John H. Dunning Centre
for International Business

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Multinational enterprises, development and globalisation: Some clarifications

Rajneesh Narula
Professor of International Business Regulation

Theory: a moving target

- Big question: *how do we leverage MNE activity for development?*
- Theories and concepts in social sciences are different from the sciences – There are no inviolable laws!
- However, as the world changes, the underlying assumptions must also change, and this requires a change in our conceptual models
- Empirical evidence ↦ theory↦ helps us analyse evidence ↦ helps us with implications ↦theory
- E.g. – story is now about MNEs not only about FDI!!
  - Issue is now control, rather than ownership (non-equity relationships)
  - Breaking-up of value chains

What is FDI?

- It involves financial, technological and managerial resources controlled by an entity that is domiciled in a foreign location.
- FDI involved not just ownership, but control of these assets
- FDI = foreign DIRECT investment. Different from portfolio investment.
- Definitions differ from country to country.
- De facto FDI and real FDI
- Stand alone enterprises,
- ultimate beneficiary owner.

Indicators of FDI and International production, 1982, 2001 and 2007			
(US$ billions, unless otherwise indicated)			
	1982	**2001**	**2007**
FDI inflows	59	735	1833
FDI outflows	28	621	1997
FDI inward Stock	734	6846	15211
FDI outward stock	552	6582	15602
sales of foreign affiliates	2541	18517	31197
employment of foreign affiliates ('000)	17987	53581	81615
Total assets of foreign affiliates	1959	24592	68716
Exports of foreign affiliates	670	2600	5714
Inward FDI stock to GDP ratio	6.79%	21.46%	27.80%
foreign affiliates' exports to total exports	32.20%	34.99%	33.34%
Source: Table I.1, UNCTAD (2002) for explanatory footnotes see UNCTAD (2002, 2008)			

Inward FDI stock

world $15 210 billion
Developed countries
=$10450 billion
which is 69% of total

- France $ 1020b
- Netherlands $673 b
- UK 1347b
- Germany 629b
- Spain $537
- Belgium $648
- **TOTAL EU = 48% of global total**
- USA $2093
- Africa $393
- Latin America = $1140b
- Asia $2706b
- SE Europe $505b

Inward FDI, developing countries

	Africa	393 429	
of which	**South africa**	93 474	24%
	Nigeria	62791	16%
	Egypt	50503	13%
			53%
	Latin America	1 140 007	
of which	**Mexico**	265 736	23%
	Brazil	328 455	29%
	Chile	105 558	9%
	Venezuela	309 810	27%
		Total	89%
	ASIA	2 706 635	
of which	**Turkey**	145 556	5%
	China	327 087	12%
	HK	1 184 471	44%
	Korea	1 378	0%
	Taiwan	48 640	2%
	India	76 226	3%
	Indonesia	58 955	2%
	Malaysia	76 748	3%
	Singapore	249 667	9%
	Thailand	85 749	3%
			83%

