment is not only stabilizing the global earnings of MNEs as Cohen says, but also provide highly profitable premises, thus elevating the global average rate of return on investment.

Basic Pre-requisites

Willingness alone is not a sufficient condition to invest in foreign countries. With respect to the profit maximization principle, the decision-makers of MNE expect

certain preconditions to prevail in the potential host country, even before considering an investment. The main and essential expected preconditions are:

1- Political stability: a friendly investment climate is very important for the FDI. The management of an enterprise would be reluctant to invest in a country where hostile attitudes are strong. The unfavorable investment climate increases the risks and uncertainty of the future events. One should note, however, it is not the political color of the government that counts, but the attitude towards FDI.

2- Market size: Disregarding the purely export-oriented FDIs, the market size, including export markets, plays an important role one FDI decisions. Assuming a small market and availability of more profitable investment alternatives, FDI is unlikely to take place on economic grounds. But if the market were large enough the MNE would be more inclined to invest, especially in protected markets.

3- Supply of manpower: As labor supply is abundant and the labor force is growing rapidly in LDCs, manpower supply is hardly likely to be a problem for the unskilled jobs. But if the local production requires technically complex and advance skills, which is of short supply in LDCs, foreign investor would be discouraged.

4- The stage of infrastructure: The foreign investor would be highly sensitive to the stage of infrastructure in the potential recipient country of FDI. The poorer the transport facilities, communication network, etc., the more reluctant the foreign investor is likely to be.

Incentives Influencing FDI Decisions

Such preconditions as stated above are quite necessary but absolutely not sufficient to attract foreign investment. Incentives influencing MNE-management's investment decisions and eventually leading to direct investment response in a particular country display various features. Results of a survey made by the National Foreign Trade Council in the U.S.A. among the MNEs indicated that the main factors inducing them to undertake production abroad were ranked as follows:

1-"To jump tariff and import barriers and regulations.

2- To reduce or eliminate high transportation costs.

3- To obtain or use local raw materials.

4- To obtain incentives offered by host governments.

5- To maintain existing market positions.

6- To participate in the rapid expansion of a market abroad.

7- To control quality in the manufacture of specialized products

8- To follow customs abroad.

9- To obtain foreign technical, design, and marketing skills." {21:p.68}

Bergsten-Horst-Moran (1978) studying the motives of U.S.-based firms for investing abroad also ranked the tariff barriers as the most important factor, as above, but the classification of other factors were different, as follows;

1- "an increase in the tariff on its exports;

2- other host-country incentives to local production;

3- high U.S. labor and material costs relative to those abroad;

4- devaluation of the foreign currency against the U.S. dollar;

5- competition in the foreign market, forcing the use of cheaper foreign production;

6- growth of the foreign market to a point where start-up and overhead costs are relatively minimal; and

7- the firm's gratuitous reassessment of foreign production relative to exporting." {10:pp.69-70}

Bergsten-Horst-Moran pointed out that F.A. Southart in hit study called "American Industry in Europe" in 1931 had also found the tariff barriers imposed by the Europeans as the most important motive for U.S. direct investments in Europe, while transportation costs was ranked as the second most important motive. Since then, Bergsten-Horst-Moran assert that non-trade barriers such as import-quotas, government procurement preferences for local suppliers, potential host country industrial standards and policies "have become increasingly the focal points of national trade policies. These newer forms of protection are now more likely than tariffs to induce foreign direct investment, because tariffs have been reduced to low levels in most industrialized countries, and because firms can handle price barriers but cannot circumvent quantitative limits." {10:p.292} In developing countries, however, the tariff barriers and various financial incentives still seem to be the major attractions.

