World Investment Report 1995

Transnational Corporations and Competitiveness

Overview

Enabled by increasingly liberal policy frameworks, made possible by technological advances, and driven by competition, globalization more and more shapes today's world economy. Foreign direct investment (FDI) by transnational corporations (TNCs) now plays a major role in linking many national economies, building an integrated international production system -- the productive core of the globalizing world economy. Transnational corporations deploy their tangible and intangible assets (capital, research-and-development capacity and technology, organizational and managerial practices, trade links), with a view towards increasing their competitiveness and profitability. At the same time, the deployment of these assets by firms strengthens the resource base of countries and their capacity to produce, to reach and expand markets for their products and to restructure their economies -- in brief, to improve their overall economic performance. To link the increased competitiveness of TNCs to the economic performance of host and home countries as closely as possible poses a challenge for policy makers. These developments and issues are the particular theme of the *World Investment Report 1995*.

Part One of the *World Investment Report 1995* examines recent global and regional trends in FDI, with a special emphasis on the emergence of TNCs from developing countries and on changing forms of international transactions. Part Two focuses on the role of TNCs in influencing countries' access to resources and markets and in facilitating economic restructuring. Part Three discusses policy issues, from an inward and outward FDI perspective. The annex contains statistics on FDI trends.

Global and regional trends

International production by TNCs -- now some 40,000 parent firms and some 250,000 foreign affiliates -- increasingly influences the size and nature of cross-border transactions. In the process, it shapes the nature of the world economy. Outward FDI stock and global sales of foreign affiliates -- two generally accepted proxy indicators of international production -- now stand at $2.6 trillion (1995) and $5.2 trillion (1992), respectively (see table 1). In the 1990s, the rate of growth of FDI stock has substantially exceeded that of world output (GDP) and world exports. The size and scope of international production are amplified further by the activities of TNCs in forms other than FDI, such as subcontracting, licensing and franchising, through which markets for goods, services and factors of production can be reached and international production organized. Global sales in international markets associated with this more broadly defined international production amounted to an estimated $7 trillion in 1992, compared to some $3 trillion in arm's length trade. In fact, in the case of TNCs headquartered in the United States, four out of five dollars received for goods and services sold abroad by these firms are actually earned for goods and services produced by their foreign affiliates or sold to them. The various forms of international production may be substitutes or complements for each other, depending on the strategies of TNCs. All of them are aimed at ensuring access both to markets for goods and services and to markets for tangible and intangible factors of production, in a quest to convert globally inputs into outputs for global markets as efficiently and profitably as possible.

Table 1. Selected world FDI, economic and financial indicators, 1981-1993

Indicator	Value at current prices, 1993 (Billions of dollars)	Average annual growth rates (Percentage) 1981-1985	1986-1990	1991-1993
FDI outflows	222		0.8	28.3 5.6
FDI outward stock	2 135		5.4	19.8 7.2
Sales of foreign affiliates of TNCs [a]	5 235[b]	1.3 [c]	17.4	-2.6 [d]
Current gross domestic product at factor cost	23 276	2.1	10.6	3.3
Gross fixed capital formation	5 351	0.7	9.9	3.2
Exports of goods and non-factor services	4 762	-0.1	14.3	3.5
Royalties and fees receipts	38	-0.7	21.8	13.0

Source: UNCTAD, Division on Transnational Corporations and Investment, *World Investment Report 1995: Transnational Corporations and Competitiveness* (United Nations publications, Sales No. E.95.II.A.9).

[a] Estimated by extrapolating the worldwide sales of foreign affiliates of TNCs from France, Germany, Italy, Japan and the United States on the basis of the relative importance of these countries in worldwide outward FDI stock. However, the data on sales of foreign affiliates for France are included only after 1988 because of unavailability of the data prior to that year. For Italy the sales data are included only in 1986, 1988, 1990 and 1992.
[b] 1992.
[c] 1982-1985.
[d] 1991-1992.