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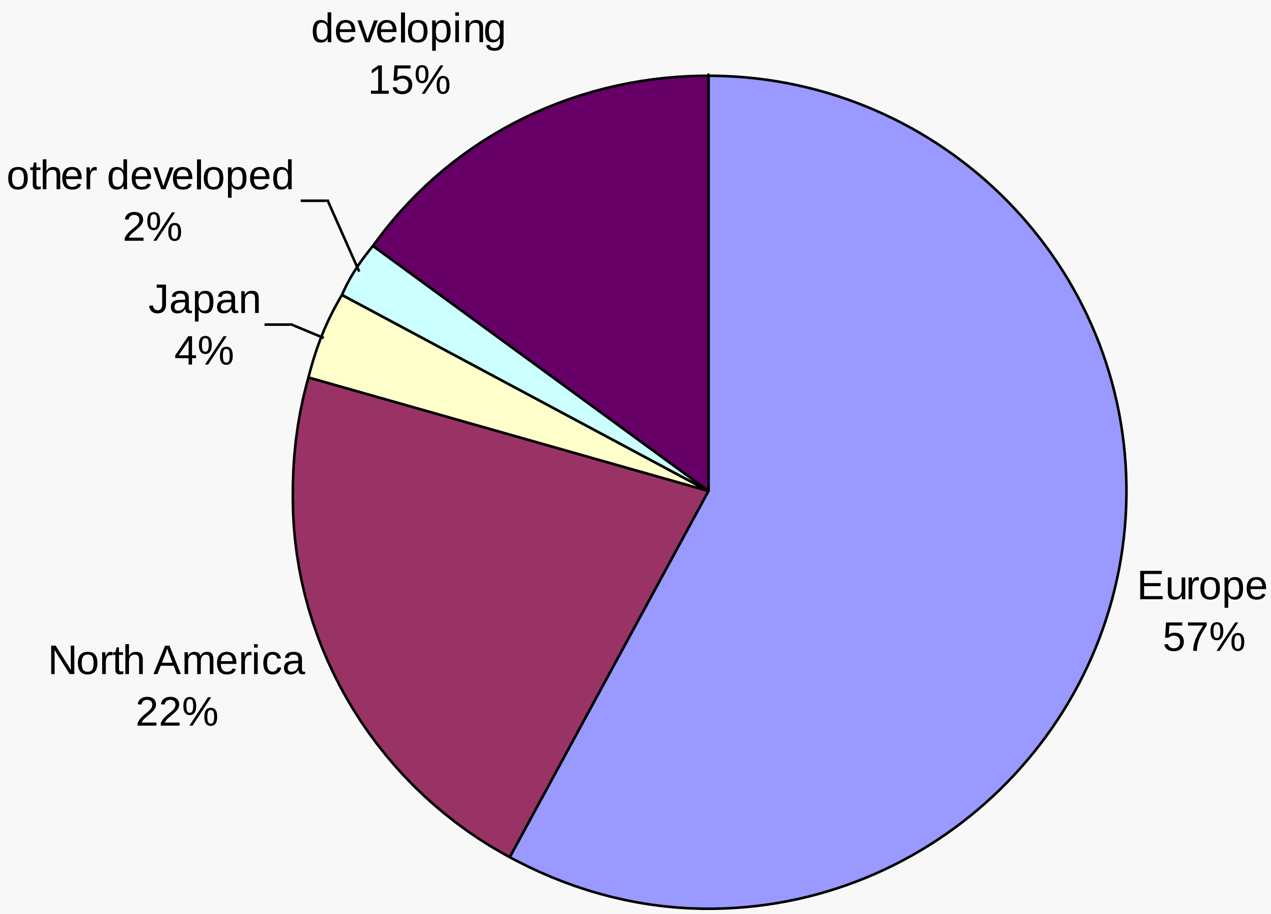
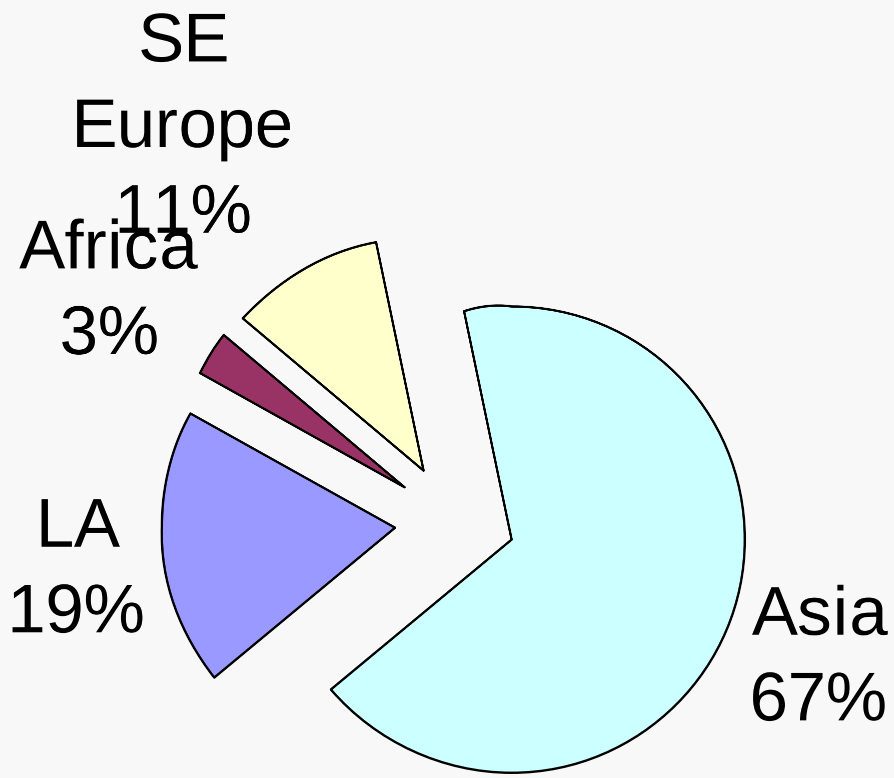
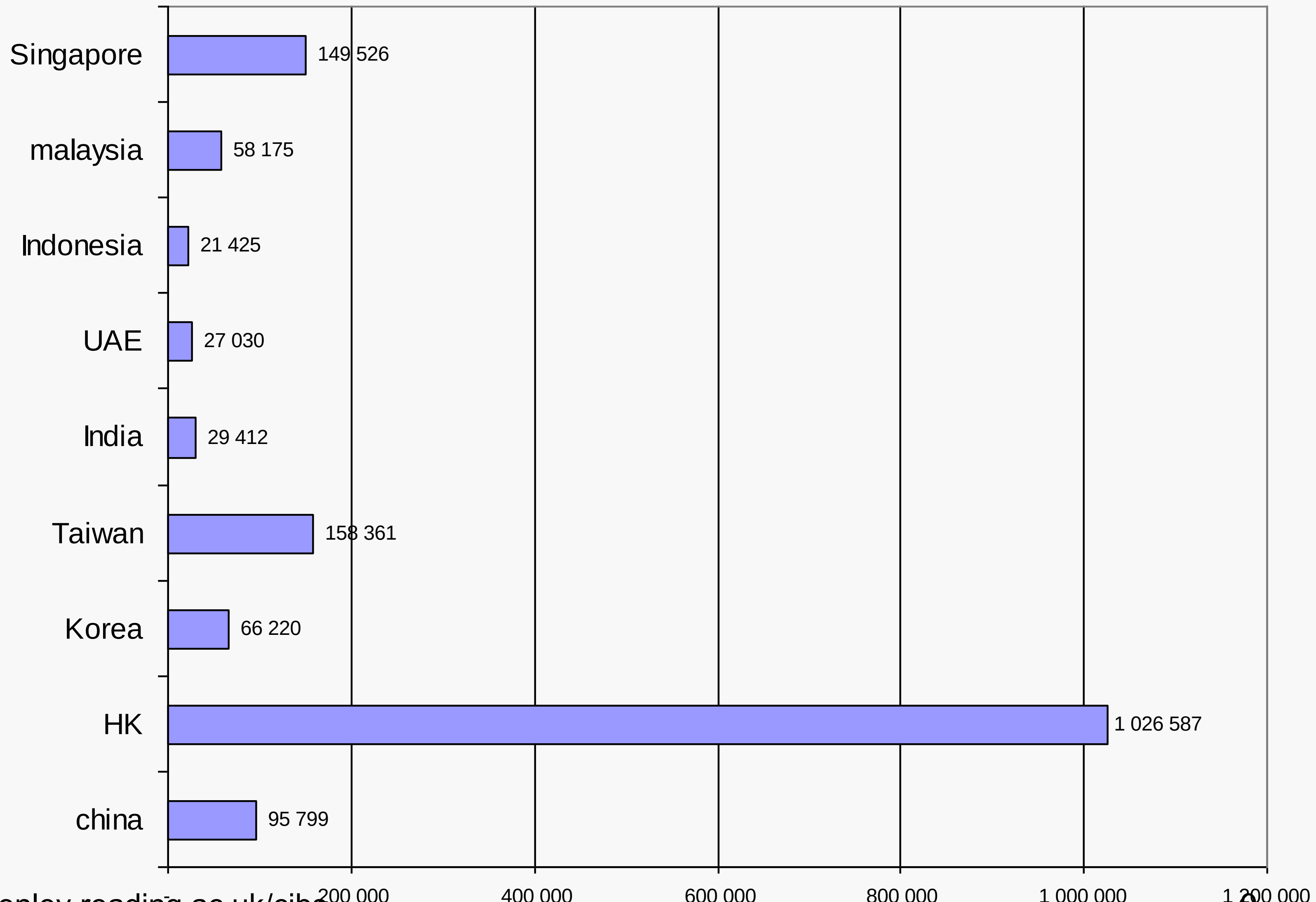
Outward FDI Stocks 2007
Total world = US$ 1560 billion