L.G. Franko points out that even the U.S., one of the most liberal countries in trade policy, had resorted to various forms of trade restrictions for protection. He says that "effective rates of U.S. tariff protection in chemicals, drugs, electric lighting, fabricated-metal products, and scientific instruments in 1964 were all estimated to equal or exceed 20 %. These estimates took into account the incidence of some non-tariff barriers (such as the American Selling Price system) but not all NTB's. Indeed, about 70 % of the subsidiaries of Continental

enterprises in the United States were producing products which apparently enjoyed effective protection of 20 % ad valorum or greater." {24:p.175ı (see also Appendix D-2)

Studying the foreign investments in Turkish manufacturing sector, A.Erdilek (1979) found some interesting results. Apparently, the most important motive for MNEs to invest in Turkey was 1-) the rapid expected growth of the Turkish economy and the increase of demand for the products of MNEs. The second important motive was said to be 2-) the expected high rate of return in supplying primarily the Turkish market. And in contrast to the expectations,

3-) trade barriers came in the third place. {20:p.19,Table: A-6} These are surprising findings because Turkey had pursued a heavily import-oriented growth strategy between 1960 and 1980 with rather high trade barriers.

Apparently, trade barriers are one of the major factors leading to foreign investment response in developing countries. Such imperfections in the market often induce the MNEs to start production abroad. If the foreign markets could be serviced profitably by exports, the amount of foreign investments would be much smaller. "Companies repeatedly pointed out that at the time they made their foreign investments competitive pressures in the relevant market were causing a decline of exports, that the only meant of maintaining their market position was production 'on the spot'." {10:p.55} Some countries and regions seem to be luckier than the others in attracting foreign investments. "a number of countries (particularly in Africa and the Caribbean) with small domestic markets and limited natural resources were unable to attract significant inflows of direct investment during the 1970s, despite offering substantial incentives. However, a few countries with relatively small domestic markets (including Hong Kong, Singapore, and, to some extent, Malaysia) that pursued open economic policies and maintained few restrictions on foreign investment were able to attract substantial export-oriented direct investment, while generally offering only moderate incentives. In contrast, many countries with larger domestic markets (including India, Nigeria, and most of the larger Latin American countries) and consequently with greater potential for attracting direct investment for import-substituting production, imposed a number of restrictions or specific performance requirements to extract greater benefits." {32:p.14}

CHAPTER- III SUMMARY OF THE FINDINGS

MNEs began to emerge in the 19th century, partly to exploit the opportunities in colonial settlements and mainly, outside the colonies, as a response to growing trade restrictions. Some of the pioneering FDIs were made by enterprises like Cockerill of Belgium, Phillips of Netherlands, Siemens, Bayer, BASF, Hoechst of Germany, and Ciba, Geigy of Switzerland. In the 20th century, especially after W× II, expansion of foreign manufacturing subsidiaries accelerated around the world, sometimes to take advantage of host-country outward-growth incentives and sometimes to benefit from the fruits of protected domestic markets behind trade barriers. Regardless of the motives for setting up a production plant abroad, the profit maximizing behavior is the driving force of FDIS.

Global operations of the MNEs, in a way, stabilize the production on a global scale while restructuring the international division of production and increasing the interdependence of nations. Many developing nations acquired new production methods and new commodities from industrialized nations which would, perhaps, not have taken place in the absence of FDI. In spite of all valuable positive contributions to the national economy of host countries, one should not make the fallacy of assuming that the MNEs are the agents of development, or that they undertake FDI to comply with the national objectives of any nation. On the contrary, MNEs only pursue their own internets with the ultimate responsibility to their share-holders.

A MNE may be a legal citizen of many nations but only has one home country. Their impacts on the national economy are mainly the outcome of economic policies implemented. The more successful economic policies the more contributions may accrue to host nations. It would not be an exaggeration to claim that even home-country objectives are of secondary importance to the MNE preceded by company interests. MNEs are so powerful that they can affect the sovereignty of some nations, and are capable of producing effective counter-measures when their sovereignty or internets are threatened. Whether one likes it or not, MNEs are here to stay and appear to be an indispensable source of capital accumulation and technological change.