The diverse nature of international production suggests that international policy discussions about market access have to deal not only -- as they currently do -- with trade in goods and services but also with FDI as a modality to access markets. Beyond that, FDI is also a modality to access factors of production. Such a broader perspective also raises the question as to the extent to which specific government policies may introduce a bias in favour or against any specific modality of international transactions and, therefore, distort the way in which firms undertake and organize their international activities. The importance of such distortions would become clearer if governments paid greater attention to the interrelationships between investment, trade and other forms of international transactions in their dual function of accessing markets for goods, services and factors of production and organizing international production.

Partly in response to globalization, progress in coming to grips with the nature of international production is already being made. National, regional and international agreements are paying more attention to FDI. Although for a number of countries there is still an imbalance between the degree of liberalization of FDI and trade regimes (with progress achieved for the latter, furthermore, bound in multilateral agreements), FDI regimes at the national level are rapidly being liberalized: continuing a trend of earlier years, 101 out of 102 legislative changes made in 1993 in 57 countries were in the direction of a more liberal FDI framework; in 1994, 108 out of 110 legislative changes made in 49 countries were in the same direction. In fact, only 5 out of a total of 373 FDI regulatory changes during 1991-1994 were *not* in the direction of greater liberalization (table 2). Such unilateral measures have been accompanied by the conclusion of bilateral investment agreements, primarily between developed and developing countries, but increasingly also among developing countries. Of the more than 900 treaties that existed by mid-1995 between 150 countries, nearly 60 per cent date from the period since the beginning of 1990, 299 from 1994 alone. Another dimension has been added to the liberalization process at the regional level, with the strengthening of free trade agreements which, increasingly, also liberalize FDI flows (and, therefore, properly ought to be called free trade and investment agreements). In fact, the OECD countries began negotiations in September 1995 on a Multilateral Agreement on Investment, with a view to reaching such an Agreement by May 1997 as a free-standing treaty open also to non-OECD countries. Finally, a proposal has been made to negotiate an investment agreement in the World Trade Organization. All this means that the enabling framework for FDI is being strengthened, thus giving further impetus to the process of globalization.

Table 2. Liberalization measures, 1991-1994

(Number)

Item	*1991*	*1992*	*1993*	*1994*
Number of countries that introduced changes in their investment regimes	35	43	57	49
Number of changes	82	79	102	110
Of which:				
In the direction of liberalization or promotion	80	79	101	108
In the direction of control	2	-	1	2

Source: UNCTAD, Division on Transnational Corporations and Investment, *World Investment Report 1995: Transnational Corporations and Competitiveness* (United Nations publications, Sales No. E.95.II.A.9).

International production by TNCs is boosted by the continuing recovery from the FDI recession ...

International production, as reflected by the FDI stock accumulated by TNCs, has been growing at a rapid pace since the early 1980s, a growth that only briefly slackened during the FDI recession of the early 1990s. Investment stocks and flows remain concentrated primarily in the developed world and particularly in the Triad (the European Union, Japan and the United States), both as far as their origin and destination are concerned (see figure 1). This distribution of inward FDI stock mirrors market size, with the developing countries accounting for between one-fifth and one-quarter of both world GDP and global inward FDI stock. However, the FDI stock in developing countries is highly concentrated: the 10 largest developing host countries account for about two-thirds of the total stock in developing countries, more than would be expected from their share in developing country output or trade. As far as outward stock is concerned, firms from developing countries generated only 6 per cent of the world FDI stock in 1994, reflecting the superior competitiveness of Triad firms, based on their ownership-specific advantages. As with inward investment, the outward developing country FDI stock is largely accounted for by firms from only a handful of developing countries.

