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Rolf Jungnickel\*

## Recent Trends in Foreign Direct Investment

*Global investment strategies have become a central issue in international business and in international economics. The worldwide stock of foreign direct investment (FDI) can be estimated at over US \$ 1500 billion in 1990 – three times the value of the 1980 stock. The following article discusses the driving forces behind this trend and identifies some recent changes in the pattern of FDI.*

In the late 1980s FDI well outpaced the growth of both output and trade. The average annual growth rates from 1984/85 to 1989/90 were 33% for FDI flows, 12% for world GDP and 13% for world exports of goods and services. The stock of international FDI has increased from 6% of world GDP in 1985 to over 8% in 1990 (Fig. 1).

According to US, Japanese, and German statistics, the gross output of foreign affiliates (which can better be compared with macroeconomic output data) shows less dynamism than FDI – more FDI is needed now than 10 years ago to achieve a given sales value. However, even according to this yardstick it seems safe to conclude that the internationalization of production has clearly increased, especially in the late 1980s, if at a substantially lower rate than the “explosion” of FDI flows<sup>1</sup> might suggest at first sight. UNCTC<sup>2</sup> estimates of the worldwide sales of foreign affiliates run to a value (well over US \$ 4,000 bn in 1989) corresponding to almost one-quarter of world GDP, up from 22% in 1986. Considering that

□ the estimated sales of foreign affiliates have reached the order of magnitude of the world exports of goods and services,

□ an estimated 25% of world trade and the bulk of licensed international technology transfer takes place as intra-company transactions,<sup>3</sup> and

□ non-equity engagements such as international strategic alliances are booming,<sup>4</sup>

the MNEs can be regarded as the driving force in the integration of the world economy.

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While the causes of the rapid increase of FDI and of the internationalization of production are manifold and specific to individual countries, sectors and companies, the following seem to be the most important ones:

□ With falling transaction costs, shorter product cycles, growing R&D budgets and internationalized competition, the pressure on the firms to go global has increased. They have to get involved in the centres of economic and technological activity in order to take advantage of new developments and to counteract moves of competitors.

□ Non US-firms, especially from Japan, have caught up with, and sometimes even surpassed, their US-counterparts in terms of technology, management, organization, and financial resources. This enabled them to pursue internationalization strategies on a larger scale.

To these more fundamental factors others can be added that facilitated FDI strategies:

□ The regionalisation of markets made FDI a preferred option for outsiders in order to become regional insiders.

□ Deregulation opened up new regional and product markets.

□ The internationalization of financial markets facilitated the realization of voluminous investments.

<sup>1</sup> Cf. Anne de Julius: Global companies and public policy. The growing challenge of foreign direct investment, Chatham House Papers, London 1990.

<sup>2</sup> Cf. UNCTC World Investment Report 1992, New York.

<sup>3</sup> Cf. UNCTC World Investment Report 1992, New York; Rolf Jungnickel: Weltwirtschaft und internationale Unternehmung, in: Handwörterbuch Export und Internationale Unternehmung, Stuttgart 1989.

<sup>4</sup> Cf. ILO: Employment and Multinationals in the 1990s, Geneva (forthcoming 1993).

The expansion of FDI was neither continuous nor has it equally affected all sectors and regions. The stagnation of FDI in the early 1980s was followed by a rapid expansion in the late 1980s and another setback in 1990/91. FDI is strongly pro-cyclical. It varies with overall economic activity more than proportionately, thus following a pattern similar to domestic investment. On the basis of IMF data, the "income elasticity" of FDI can be estimated at almost 4 and increasing.<sup>5</sup> FDI is, therefore, an element of microeconomic growth strategies rather than a defensive measure.

**Services on the Increase**

The sectoral pattern of international FDI changed considerably in the 1980s. While the raw materials sector lost in weight in virtually all major home countries, services were the most dynamic component, particularly in the Netherlands and Japan.<sup>6</sup> In a number of countries (e.g. Japan, UK, Germany and – probably – the Netherlands) FDI in services have overtaken the traditionally leading engagements in manufacturing (which have, however, maintained their clear lead in terms of employment).