OFDI stock, developing countries



Asia outward FDI – largest, 2007 total = 1722 billion



Latin America OFDI (with Russia thrown in) total = 493 billion

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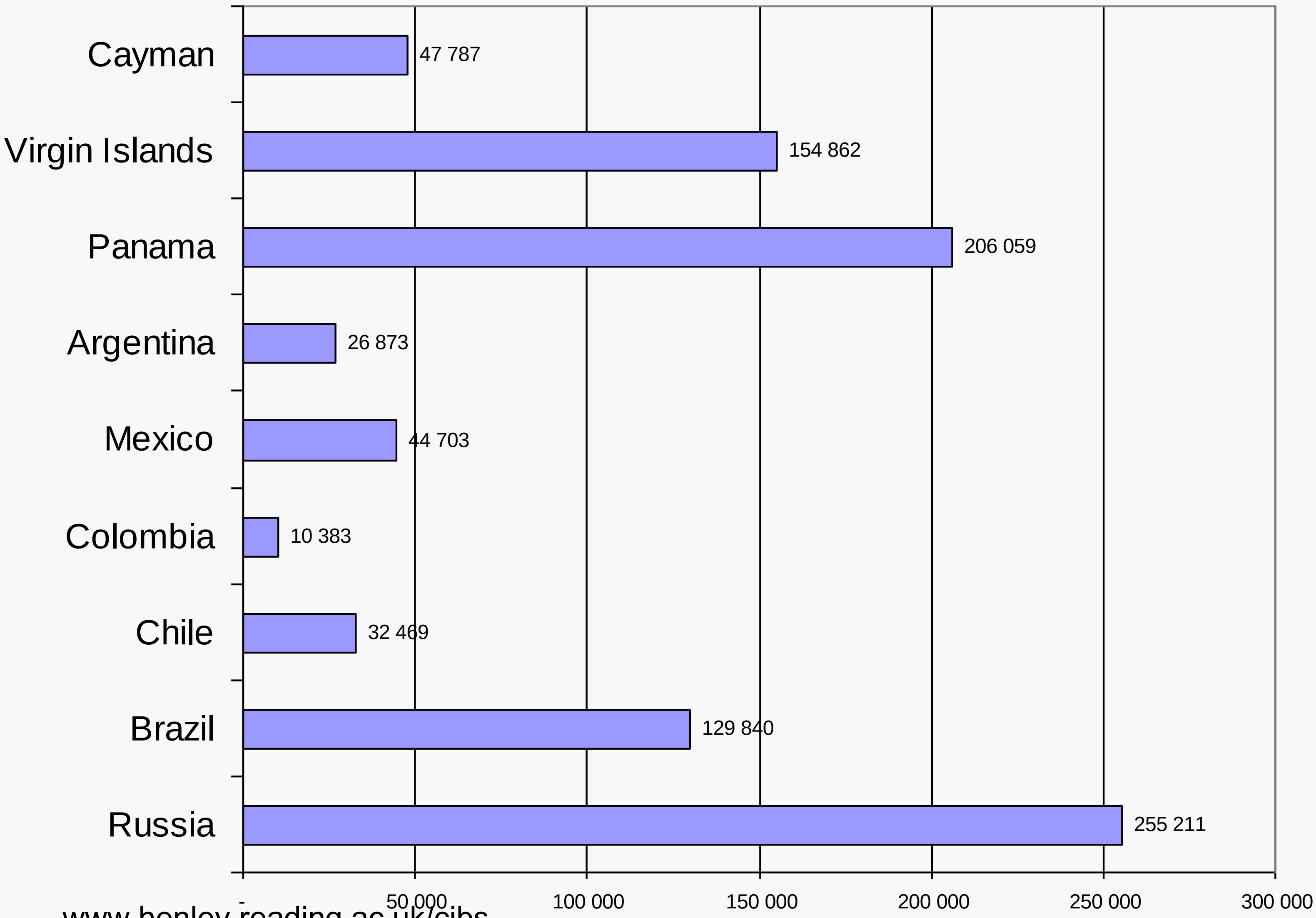
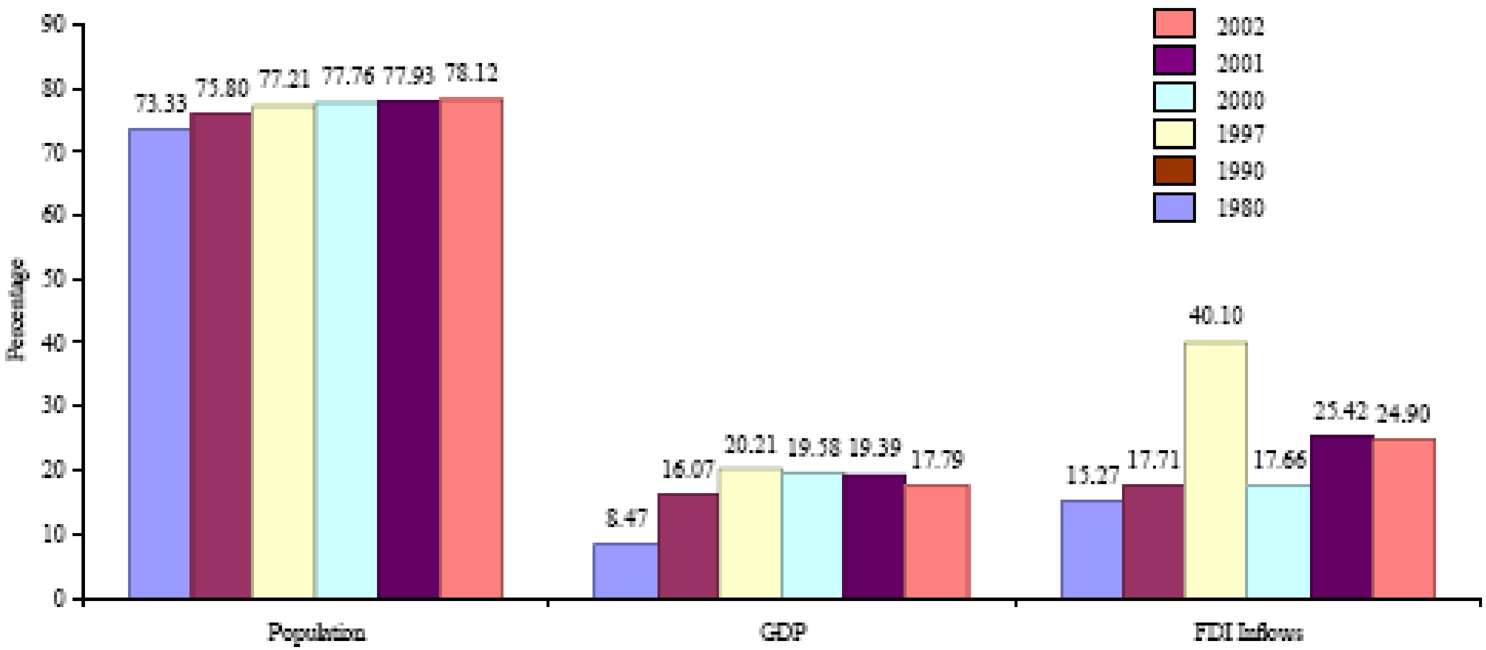


Figure 4. Developing Country Shares in the Global Economy: Selected Indicators



development

- Development needs to be seen in a much broader sense than we currently do – not only about creating aggregate economic growth, but also about income disparities, and what is defined as human development.
- Development is not the same thing as growth.
- Development comes from within, not from outside
- Development is about sustainability
- Development is about structural change.
- Development is about knowledge and learning

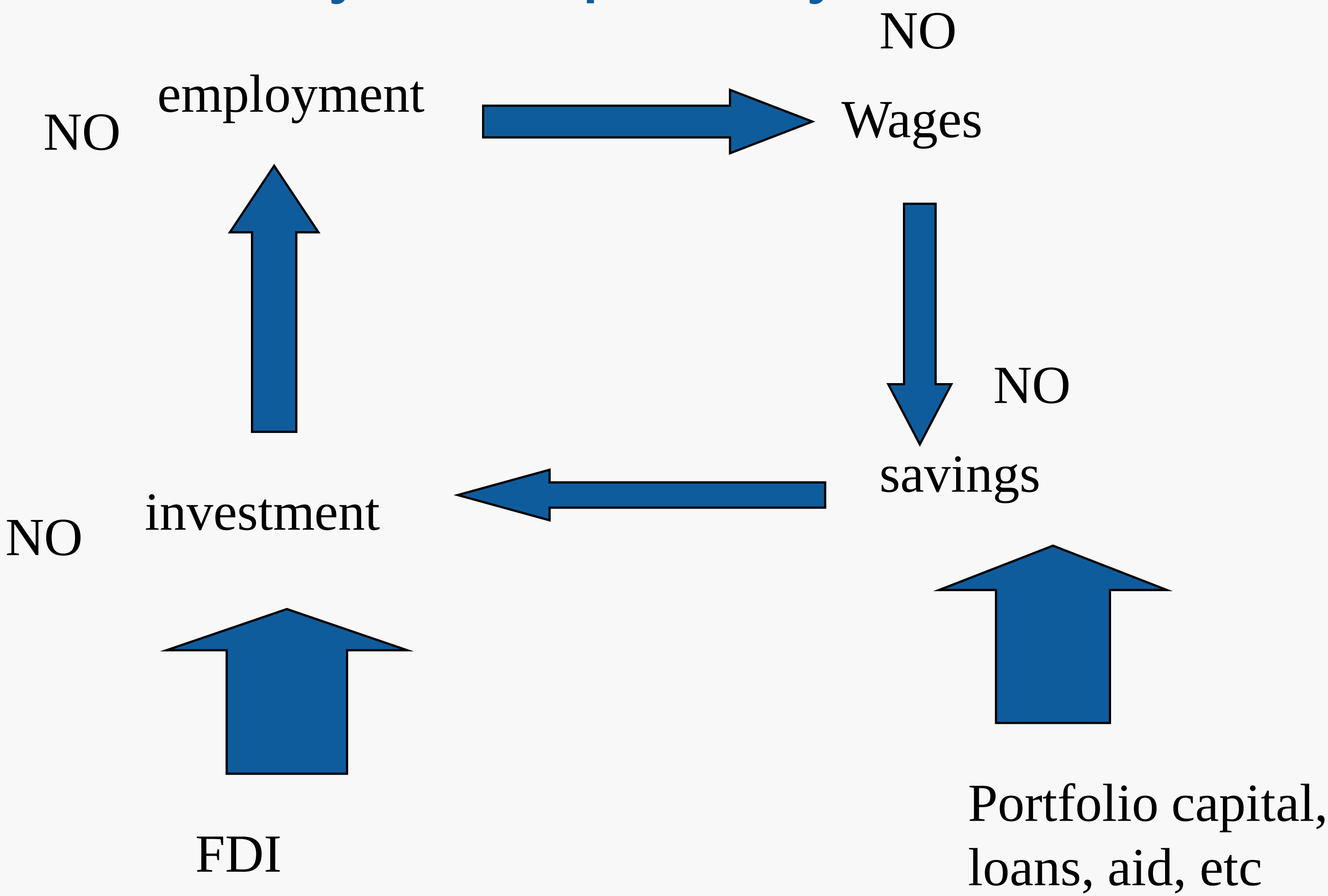
Globalisation has not all been about good outcomes