With respect to the economic-historical developments by which the present international division of labor has been shaped, it seems that primarily the MNEs based in industrialized areas have access to the required technical and managerial ability, organizational structure and the financial facilities to undertake the extremely costly R&D process with the purpose to produce (more) advanced production methods or advance technology embodying new, complex commodities. These MNEs "tend to operate in product markets dominated by a few sellers and buyers. They are thus able to manipulate prices and profits, to collude with other firms in determining areas of control, and generally to restrict the entry of

potential competition through their dominating influence over new technologies, special skills and consumer tastes as a result of product differentiation and advertising." {64:p.342}

The growing dominance of international business transactions by the MNEs has led to different responses. The proponents of the new international division of labor discovered many highly merited benefits in it for the entire world. For example, according to G. Meier (1976) foreign direct investment "brings to the recipient country not only capital and foreign exchange but also managerial ability, technical personnel, technological knowledge, administrative organization, and innovations in products and production techniques -all of which are in short supply." {48:p.373} For Meier, the MNE with its enormous facilities and global opportunities is a unit of real international integration of world economy.

The critics often draw attention to aspects such as economic and technological dependence, inappropriateness of the commodities and production methods imported, misallocation of resources as well as the income redistribution effect within the host country (rural versus urban) and between the parent firm and subsidiary or between the host and home countries. It is true that the adverse affects of foreign investment are largely due to prevailing market imperfections, but it is also true that the nature of transactions especially restrictive (abusive) practices are the cause of many evils in the market.

The most outstanding advantages of foreign investment accruing to the host country are;

1) the introduction of new commodities and production processes;
2) addition to domestic capital formation;
3) generation of new employment opportunities;
4) inflow of technical and managerial knowledge; and
5) foreign exchange.

The extent of these advantages depends mainly on the national economic policy pursued, bargaining strength, and the technological development stage of host country.

As commonly known and acknowledged, there is a wide technological gap, especially in the most dynamic sectors of economy, between the developed and developing areas. Assume, for the sake of argument, two countries with identical tastes; let "x" denote the developed and "y" the developing country, while "g" denotes the growth rate of technology. Empirical evidence shows that "g" is positive in both countries» [gx > 0] and [gy > 0], but greater in "x" than in "y", e.g. [gx > gy]. In

order to be able to narrow the gap either "gx" must fall or "gy" must rise, or a combination of both. It is highly unlikely for a developing country to realize this by relying entirely on her indigenous endowments and facilities. Therefore, "it is generally recognized that the acceleration of the rate of economic growth of the developing countries and the rapid improvement in their social structure through the eradication of mass poverty and of inequality of income INTER ALIA a large scale transfer from the vast pool of technology accumulated mainly in the developed countries."{67:p.1}

But, there is the belief that foreign investment "if left to the prevailing market forces, would accentuate rather than alleviate some aspects of under-development: it would aggravate the inequality of social and economic relations and increase external dependence." {67:p.1} Especially technological dependence tends to be perpetuated by the foreign investments, largely as a consequence technology market imperfections and national policy objectives. It is not seldom observed that the developing country decision-makers indicate clear and persistent preference for all or most of the crucial elements of advanced technology to be supplied by the foreign investor "and thereby make little use of local technology and skills and make even lest effort to build them up by their own research and development activities." {67:p.7}

Analysis of economic growth patterns in developed areas show clearly that the foreign trade contributed significantly to their overall development, especially in countries with limited domestic markets like Sweden, Switzerland and Netherlands. Foreign trade is still of vital importance for economic growth in both developed and developing areas. But the share of developing countries in the global trade of (high) technology embodying (semi-) manufactured commodities is still insignificant. "Developing countries appear to be left outside the more dynamic sectors of trade, not only because they do not develop or copy technology adequately, nor because their enterprises are relatively small with limited export horizons, etc., but also because when they acquire technology, even belatedly, contractual terms prohibit such exports." {85:p.57} It looks like, as K. Marsden put it» "The persons who gain most from the technical change are the inhabitants of the already rich countries exporting the machinery, the materials and components required by the new technologies." {48-e:p.404}