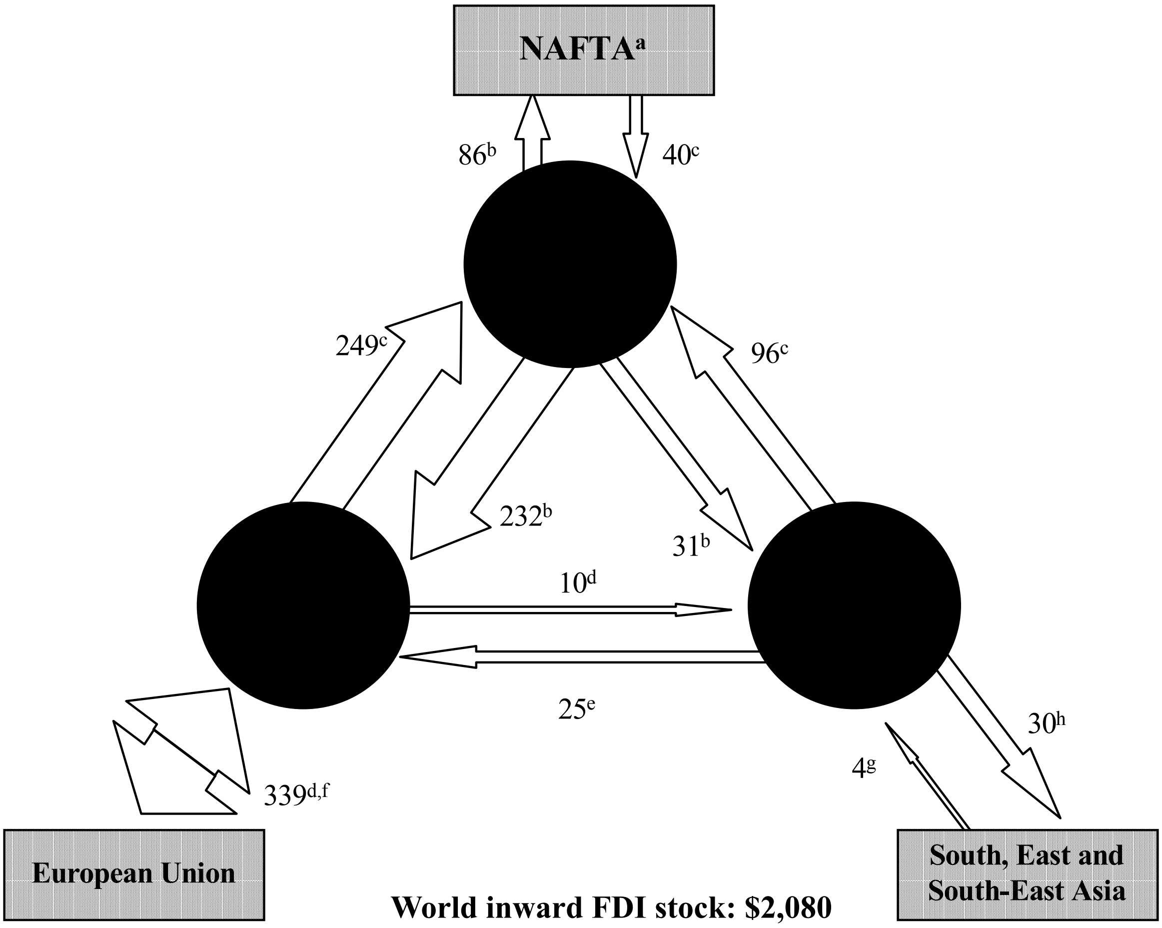
As far as FDI flows are concerned, the share of developing countries in world inflows is now higher than their share in world imports (about 30 per cent in the early 1990s). The volume of FDI flows reflects the strength of countries' current locational advantages for inflows and the strength of firms' current ownership-specific advantages for outflows. In terms of FDI outflows, the developing-country share is about a half of their share in world exports.

If the value of sales associated with inward FDI is compared with the value of imports, this suggests that, for developing countries as a group, inward FDI rivals imports when it comes to obtaining what they need from the rest of the world, while they still rely much more on exports than on outward FDI when it comes to delivering goods and services to foreign markets. The implication is that, although developing countries are becoming more fully integrated into the world economy through inward FDI, this integration is asymmetric and does not yet apply to outward FDI. There are, however, significant differences in the experiences of various groups of developing countries (see below).

By the end of 1993, FDI outflows had largely recovered from the FDI recession (reaching $222 billion) and, in 1994, maintained this level. Preliminary estimates for 1995 ($230 billion) suggest that the recovery has been further consolidated. The recovery is partly a cyclical phenomenon: as the major home countries came out of a period of recession, their firms embarked upon expansion plans that included investing abroad. Over and above this cyclical movement are structural factors -- in particular the pressures of growing international competition, coupled with advances in communications technology that allow better coordination of cross-border activities -- which make it essential for firms to invest abroad in order to be competitive internationally. Furthermore, the liberalization of the regulatory frameworks for FDI, trade and technology and the privatization of state-owned enterprises create additional opportunities for foreign investors.