- Globalisation does not mean countries are all converging to higher incomes – it would be a nice outcome, but unfortunately not true.
- Some firms and some countries have been proactive in exploiting these opportunities, not all.
- Most have reacted passively to increased competition.
- ***Knowledge creation drives competitiveness of any country***
  - Everyone still needs to develop a sustainable base of knowledge and innovation, and each country faces constraints and limitations. Not everyone is equally able to exploit opportunities.
  - Few countries can be good at everything…

Changes in GDP and OFDI growth rates

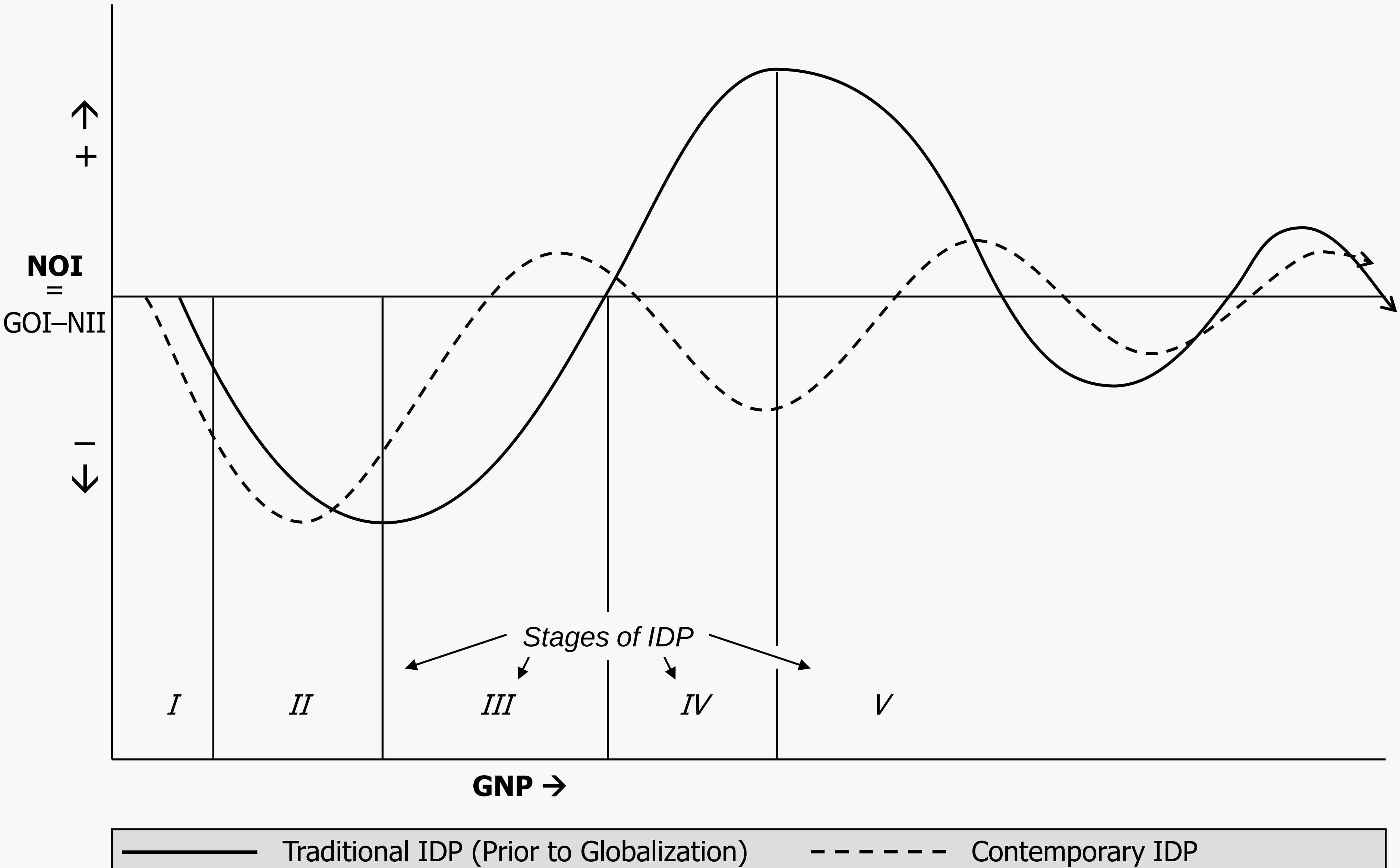
	GDP per capita			changes		O/FDI per capita			changes	
	1993	2000	2007	00/93	07/00	1993	2000	2007	00/93	07/00
Low-income economies	287.0	334.4	618.5	1.2	1.8	2.8	4.7	16.9	1.7	3.6
Low-middle income economies	541.8	866.9	2007.9	1.6	2.3	8.9	20.0	65.9	2.2	3.3
Upper-middle income economies	3262.6	3718.9	8006.2	1.1	2.2	164.2	326.9	1169.0	2.0	3.6
High-income economies	21650.7	25794.5	38162.2	1.2	1.5	2293.9	5905.3	13982.7	2.6	2.4
20 DCs average	1249.6	1640.3	3388.2	1.3	2.2	61.1	215.2	578.1	3.5	6.4
BRICs average	643.5	972.7	2517.0	1.5	2.6	24.5	38.6	180.6	1.6	4.7
NICs average	10559.1	13957.3	21795.5	1.3	1.6	1271.8	6730.8	16884.8	5.3	2.5
World	4520.3	5263.9	8257.4	1.2	1.1	0	0	0	-	-
Ratio LI/HI	1.3%		1.6%			0.12%		0.12%		
Ratio LMI/HI	2.5%		5.3%			0.39%		0.47%		
Ratio UMI/HI	15.1%		21%			7.2%		8.4%		