Manufacturing, the traditional core of international FDI, has shown no uniform development in the last decade. While it could hold its position in the USA, Great Britain and Canada, it clearly lost ground in Japan, Germany and the Netherlands. Traditionally, manufacturing FDI is concentrated in sectors which are characterized by

- complex technologies and high R&D outlays,
- high marketing costs,
- vertical integration of production,
- marked interdependence of the leading firms,

since under these conditions firm-specific competitiveness can be developed and often utilized best by way of FDI. This has not changed substantially in the last decade. The sectoral patterns of manufacturing FDI are similar internationally and they show a substantial stability over time. The chemical industry (incl. pharmaceuticals) and electrical engineering/electronics together with

<sup>5</sup> Cf. Anne de Julius, op.cit.; Philip Turner: Capital Flows in the 1980s: A Survey of Major Trends, BIS, Basel 1991.

<sup>6</sup> However, the interpretation of changes in the sectoral FDI data is somewhat dubious since MNEs increasingly organize their international industrial operations as holding companies. The growth of FDI in services therefore seems to be overestimated.

<sup>7</sup> For details see Axel Borrmann, Rolf Jungnickel: Die Position ausländischer Investoren im asiatisch-pazifischen Integrationsprozeß, HWWA-Report, No. 102, Hamburg 1992; Rolf Jungnickel: Foreign Direct Investment: Recent Trends in a Changing World, HWWA-Report, No. 115, Hamburg 1993.

<sup>8</sup> Jetro: Japan New World's largest Investor, in: Tradescope, Jan.1991, pp. 5-8.

automobiles, mechanical engineering and food are throughout among the top investors.

**Regional Trends**

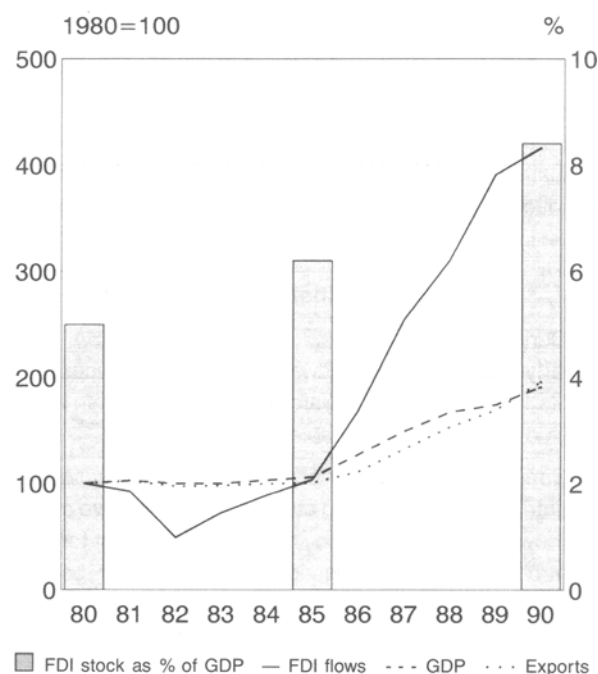
FDI has persisted in being essentially a business of First World companies and it is directed largely to First World locations. Third World firms, especially from Asian NIEs<sup>7</sup> have only recently appeared as international investors on a larger scale. Their share in the global outward FDI stock still is as low as just under 4% (up from 1.5% in 1980).

Table 1 gives details of the value and significance of FDI for a number of countries and regions where the respective data/estimates are available.

The unprecedented growth of Japanese FDI as well as the expansion of inward investment to the USA and the coming-up of European home and host countries can be regarded as the most remarkable features of the international investment scene in the later 1980s.

From 1985 to 1989, the annual capital outflows from Japan have increased fivefold. Despite a slight reduction in 1990/91, largely due to recession and financial problems both at home and in the main investment locations, Japan has probably become the biggest international investor in absolute terms.<sup>8</sup> In relation to

**Figure 1**  
FDI in the World Economy 1980-90



Source: Calculated from IMF: BOP; IMF: Economic Outlook; World Bank.

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**Table 1**  
**Stock of Outward and Inward Direct Investment 1980-1989**