Figure 1. FDI stock among Triad members and their clusters, 1993

(Billions of dollars)



Source: UNCTAD, Division on Transnational Corporations and Investment, *World Investment Report 1995: Transnational Corporations and Competitiveness* (United Nations publications, Sales No. E.95.II.A.9).

[a] Canada and Mexico.
[b] United States outward FDI stock.
[c] United States inward FDI stock.
[d] Outward FDI stock of Austria, Finland, France, Germany, Italy, Netherlands, Sweden and the United Kingdom. Data for Austria are for 1991 and data for France and the Netherlands are for 1992.
[e] Data from inward FDI stock of Austria, France, Germany, Italy, Netherlands and United Kingdom. Data for Austria and France are 1991 and data for Italy and the Netherlands are for 1992.
[f] For Sweden, the data reflect FDI to and from all European countries. Intra-European Union FDI, based on inward stocks, is $225 billion.
[g] Data are based on approvals/notifications and represent those from countries other than those in North America and Europe.
[h] Estimated by multiplying the values of the cumulative flows to the region according to FDI approvals by the ratio of disbursed to approved/notified FDI in developing countries.

... in the developed countries (led by the United States) ...

The recovery of FDI flows has been due primarily to an increase in FDI activity by firms from developed countries. A repositioning took place among the top five home countries, together accounting for nearly 70 per cent of global outflows, with the United States reasserting its lead once more as the principal home economy for FDI, accounting (with $610 billion) for a quarter of the world's stock and (with $46 billion) one-fifth of world outflows in 1994 (table 3). The vigorous FDI expansion experienced by the United States has not been matched by other Triad members. Although Japan's outward investment rose by nearly one-third (to $18 billion) in 1994, it remained way below earlier peaks ($48 billion in 1990). As economic growth in France, Germany and the United Kingdom resumed or gathered momentum, TNCs based in those countries again became more active abroad.

Most of this activity remained concentrated in the Triad. Out of an estimated $235 billion of world inflows in 1995, inflows to developed countries as a group are projected to be $138 billion, compared to $129 billion in 1993 and $135 billion in 1994. The United States resumed

Table 3. FDI outflows from the five major home countries, 1982-1994
(Billions of dollars and percentage)

Year	France [a]	Germany	Japan [a]	United Kingdom	United States [b]	Total (5 countries)	All countries
Value (Billions of dollars)							
1982-1986	3	6	7	10	11	37	57
1987-1991	20	18	35	28	25	127	195
1989	20	18	44	35	26	143	218
1990	35	29	48	19	27	157	243
1991	24	23	31	16	33	127	199
1992	31	16	17	19	39	123	191
1993	21	17	14	26	69	146	222
1994 [c]	23	21	18	25	46	132	222
Share in total [d] (Percentage)							
1982-1986	5	10	13	18	19	65	100
1987-1991	11	10	18	14	13	65	100
1992	17	9	9	10	21	64	100
1993	10	9	7	13	34	66	100
1994 [c]	11	10	9	12	23	59	100

Source: UNCTAD, Division on Transnational Corporations and Investment, *World Investment Report 1995: Transnational Corporations and Competitiveness* (United Nations publications, Sales No. E.95.II.A.9).

[a] Not including reinvested earnings. In the case of France, reinvested earnings are not reported after 1982.
[b] Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles. Also excludes currency-translation adjustments.
[c] Based on preliminary estimates.
[d] Calculated on the basis of FDI flows expressed in millions of dollars.

its position as the single largest FDI recipient ($49 billion in 1994), while flows to Japan remained negligible (with less than $900 million in 1994, about the same order of magnitude as flows to the Czech Republic). Although Western Europe continues to be the largest FDI recipient, a number of countries in the region (such as the Netherlands and the United Kingdom) have not yet emerged from the FDI recession. The region's recovery in terms of inflows has been slower than its recovery in terms of outflows, reflecting partly the more dynamic performance of other parts of the world.