Vicious cycle of poverty

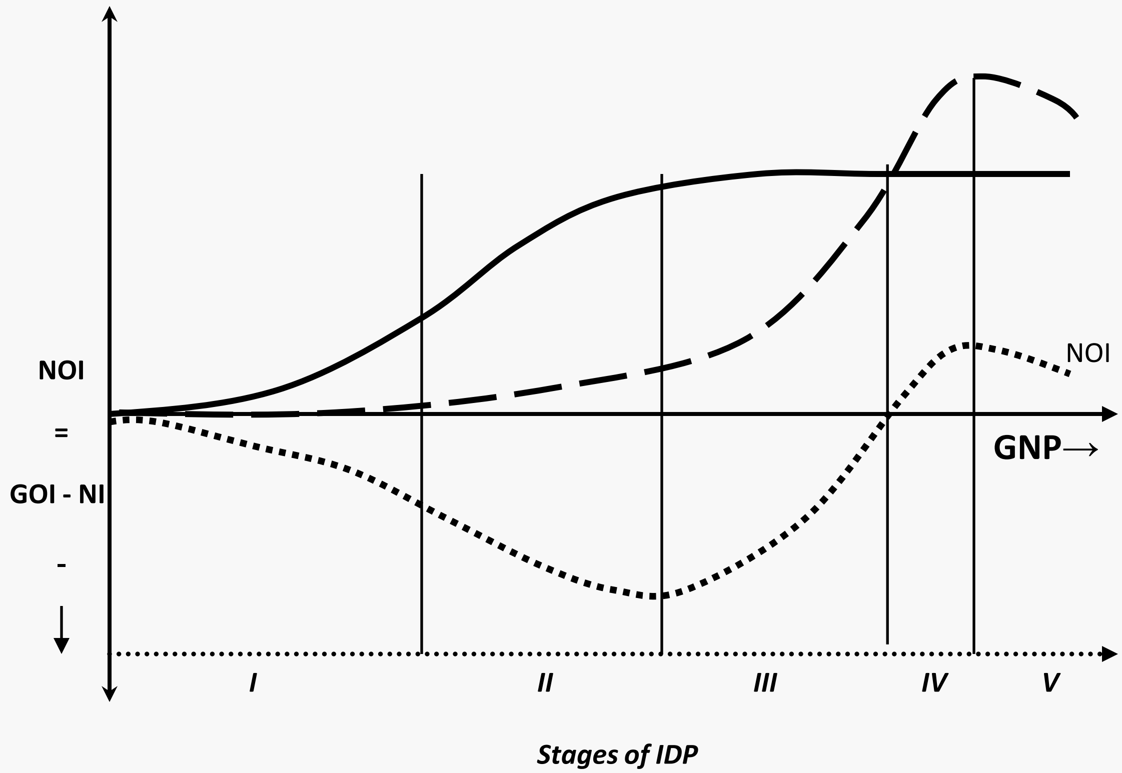


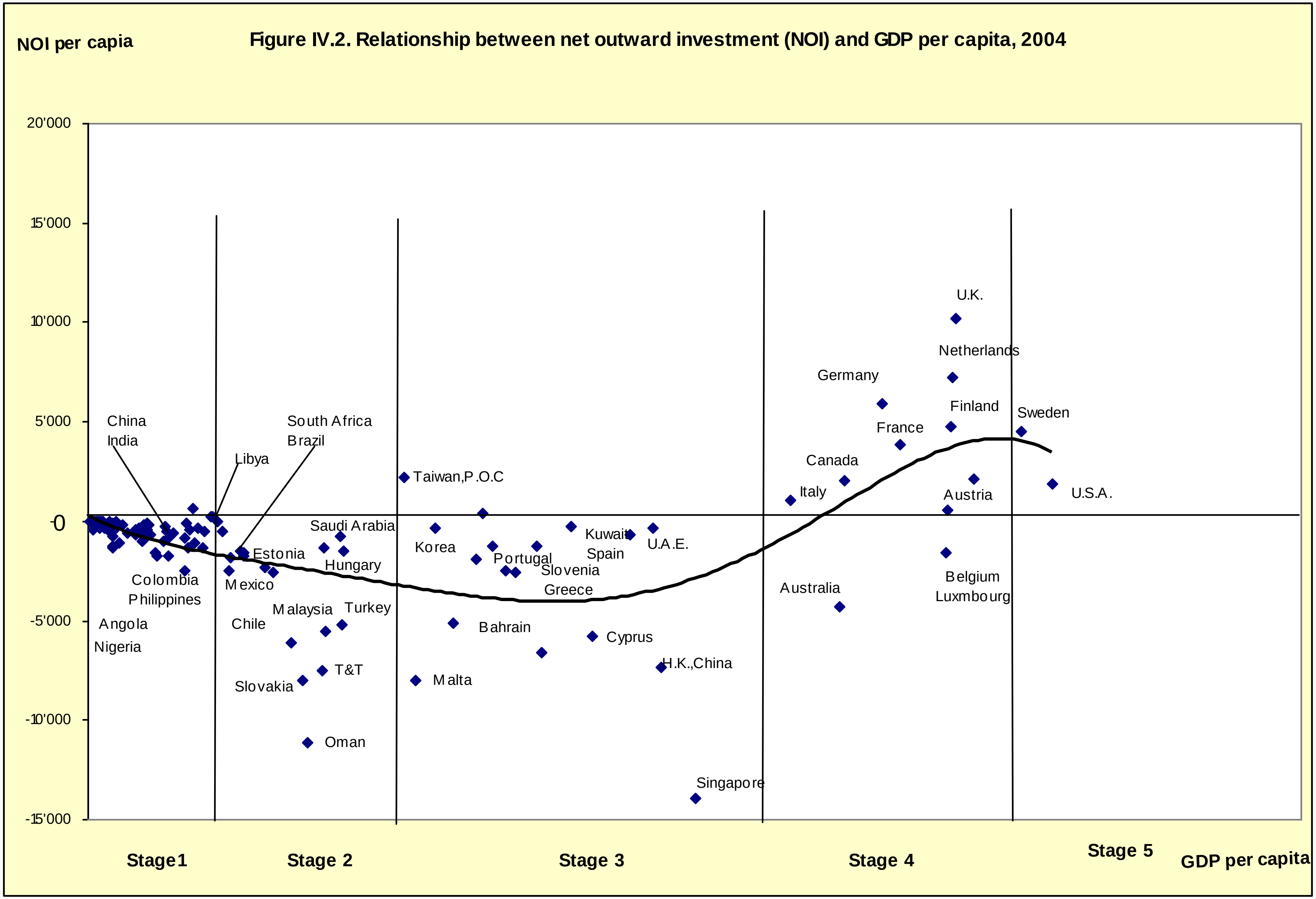
The Investment Development Path

(N.B.: Not drawn to scale; for illustrative purposes only)



The investment development path





NOI per capia
Figure IV.2. Relationship between net outward investment (NOI) and GDP per capita, 2004
20'000
15'000
10'000
5'000
0
-5'000
-10'000
-15'000
China
India
Libya
South Africa
Brazil
Taiwan,P.O.C
Saudi Arabia
Estonia
Hungary
Colombia
Philippines
Mexico
Angola
Nigeria
Chile
Malaysia
Turkey
Slovakia
T&T
Oman
Korea
Malta
Portugal
Slovenia
Greece
Bahrain
Kuwait
Spain
U.A.E.
Cyprus
H.K.,China
Singapore
U.K.
Netherlands
Germany
Finland
Sweden
France
Canada
Italy
Austria
U.S.A.
Belgium
Luxmbourg
Australia
Stage1
Stage 2
Stage 3
Stage 4
Stage 5
GDP per capita

The world has changed

- Laissez-faire liberalism to neo-imperialism, dependencia, and then back.
- But the two sides have different goals
  - MNEs wish to maximise their profits world-wide
  - nation states seek to improve the welfare of their society and also maintain sovereignty, stability, etc
- Countries offer a new range of financial incentives and must compete with industrialised countries
- MNEs are interested in locations that have certain characteristics

It is no longer clear that MNEs cause development

- **FDI** per se ≠ **economic development**
- There are a number of intervening factors between the two – it is not entirely clear whether FDI causes development, or whether it can simply be **attributed** to it.