C.V.Vaitsos claims that "foreign direct investments fall basically within a bargaining model and not, as they are traditionally defined within a one-sided benefit-cost analysis applied generally to the host country." {85:p.53} The weaker the bargaining power of developing country, the weaker will be the resistance to contractual restrictive (abusive) practices imposed by the technology supplier, and consequently, the greater the costs accruing to the host country. As a result, the

measures taken by the technology supplier to secure maximum global profits would tend to be incompatible with host country interests. Apart from low employment generation due to capital-intensive production methods, introduction of inappropriate commodities developed essentially for high-income markets, dependence on foreign managerial/technical expertise, foreign exchange costs resulting from repatriation of profits/royalties and transfer-pricing (visible and invisible transfers) tend to be substantial.

As we have studied in the previous chapters, contractual restrictive practices are used to control the quality, quantity, prices, exports, sources of imports, interest rate on loans, etc. Major consequent negative impacts of such practices can be summarized as follows:

1- Diffusion of transferred technological/managerial knowledge and skills is far from satisfactory (inadequate linkage effects);

2- Key decisions affecting the nature of transactions of the subsidiary and/or the internets of host country are often taken by foreigners;

3- Excessive foreign exchange costs appear as a result of transfer-pricing mechanism and interest rate on intra-firm loans;

4- Tax revenue losses arising from tax-incentives and undeclared profits (transfer pricing) are substantial;

5- Restrictions on local technological adaptations;

6- "Potential" lost of foreign exchange earnings due to restrictive export clauses;

7- Economic/political dependence and vulnerability on external factors in critical periods, such as international conflicts;

8- 8- Technological dependence perpetuated by market imperfections due to heavy reliance on foreign technology instead of encouraging/developing domestic technological capabilities;

9- Pollution arising from the lack of effective protective measures and personnel to preserve the environment.

Any attempt to assess the costs and benefits of technology transfer through the foreign direct investments of MNEs based on the premises of pure market values is bound to produce misguiding results. Because the socio-economic priorities and development goals set by developing country decision-makers could differ

substantially from the private priorities of commercial enterprises. To put it differently, the social values of importance are not always in line with the private values and targets of business firms. For example, "whilst it may be quite beneficial for the local enterprise to rely on foreign technology suppliers in the short run, this dependence may not be desirable from a social point of view and is often detrimental to the development of the country in the long run. From a social point of view it might be preferable to use local technical capabilities even if they are limited and inefficient in the short run, because in the long run they will become more efficient and make it possible to diminish reliance on external sources of technical skill and to generate a more appropriate technology." {67:p.7} The principal meant to reach this target could be either instructive through legislation or suggestive through various market incentives under the guidance of authorities, or a combination of both.

To conclude, the major findings of the study of technology transfer to the developing areas through direct investments of MNEs can be summarized as follows:

1- When foreign investor newly forms a plant, its contribution to domestic capital formation and employment generation is positive. In case of market entry through acquisition, as in about 30 percent of all FDI, there will be no, or limited contribution to national economy.

2- Foreign investment improves the foreign exchange reserves of host country at the initial stage. But what is taken out of the country after some years in forms of royalties and profits (official and clandestine) tend to exceed the inflows by a good margin. Transfer-pricing mechanism is the principal source of clandestine profits (foreign exchange costs).

3- An important aspect of the imported new technology is the introduction of new commodities and increased (potential) competition. But as the commodities are designed and developed in industrial countries reflecting their tastes and high purchase power, they often are "inappropriate" or luxury goods for developing countries afforded only by a small minority of population. In other words, such products create socially undesirable consumption patterns.

4- Another important aspect of the transferred advanced technology is "how" the commodities are produced, i.e., methods of production. Foreign technology is a typical expression of the development stage of industrialized nations. Accordingly, their production methods reflect the relative scarcities of production factors. And as we know, the reverse conditions are valid for developing countries, i.e., relatively scarce capital and abundant manpower. As a result, the transferred

production methods tend usually to be inappropriate with respect to factor endowments.