	outward			inward		
	1980	1985	1990	1980	1985	1990
<b>Values in \$ bn</b>						
United States <sup>1</sup>	220	251	423	83	185	404
Canada	23	36	73	52	59	109
Germany <sup>2</sup>	43	60	155	37	37	94
United Kingdom	79	107	249	63	63	206
Netherlands	40	50	105	20	25	66
France	14	19	100	16	20	78
Italy	7	18	64	9	19	61
Switzerland	22	24	66	9	11	18
Japan	20	44	202	3	5	15
<b>Total 9 countries</b>	<b>470</b>	<b>610</b>	<b>1440</b>	<b>290</b>	<b>420</b>	<b>1010</b>
Other developed <sup>3</sup>	25	40	140	70	80	200
Developing <sup>3</sup>	8	20	60	120	185	270
<b>World</b>	<b>510</b>	<b>670</b>	<b>1640</b>	<b>480</b>	<b>685</b>	<b>1520</b>
<b>Significance (% of GDP)</b>						
United States <sup>1</sup>	8	6	8	3	5	7
Canada	8	10	13	20	17	19
Germany <sup>2</sup>	5	10	10	5	6	6
United Kingdom	15	24	26	12	13	21
Netherlands	24	39	37	12	20	24
France	2	4	9	2	4	7
Italy	2	4	6	2	5	6
Switzerland	22	26	29	9	12	8
Japan	2	3	7	-	-	1
<b>Total 9 countries</b>	<b>7</b>	<b>8</b>	<b>10</b>	<b>4</b>	<b>5</b>	<b>7</b>
Other developed <sup>3</sup>	3	5	7	8	10	10
Developing <sup>3</sup>	-	1	2	5	9	8
<b>World</b>	<b>5</b>	<b>6</b>	<b>8</b>	<b>5</b>	<b>6</b>	<b>8</b>

<sup>1</sup> The United States' outward FDI corrected for financial FDI in the Netherlands Antilles. <sup>2</sup> Inward FDI underestimated since indirect investment cannot be included. <sup>3</sup> Other developed and developing countries as well as some national 1990 inward stocks calculated from the shares in FDI flows since 1970; developing countries' data include former socialist countries and estimates for Taiwan and Hong Kong, based on Eric D. Ramstetter: Foreign Direct Investment in Asia and the Pacific in the 1990's: Potential, Policies and Issues, mimeo, Honolulu 1991; Sanjaya LaI: Emerging Sources of FDI in Asia and the Pacific, mimeo, Honolulu 1991, and national statistics.

Source: Calculated from national sources; UNCTC; IMF.

GDP, the annual outflow of FDI capital has reached a level clearly above the OECD average and the FDI stock is approaching this average (Table 1). However, offshore industrial production as a percentage of domestic production (5-6%) is still clearly beyond the ratios for the other important industrialized countries.<sup>9</sup>

### The American Challenge Reversed?

During the entire 1980s, FDI inflows to the USA have clearly surpassed the outflows. It was only in the recession years 1990/91 that the outward flows picked up again while inward FDI fell strongly (Table 2).

Similarly to a number of European and developing countries in the 1960s and early 1970s, fears have come up now in the USA of a too strong dominance of foreign controlled firms in the economy. However, from both a theoretical and empirical point of view such concern is no better founded now in the USA than it was 20 years ago in other countries:

□ With 5% of all non-bank business employment and an

FDI/GDP ratio of 7%, the US economy, on average, is still less internationalized than other major developed market economies and many developing countries.

□ The involvement of foreign-owned firms in the USA has to be set against the foreign involvement of US-MNEs. With a roughly balanced FDI position, there is hardly reason for general concern. Furthermore, US outward FDI is on average much older than inward investment. Hence, it is relatively underestimated.<sup>10</sup> A comparison of sales and employment data reveals that the economic potential of US-owned foreign firms is equivalent to that of a medium-sized highly developed country (such as the BeNeLux Group) and that there is an obvious, although declining, lead of outward activities of US-MNEs over the inward activities of foreign firms (Table 3). Even the "investment balance" (in terms of sales and employment) with Japan still is far from being one-sided.

<sup>9</sup> R. Komiya, R. Wakagusi: Japan's Foreign Direct Investment, in: The Annals of the American Academy, No. 513, Jan. 1991.

<sup>10</sup> SCB (Survey of Current Business), June 1991.

□ Quite independent of the balance of FDI flows and stocks it is by no means clear that inward investment is detrimental to the host country's economy. The inflow of superior production factors can, and does, as Graham and Krugman have argued,<sup>11</sup> increase competition and lead to productivity growth, thus furthering structural change and the income level.

All in all, the trends and position of US-FDI hardly justify speaking generally of a particular foreign investment challenge to the USA. Although on a sectoral level (e.g. automobiles and electronics) there may be reason for concern about a lack of competitiveness of US firms, this cannot simply be blamed on foreign-owned firms in the US. Rather these can serve as indicators of (lacking) competitiveness of the indigenous industries and as growth engines for the economy.