- *If* **FDI** results in technology transfer, and *if* domestic firms internalise the spillovers, and *if* domestic conditions support learning, there will be **economic development**

- Converting *appropriate* types of FDI to support economic development requires us to move away from passive view of economy
  - Host economy is inextricably linked to global economy, MNE linked to other MNEs and other locations
  - FDI is often either mainly capital, or un-transferable skills
  - FDI is not created equal!!

MNEs and development are about interaction and using opportunities

- FDI is not essential for growth: Korea, Japan and (and to a lesser extent) Taiwan relied extensively on licensing, technology transfer agreements, imitation and other non-FDI based modalities to catch-up
- the common element is the use of foreign knowledge sources (which may be tied to MNEs in general), rather than FDI.
- MNE (or FDI) activity is not a *conditio sine qua non* for development .
  - Many developing countries demonstrate a dual (or even multiple) economy.
  - Nation states experience increasingly ‘fuzzy’ policy boundaries because policy space is limited by other non-national economic actors

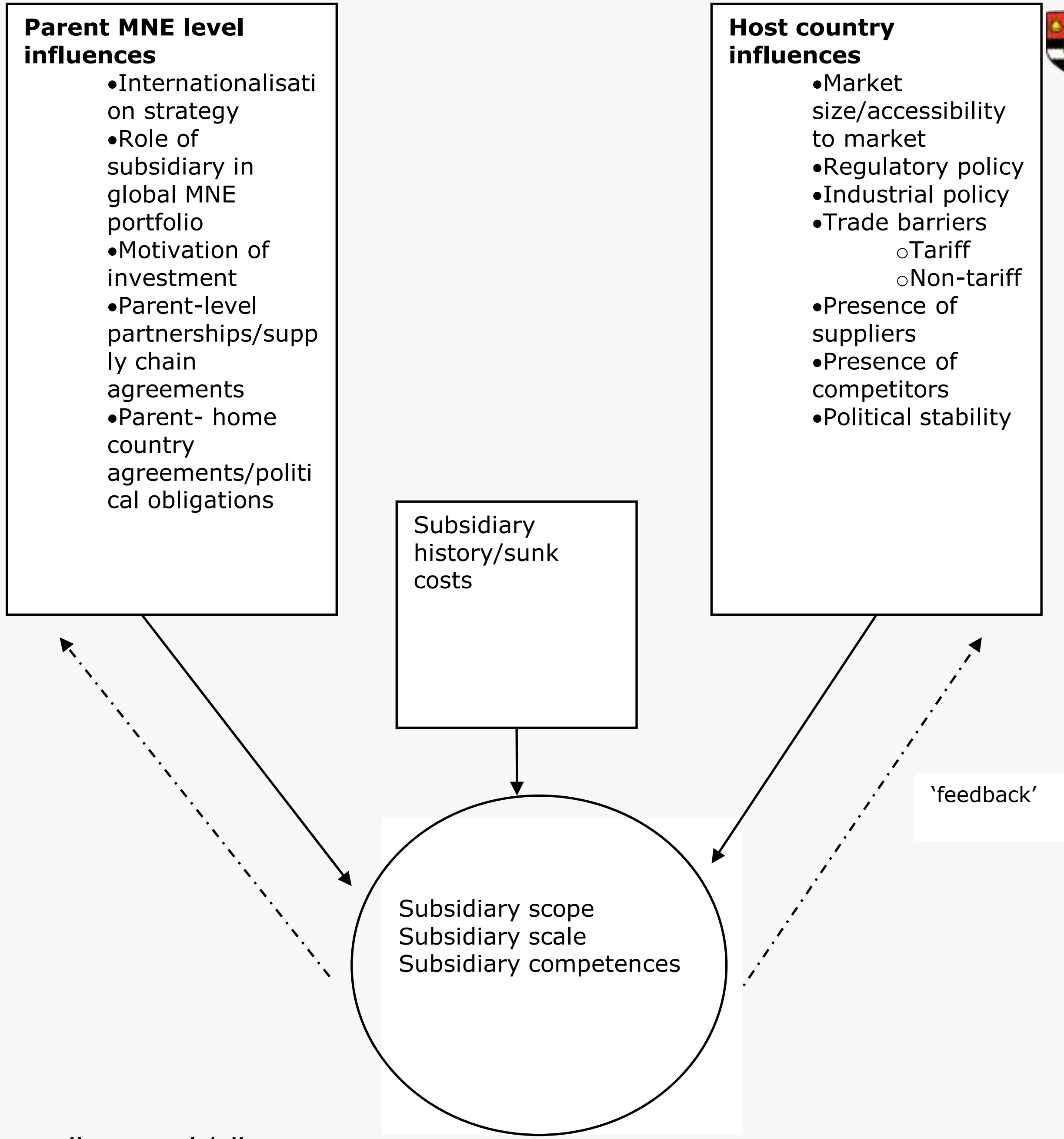
development effects determined in part by motive of FDI – and MNEs are heterogeneous

- MNE motives and strategies are interrelated, and affect opportunities for externalities.
  - In the primary sector, the scope for vertical linkages is often limited, due to the use of continuous production processes and the capital intensity of operations.
  - In manufacturing the potential for vertical linkages are broader, depending on the extent of intermediate inputs to total production and the type of production processes.
- Policy makers and commentators fall into a well-known trap of presuming that the development potential of every dollar of MNE investment is the same, regardless of industry and regardless of the capacity of the host country to efficiently utilise the spillovers and linkages that are potentially made available.
- South-South capital and knowledge flows are not an obviously superior option to North-south options.

– MNE level factors are often ignored:
  - The size of the parent company is important
  - The role (and size) of the affiliate in the overall MNE structure

We will also talk about subsidiaries

- If we are talking about MNEs rather than FDI, maybe we need to talk about the actual units.
- What types are there?
- What effects do different subsidiaries have?
- How can we change the effect?
- What determines the costs and benefits? Its size? Its capital? Its employment?



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Development presumes ‘multiple embeddedness’ of subsidiary

- Ideally, subsidiary needs to be deeply embedded:
  - Within the MNE network;
  - Within the host country
- But this is not always possible!