5- If the foreign subsidiary is established to service entirely foreign markets, there is the risk of "non-transfer" of technology to host country. In case of production for the local market, at least to some extent, the technological productive knowledge transferred seems to be rather limited as the technology supplier would be reluctant to provide access to key knowledge to prevent the possible imitation of its technology or be indifferent to the attempts aimed to improve host country technical capability which could undermine the foreign investors bargaining strength. In other words, the more the host country learns, the more disadvantages it would be for the technology supplier.

6- Tax-incentives deprive the developing host countries of vital revenues for the state, which could be utilized to promote the indigenous facilities. "Empirical findings" says B. Knall "reveal that tax concessions were a relatively minor consideration in the decision to invest in LDCs." {40:p.821 Regarding Knall's argument and the revenue lost of state it is, perhaps, in better interest of developing nations to eliminate these incentives and to discourage all investments undertaken for tax purposes globally. But, unfortunately, many developing nations seem to compete with each other in providing more generous tax-incentives.

7- Economic/political and technological dependence has been one of the most delicate issues concerning direct investments. In spite of its all contributions to national economy, the subsidiary is in the final stage subject to the interests of parent firm and eventually home country. The home country can use the subsidiaries as proxy to promote her national interests, and examples of this is not few (see Chapter III -3:3) In addition, the MNEs with their enormous economic facilities sometimes greater than many developing countries, can exercise economic and political pressure like a nation-state in crises/conflicts with the host country. The trend and nature of international economic transactions tend to perpetuate the technological and economic dependence on MNEs as well as their home countries.

8- Restrictive practices, whether implicit or explicit, constitute major impediments to development. These practices range from the prohibition of exports to tying the imports to a source determined by the foreign investor or quality-quantity restrictions. In some cases, it prevents the host country from the full-scale utilization of subsidiary in accordance with social values and priorities. Restrictive practices tend to favor strictly the foreign investors' interests.

"Foreign direct investment is neither the panacea for under-development as claimed by proponents, nor a bogey as claimed by its opponents." {10:p.485} It can

make significant contributions in various ways to the economy of developing countries. In particular, the foreign owned subsidiaries could increase the export of (semi-) manufactured commodities, which the developing countries seem to need badly to earn foreign currency. Meanwhile, the developed nations should reduce/eliminate trade barriers for commodities coming from developing areas. The present technology transfer transactions and the world division of labor, as we have seen in previous chapters, tend to operate mainly in favor of the MNEs and industrialized countries.

What would have happened in the absence of FDI ¿ If we generalize J. Niehans' conclusions on the consequences for Swiss economy, the following would be likely to happen in the home countries of MNEs;

1- increased demand for exports;

2- improved terms-of-trade and higher real-wages (real-income);

3- increased demand for imports because of higher real income;

4- no transfers of dividends or transfer-pricing, but greater remittances of royalties, license fees, etc.

5- lower unemployment, especially of the low- and un-skilled workers.

The probable consequences for the developing countries in terms of economic growth are less certain. But, very likely;

1- local manufacturing of many commodities would not have taken place;

2- real-incomes and total capital stock would have been lower;

3- technology flow through license/patent arrangements would have increased;

4- foreign exchange costs in forms of dividends and transfer-pricing would have been lower but in form of royalties, license/patent fees greater;

5- (un-) employment would change in accordance with foreign demand on export products;

6- technology related expenditure on r & d and adoption would increase;

7- more labor-intensive production methods would have been used» and

8- portfolio investments would have increased.

Barriers to, or discouragement of, FDI by MNEs is, by no means, what is recommended here. On the contrary, if right steps in the right direction are taken, there is a great potential contribution to be made by foreign technology and

investment. Developing countries have a lot to learn from the experience of MNEs in terms of technical knowledge, marketing skills, managerial efficiency, etc.

What we reckon is the improvement of present conditions in favor of the developing countries. For the sake of global prosperity and stability, such improvements are imperative, so it seems to me anyway.

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