### European Internal Market

The EC '92 programme had, and still has, obvious implications for FDI decisions of both EC and third country firms:

□ For *EC-firms*, there is on the one hand better market access for exports, hence less pressure for FDI. On the other hand, with reduced government-imposed barriers to international trade and investment, there may be more room for firms to re-organize their existing pattern of international production, sourcing, and distribution according to locational advantages, scale economies and reduced transaction costs. Also, the perspective (or the experience) of being confronted with tougher competition can induce firms to offensive FDI in order to capture first-mover advantages, balance prior moves of competitors, and reduce uncertainty about the effects of EC '92.

□ The (re)actions of EC-firms have their bearings on *third country competitors*.

- To the extent that these firms have built up an insider position in the EC already, they are affected in much the same way as EC-firms.

- For *EC-outsiders*, the Community's integration and economic dynamism make it a more attractive investment

<sup>11</sup> E. M. Graham, P. R. Krugman: Foreign Direct Investment in the United States, Washington, D. C., 1989.

<sup>12</sup> A. M. Rugman, A. Verbeke: Corporate strategy after the free trade agreement and Europe 1992, in: J. Longair (ed.): Regional Integration in the World Economy: Europe and North America, Ottawa 1990.

<sup>13</sup> UNCTC: World Investment Report 1991, New York, John Cantwell: The Effects of Integration on the Structure of Multinational Corporation Activity in the EC, in: Klein, Welfens (eds.): Multinationals in the New Europe and Global Trade, Heidelberg 1992, pp. 193-233.

location compared with the rest of the world. On the other hand, EC-outsiders may face higher natural entry barriers<sup>12</sup> due to the increased competitiveness of indigenous firms. Also, they are directly affected by the EC provisions and policies concerning market entry for outsiders such as voluntary export restraints (VERs) and an excessive antidumping policy which is guided by certain national industrial interests only. Uncertainty about future market access could then be overcome by investing behind such trade barriers.

Empirical evidence shows that the factors furthering FDI clearly dominate the ones frustrating it. EC locations have moved upwards in the ranking of investors both from the EC and from third countries, as can be seen from Table 4.

*Intra-EC FDI* has traditionally been modest compared with investments in (and by) third countries. However, after the internal market programme was launched (and thus well before it was fully implemented) there has been a clear reversal: intra-EC flows have grown stronger than both inflows from and outflows to the rest of the world.

The boom in intra-EC FDI is often seen as being part of a regional rationalization of EC business activities.<sup>13</sup> While

**Table 2**  
**Shift in the US FDI Position 1980-91**  
(\$ bn p.a.)

flows p.a.	1980-84	1985-88	1989	1990	1991
(1) inward <sup>1</sup>	17	43	66	41	13
(2) outward <sup>1</sup>	7	15	25	28	27
(3) balance (1)-(2)	11	28	40	14	-14
stocks: end of...	1980	1985	1989	1990	1991
(4) inward <sup>1</sup>	74	169	355	379	392
(5) outward <sup>1</sup>	198	225	341	387	411
(6) balance (4)-(5)	-124	-56	14	-8	-19

<sup>1</sup> FDI in/from "other Western Hemisphere" and Panama excluded.

Source: Survey of Current Business, various issues; author's calculations.

**Table 3**  
**Performance of US Inward and Outward Investment<sup>1</sup>**

	1983	1988	1989	1990
<b>inward</b>				
sales (\$ bn)	533	886	1,041	n.a.
employment (1000)	2,547	3,844	4,440	
<b>outward</b>				
sales (\$ bn)	902	1,195	1,285	1,481
employment (1000)	6,383	6,404	6,622	6,706

<sup>1</sup> Non-bank affiliates.

Source: SCB, various issues.

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**Table 4**  
**Share of Outward FDI Invested in the EC, 1985-90**

Home country	Share of EC in						Increase of flows to the EC 1985/86-1989/90 <sup>c</sup> (%)
	FDI stock 1990		FDI flows p.a. (%)				
	bn \$	%	1985-87	1988	1989	1990	
USA	178	42	38	54	58	28 <sup>b</sup>	+ 95
Japan <sup>1</sup>	55	18	17	18	21	23	+ 428
Switzerland	32	48	42	69	24	51	+ 79
Sweden	18 <sup>a</sup>	50 <sup>a</sup>	31	46	52	70	+ 768
UK	54	24	17	26	27	55	+ 142
Netherlands	48	46	46	24	51	58	+ 197
Germany	70	45	32	36	63	68	+ 218
France	59	60	41	63	62	68	+ 980
Italy	32	57	.	.	.	.	.