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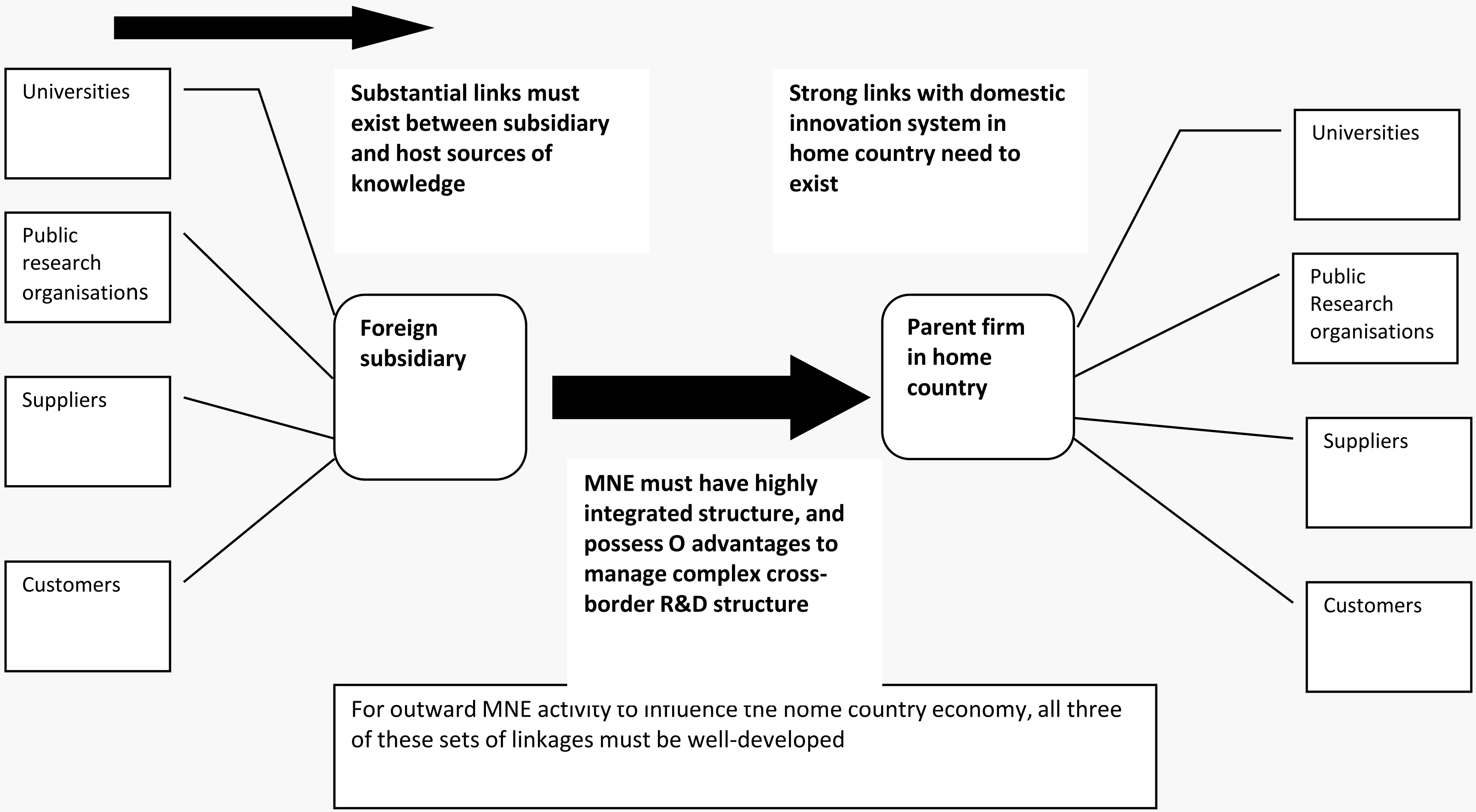
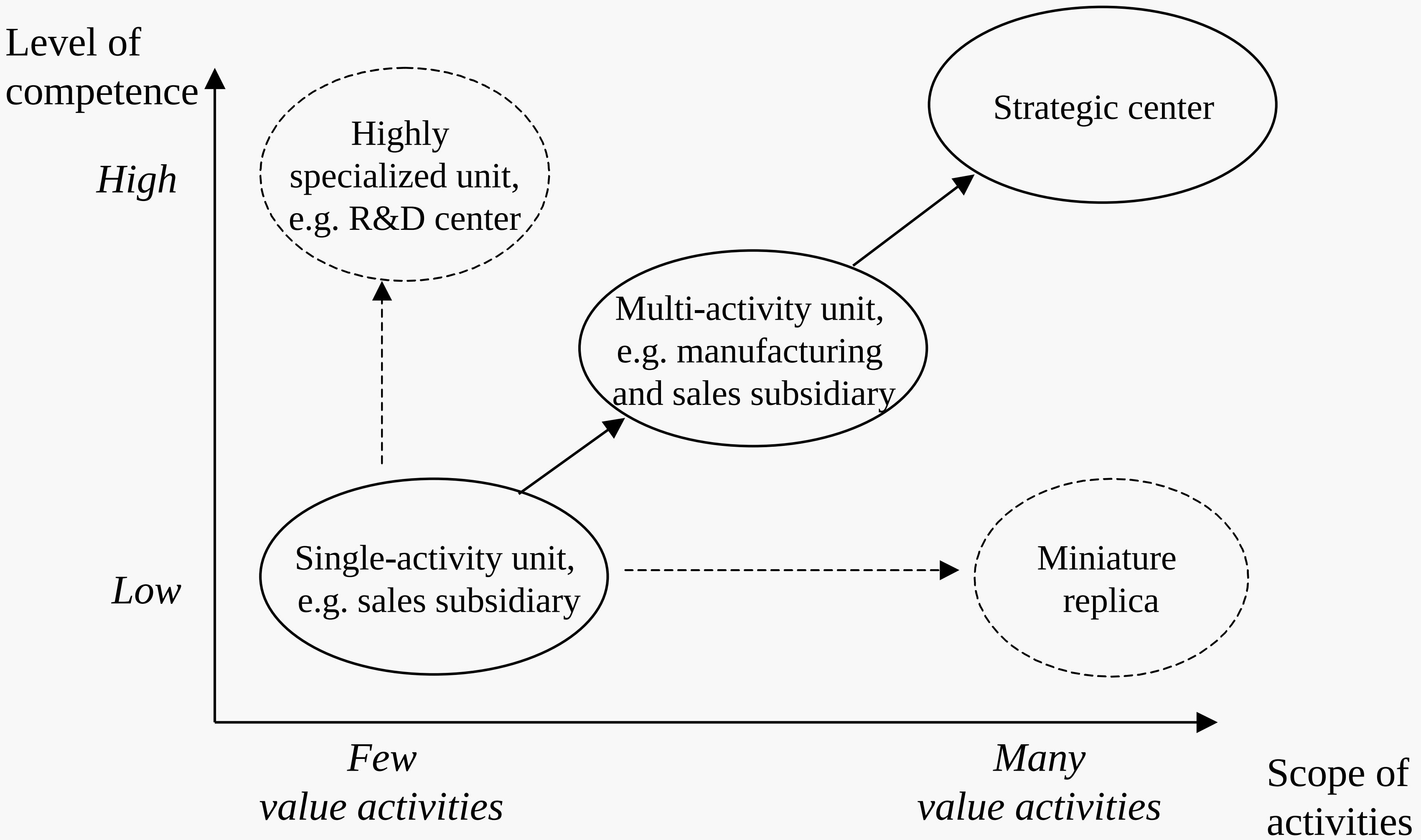
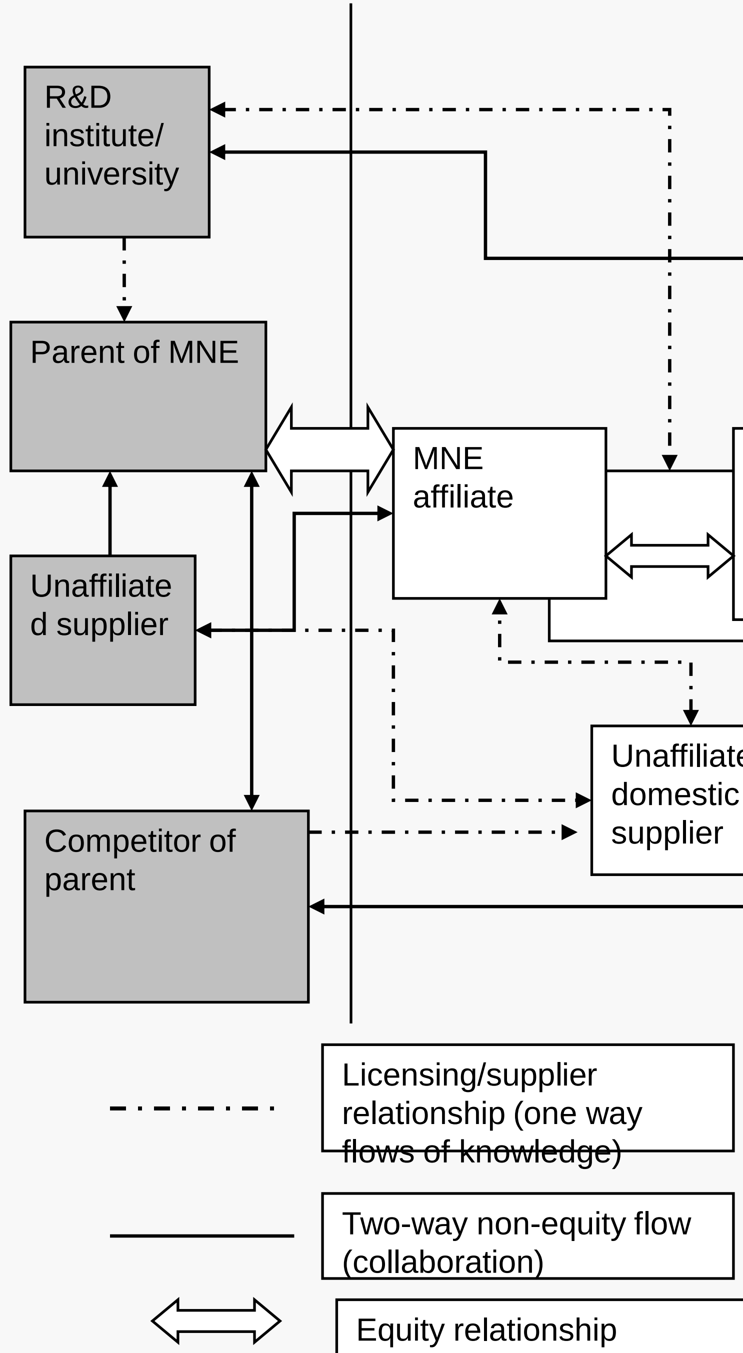