While outward FDI flows from European countries have regained their momentum, South, East and South-East Asia -- the most dynamic region in the world -- continues to be neglected by them as a host region. Perhaps preoccupied with regional integration, European Union firms have only some 4 per cent of their stock and about 3 per cent of their flows directed to this region. The region's share of European Union exports is not much larger, about 5 per cent. Japanese TNCs have invested four times more in this region, and United States TNCs two-to-three times more than their European Union competitors. Country level data illustrate this further: for instance, Germany's FDI stock in developing Asia (excluding West Asia) is about half the size of her stock in Spain, and Germany's flows to that region during 1990-1993 were less than Germany's flows to Austria. In the case of the United Kingdom, the country's FDI stock in developing Asia is about the same as in Australia, while flows are about the size of flows to Sweden. However, there are signs that European Union firms are changing course, as reflected in their increasing outflows to Asia. With South, East and South-East Asia being the fastest growing region in the world, FDI competition there is set to intensify, both in terms of countries seeking to attract FDI and in terms of TNCs competing for investment opportunities. Firms from the region itself have actually acquired a leadership role in this competition.

... and the enduring growth of FDI flows to developing countries, ...

In spite of the renewed attractiveness of the developed countries, developing countries have succeeded in attracting growing investment flows, reaching $84 billion in 1994 to account for 37 per cent of world FDI inflows (table 4). This is a continuation of a trend that began in 1990 and has propelled developing countries to become a major force in world FDI. (If intra-European Union flows are excluded, the share of the developing countries in world FDI flows rises from 35 per cent in 1993 to 44 per cent in 1994.) To a large extent, the successive annual increments to FDI flows into these economies reflect the growing attractiveness of a single country, China. With some $34 billion in inflows, China was the second largest recipient of FDI flows worldwide in 1994, accounting for some 40 per cent of all flows into developing economies. But, even if China is excluded, FDI flows into developing countries registered an increase of 11 per cent in 1994 (from $46 billion to $51 billion). The year 1995 may well register another increase, both for China and all other developing countries as a group, to reach an estimated total of $90 billion.

A notable aspect of the increase in FDI inflows into the developing world is that, since 1990, these flows have become the largest and fastest growing single component of external finance for this group of countries, taken together. More specifically, FDI flows accounted for 7 per cent of domestic fixed capital formation in 1993 and have been larger than official development assistance flows since 1992 for the developing world as a whole. They were also larger than other private flows in some years during the late 1980s and early 1990s. Indeed, for 30 developing economies and four economies in Central and Eastern Europe, FDI inflows in 1993 represented the single largest component of all net external resource flows. The number increases to 81 developing economies and seven economies in Central and Eastern Europe, if only private net external resource flows are considered. The dominant role of FDI flows is not only important because of the productive assets associated with them, but also because of their greater resilience, as compared with portfolio equity investments, to adverse economic shocks and currency depreciations, reflecting the fundamental differences in motivation between these two types of external finance.

The success of the developing countries in attracting FDI lies in an investment climate characterized by growing markets and increasingly favourable regulatory frameworks coupled with the general trend for firms from all countries to invest abroad in order to remain competitive internationally. Naturally, there are significant inter- and intra-regional differences (table 5):

- Driven by its relatively fast economic growth, the *Asia-Pacific* region as a whole remains the most important host region among developing countries, with some $61 billion in inflows in 1994. That region now accounts for more than 70 per cent of the

Table 4. FDI inflows and outflows, 1982-1994

(Billions of dollars)

Year	Developed countries		Developing countries		Central and Eastern Europe		All countries	
	Inflows	Outflows	Inflows	Outflows	Inflows	Outflows	Inflows	Outflows
Value								
1982-1986	43	53	19	4	0.02	0.01	61	57
1987-1991	142	183	31	12	0.6	0.02	174	195
1989	172	202	29	15	0.3	0.02	200	218
1990	176	226	35	17	0.3	0.04	211	243
1991	115	188	41	11	2.5	0.04	158	199
1992	111	171	55	19	4.4	0.02	170	191
1993	129	193	73	29	6.0	0.08	208	222

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