<sup>1</sup> Notification based, cumulated flows. <sup>2</sup> Calculated in national currencies. <sup>a</sup> 1989. <sup>b</sup> Low share of FDI in EC because of net disinvestment in UK. EC share was up to 50 % again in 1991.

Source: National statistics of home countries.

this can be observed frequently in the distribution and logistics functions, examples are not (yet) too frequent for massive FDI aiming at a locational rationalization of the production system.<sup>14</sup> Given

- the similar locational conditions in the core EC countries,
- the high degree of openness of markets (both for trade and FDI) that has been achieved already, and
- the advantages of local investment presence in terms of better adjustment to local needs,

the companies more often appear to be following market-oriented strategies. They expand into the EC-partner countries in order to strengthen their market position. Thereby they reduce at the same time the uncertainties and adverse consequences of the intensified competition which is – or is expected to be – brought about by EC '92. The rationalization of industrial production systems on a European scale seems to have received more attention only recently as a consequence of the economic recession.

It seems that MNEs from *non-EC countries* follow not too different strategies in their re-orientation to the EC.<sup>15</sup> The principal question is: What is the role of barriers to trade? If they were the main factor, one would expect only a once-for-all effect on FDI with as little transfer of value added as possible. If, on the other hand, FDI were driven by the aim to capture new markets and participate in the growth of existing ones and profit from industrial policy

measures favouring EC insiders one could rather expect lasting economic and technological dynamics.

For the bulk of EFTA and US investors the answer is obvious: in view of the existing voluminous production bases in the EC and – for EFTA countries – negligible trade barriers, the expansion into the EC can be regarded largely as part of offensive strategies aiming at new markets.

For Japanese investment the assessment is less clear.<sup>16</sup> While there is some evidence of jumping over trade barriers, this motive can only be viewed as an initial or additional pull factor. Account has to be taken of the pressure of increasingly global competition and the chances opened up by engagement in the most dynamic high-income markets. Thus, the Japanese FDI can also be looked at as being part of global expansion strategies.

### New Opportunities in the Eastern Reform Countries?

In the formerly so-called “socialist” countries modern industrial structures have to be built up. There is an immense need for exactly those factors with which MNEs are endowed and which make up their competitive strength. To name but a few: modern technology, organization and management know-how, knowledge of marketing and export markets and, of course, capital. Thus, the potential of MNEs ideally matches the needs of the eastern reform countries.

The evidence, limited as it is, at first glance seems to support the optimistic view of a good fit of eastern

<sup>14</sup> Rolf Jungnickel: Unternehmensstrategien im Binnenmarkt, in: O. G. Mayer et al. (eds.): Der Europäische Binnenmarkt, Hamburg 1989.

<sup>15</sup> Susanne Erbe et al.: Drittlandsunternehmen im europäischen Binnenmarkt, Hamburg 1991.

<sup>16</sup> The motivation of Japanese FDI in the EC is discussed in more detail in Phedon Nicolaides, Stephen Thomsen: Can protectionism explain direct investment?, mimeo, Feb. 1991; Stephen Thomsen, Phedon Nicolaides: The evolution of Japanese direct investment in Europe: Death of a transistor salesman, Hempstead 1991; Susanne Erbe et al., op. cit.

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countries and western companies. The number of joint ventures and even the capital (to be) invested has multiplied from year to year. It is estimated by the ECE at US \$ 10 bn invested in 34000 joint ventures in 1/92.<sup>17</sup> Other estimates<sup>18</sup> arrive at similar orders of magnitude (Table 5). Set in relation to the size of the host-countries, the MNEs' interest concentrates on Hungary.

However, such statistics are largely based on estimates and subjective information from the parties involved.<sup>19</sup> Furthermore, high growth rates are largely the result of an extremely low basis and the majority of the projects are only registered and have not (and possibly never will) come into operation.<sup>20</sup> Host country data therefore have to be evaluated in connection with home country data. Although German MNEs, so far often considered the No. 1 investors in the eastern reform countries, have invested there 6% of their total FDI in the first three quarters of 1992, the share in the stock data, which has not yet been published, is probably no higher than 1%. For the other major home countries it is even much less (Table 6). With up to 15% of the rapidly increasing FDI placed in eastern reform countries, especially in Hungary, Austria seems to be an exception among western source countries. Austrian MNEs focussed on Hungary and the former CSFR with an estimated share of 25% and 12%, respectively, of all western FDI in these countries.<sup>21</sup>

All in all, therefore, the discussion of MNEs' involvement in the eastern reform countries has to concentrate on future prospects rather than recent trends. Even in the medium term, some doubts about substantial FDI growth have to be raised, both for investment oriented towards the eastern market and that directed at western export markets:

□ For successful *market-oriented* businesses the urgent need for modern products is not a sufficient condition. Money is lacking for making demand effective unless

sufficient capital is transferred (which seems highly unlikely).

□ For *export-oriented production*, the proximity to the high income markets in the West may be a purely geographical advantage and not a commercial one, given the poor infrastructure and industrial support systems, administrative bottlenecks and legal and political uncertainties.

A number of examples demonstrate that ventures in the eastern reform countries can be highly profitable. Generally, however, problems seem to have clearly outweighed profit opportunities so far. Thus a short term surge of domestic-market-oriented FDI or a massive shift of export-oriented FDI from the south to the east seem unlikely, in particular to countries other than Hungary, Poland and the former CSFR.

### Developing Countries Left Aside?

For developing countries (DCs) seeking FDI, the 1980s were a disappointing decade. Although there was a shift towards a more liberal policy with less restrictions and more promotional efforts<sup>22</sup> the volume fell behind in relative terms from roughly one quarter of the world's inward flows around 1980 to a mere 12% in 1987. Since

**Table 5**  
**FDI in Eastern Reform Countries**

FDI stock mid 1992	Poland	CSFR	Hungary	Romania	Bulgaria	CIS
US \$ mill.	800	1000	3000	370	300	5600
% of GDP	0.7	2.0	6.9	0.7	1.8	.

Source: OECD: Foreign Direct Investment Flows: Recent Development and Perspectives, in: Financial Market Trends, June 1992; UNIDO: Foreign Direct Investment in Central and Eastern European Countries, Vienna, 16 June 1992; Jan Stankovsky: Direktinvestitionen Österreichs in den Oststaaten, in: WIFO Monatsberichte, No. 8, pp. 415-420.

**Table 6**  
**FDI of Western MNEs in the Eastern Reform Countries**  
(% of total national FDI)

home country	stock		flows		
	1990	1991	1989	1990	1991
USA	< 0.04 <sup>a</sup>	< 0.1 <sup>b</sup>	0.05 <sup>a</sup>	0.5 <sup>a</sup>	0.9 <sup>a</sup>
D	0.16	.	0.5	0.7	3.4
F	< 0.1 <sup>c</sup>	.	0.05	0.16	1.0
Japan	< 0.17 <sup>d</sup>	0.2 <sup>d</sup>	< 0.1 <sup>d</sup>	0.17 <sup>d</sup>	0.7 <sup>d</sup>
GB	< 0.22 <sup>e</sup>	.	0.3 <sup>e</sup>	1.6 <sup>e</sup>	.
Austria	> 10	~ 15	.	~ 20	~ 27

<sup>17</sup> UNIDO: Foreign Direct Investment in Central and Eastern European Countries, Vienna, 16 June 1992.

<sup>18</sup> OECD: Foreign Direct Investment Flows: Recent Development and Perspectives, in: Financial Market Trends, June 1992; Jan Stankovsky: Direktinvestitionen Österreichs in den Oststaaten, in: WIFO Monatsberichte No. 8, 1992, pp. 415-420.

<sup>19</sup> Jan Stankovsky, op. cit.

<sup>20</sup> Klaus Bolz (ed.): Ordnungspolitische Standortbedingungen für Direktinvestitionen in Mittel- und Osteuropa – Länderstudien CSFR, Polen, Rumänien, Ungarn, UdSSR –, Hamburg 1990; John H. Dunning: The Prospects for Foreign Direct Investment in Eastern Europe, University of Reading, Discussion Papers in International Investment and Business Studies, No. 155, 1991.

<sup>21</sup> Estimates by the Austrian Ministry of Economics. The host countries' statistics show a somewhat lower share (Stankovsky, op. cit.). Included in the Austrian FDI is an unknown share of indirect FDI by non-Austrian MNEs via their Austrian subsidiaries which often enjoy an advantage in dealing with eastern countries. The most recent example is the German tyre company Continental.

<sup>a</sup> "Other" Europe not specified, incl. former Yugoslavia, Iceland, Greenland. <sup>b</sup> Hungary, Poland, Romania, former Soviet Union. <sup>c</sup> 1989. <sup>d</sup> Including some minor western European countries. <sup>e</sup> Including returns received from unspecified areas.

Source: National Statistics.

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**Table 7**  
**FDI of Industrialized Countries in the Third World<sup>1</sup> 1980-1991**  
 (% of total outward FDI)

Home country	outward stocks				outward flows		
	1980	1985	1990	1991	1989	1990	1991
USA	19	22	17	18	18	26	31
Japan	53	45	24	24	16	17	20
F	25 <sup>d</sup>	24 <sup>d</sup>	7	.	6	3	6
D	17	13	8	.	5	3	4
UK	17 <sup>a</sup>	17 <sup>b</sup>	11	.	9	16	.
NL	12 <sup>c</sup>	10 <sup>c</sup>	8 <sup>c</sup>	.	11 <sup>c</sup>	7 <sup>c</sup>	11 <sup>c</sup>

<sup>1</sup> Caribbean tax havens and Panama excluded as far as possible. <sup>a</sup> 1981. <sup>b</sup> 1984. <sup>c</sup> NL Antilles only excluded. <sup>d</sup> Cumulated flows to non-OECD countries as of 1976; tax havens could not be excluded.

Source: Calculated from national statistics.

1989, a recovery seems to have begun. In 1989/90, FDI reached a new peak with inflows of over US \$ 28 bn and even an estimated US \$ 40 bn in 1991.<sup>23</sup>

The declining share of FDI invested in DCs<sup>24</sup> is (or at least was until 1990) a feature common to virtually all important source countries, as can be seen from Table 7. Especially French and German MNEs have engaged only marginally in DCs recently.

The falling behind (as well as the recent revival) of DCs as hosts to FDI did not equally affect all regions and types of investment: while the decline in the 1980s was largely in natural resources and market oriented industrial investments, services and export oriented manufacturing have gained in weight.<sup>25</sup> Also, a technological upgrading of products and production processes is taking place. "... worldwide industrial restructuring is now spreading into many additional product groups in branches such as transport equipment, electrical machinery, machine tools ..."<sup>26</sup>

At the regional level, the Asian-Pacific countries took the lead in the competition for FDI, while the Middle East and Latin American countries on the whole experienced an erosion of locational competitiveness with Brazil being the main "loser". Countries like China, Thailand and Indonesia have come into the limelight. In China, foreign-controlled firms carry out 5% of total industrial production and as much as 17% of Chinese exports.<sup>27</sup> However, a

remarkable revival of FDI in Latin America started in 1990, when a "liberalisation of trade policies, greater openness to foreign investment and the gearing of macroeconomic policies towards stabilisation ... contributed to the creation of a more favourable climate for foreign investors ..."<sup>28</sup> Mexico and Argentina attracted two thirds of the 1990/91 FDI inflow to Latin America.<sup>29</sup>

From the increasing outward orientation, the technological upgrading, and the widely differing positions of the various countries, we can conclude that there was no general trend against "the" Third World. The success in attracting FDI largely depends on country specific factors. The winners in the locational competition are countries

- with large and growing markets;
- with a good supply of skilled but low-cost labour;
- with supporting industries and infrastructure available;
- with a stable and predictable environment (in terms of political stability, administrative efficiency, level of regulation) offering good prospects for profitable operations.<sup>30</sup>

Furthermore, *economic proximity* seems to play a crucial role. This is clearly visible in the regional FDI patterns of the triad poles USA, Japan, EC as well as the Asian NIEs. Each of them has traditionally concentrated its Third World investment on a limited number of nearby

<sup>22</sup> Thomas L. Brewer: Foreign Direct Investment in Developing Countries, World Bank, WPS 712, 1991; UNIDO: Foreign Direct Investment Flows to Developing Countries: Recent Trends, Major Determinants and Policy Implications, Vienna 10.7.1990.

<sup>23</sup> BIS: 62nd Annual Report, Basel 1992.

<sup>24</sup> The relative decline of FDI in DCs was not disproportionate. It reflects the changed economic weight of the region. The inward FDI/GDP ratios of the First and the Third World converged during the late 1980s and have now reached a similar level (Table 1).

<sup>25</sup> UNIDO: Foreign Direct Investment Flows to Developing Countries: Recent Trends, Major Determinants and Policy Implications, Vienna 10.7.1990.

<sup>26</sup> Ibid.

<sup>27</sup> Pekings Wirtschaftsstrategen registrieren einen starken Zufluß an Auslandskapital, in: Handelsblatt, 1. 12. 1992.

<sup>28</sup> BIS: 62nd Annual Report, Basel 1992, p. 93.

<sup>29</sup> Inter-American Development Bank: Economic and Social Progress in Latin America, 1992 Report, Washington, D. C.

<sup>30</sup> UNIDO: Foreign Direct Investment Flows to Developing Countries: Recent Trends, Major Determinants and Policy Implications, Vienna, 10.7.1990; UNCT: Transnational Corporations in World Development, New York 1988; Thomas L. Brewer: Foreign Direct Investment in Developing Countries, World Bank, WPS 712.



countries - nearby in terms of geography, culture, language, political links (such as post-colonial ties), transportation etc. Often dominant positions of one triad pole have evolved in the inward FDI of individual DCs in the focal regions.<sup>31</sup>

The differences in the regional FDI structure of the most important source countries have proven to be fairly stable.<sup>32</sup> However, this does by no means exclude future changes or the coming up of new competitors for FDI, as has been demonstrated e.g. by Asian first and second generation NIEs. FDI will persist on high levels (or catch up, as has been demonstrated by Mexico and Argentina most recently) if a sufficient political, economic and administrative performance is achieved.

### Production Networks?

With increased foreign operations, the scope widens for specialization and integration of affiliates. The building of such production networks, especially on a regional basis, is often seen as a typical feature of the FDI growth in the late 1980s.<sup>33</sup> While this view seems to be supported by empirical studies e.g. on the Asian Pacific region<sup>34</sup> and by a number of individual cases, it remains an open question to what extent this evidence can be generalised. The establishing and shaping of international production networks should result in an increasing weight of foreign countries (especially third countries) in the sales as well as the procurement of the affiliates. However the data available for US and Japanese MNEs indicate on average (total manufacturing, all host countries) no substantial increase of these shares.<sup>35</sup> Thus, the significance of network strategies has to be assessed on a sectoral and regional level.

### Conclusions

All in all, the 1980s showed a certain diversification of international FDI stocks and flows. In outward FDI a triad structure has developed with not too different weights for two of the three core regions (USA and EC excluding intra-EC investment) and less weight but more dynamism for the third pillar, Japan. On the other hand, in inward FDI the concentration on the USA has left room for diversification only recently.

With the regional diversification of outward FDI and the concentration of inward FDI on the USA and new and old European locations, there seems to be a movement towards

- more balanced national FDI positions and
- a regional FDI structure more in line with national economic potentials.

Both should help reduce conflicts arising from one-sided FDI positions and lead to an economic interdependence which is no longer confined to a few countries.

While any assessment of future FDI trends is necessarily highly speculative, there are important arguments in support of the view that FDI will remain one of the more dynamic elements of the world economy:

If one takes the traditionally high and increasing internationalization of the UK economy as a reference for what may be desired by MNEs and considered "normal" for countries (sometime maybe even for Japan!), it becomes obvious that there is a large scope for further FDI. This potential could be activated in the course of a general economic recovery.

The internationalization of the services sectors seems to have just begun. Up to now it has been much lower than in manufacturing. With further liberalization, such a development could be pushed forward.

Privatization in the industrialized west, in the developing south and in eastern reform countries will open up new opportunities and create a competitive pressure for FDI.

Further integration efforts in east and west Europe, the NAFTA and the Asia Pacific Area could push FDI both by regional insiders and outsiders.

FDI will hardly be replaced by non-equity arrangements, such as strategic alliances that have become commonplace especially in high tech industries. Rather, it may be assumed that a number of alliances will finally result in mergers or acquisitions and hence in FDI. An immediate effect of alliances on FDI takes place to the extent that reciprocal minority shares are part of the deal (as increasingly seems to be the case).

Having established new operations abroad, MNEs can be assumed to knit these together across borders, thereby creating more foreign trade (intra-firm trade) and furthering economic integration regionally or worldwide. Thus, it seems that MNEs will remain highly significant actors in the world economy.

<sup>31</sup> UNCTC: World Investment Report 1991, New York.

<sup>32</sup> Rolf Langhammer: Competition among Developing Countries for Foreign Investment in the Eighties - Whom did OECD Investors Prefer?, in: Weltwirtschaftliches Archiv, No. 2, 1991.

<sup>33</sup> UNCTC: World Investment Report 1991, New York; John Cantwell: The relationship between international trade and international production, discussion paper No. 161, University of Reading, 1992.

<sup>34</sup> Axel Borrmann, Rolf Jungnickel, op. cit.

<sup>35</sup> Axel Borrmann et al.: Regionalismstendenzen im Welthandel (forthcoming).