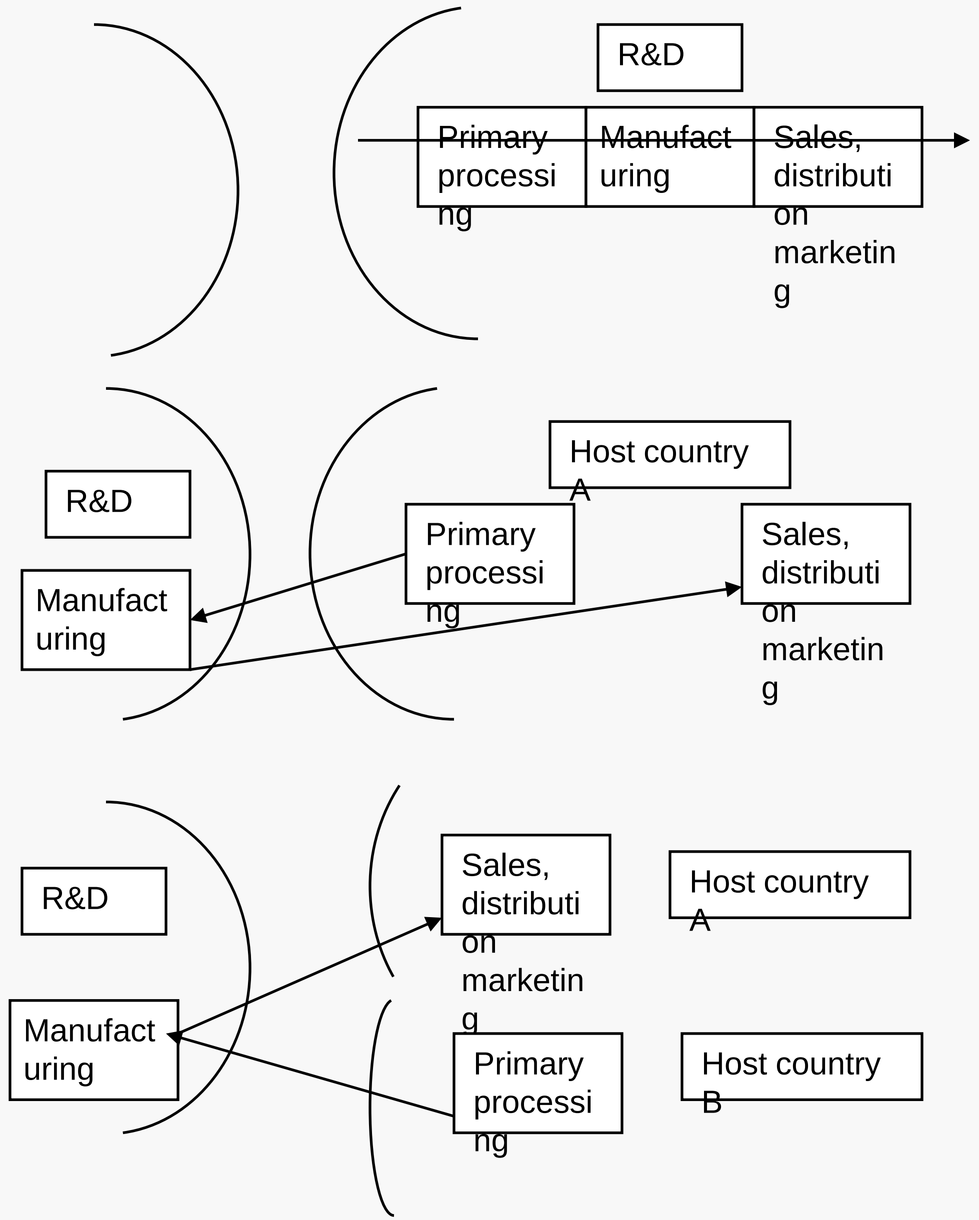

Level of competence
High
Low
Highly specialized unit, e.g. R&D center
Strategic center
Multi-activity unit, e.g. manufacturing and sales subsidiary
Single-activity unit, e.g. sales subsidiary
Miniature replica
Few value activities
Many value activities
Scope of activities


R&D institute/ university
Parent of MNE
Unaffiliated supplier
Competitor of parent
MNE affiliate
R&D institute/ university
Domestic firm
Unaffiliated domestic supplier
Licensing/supplier relationship (one way flows of knowledge)
Two-way non-equity flow (collaboration)
Equity relationship

Exactly what is the ‘line of control’?

- This raises questions about the issue of internalisation and the classical theory of the firm.
- Three types of MNEs:
  - 1. organised as a loosely coupled network of relatively autonomous subsidiaries, each with its own strategic goals and activities
  - 2. tightly coupled organization, with a high degree of interdependence and coordination between subsidiaries
  - 3. tightly coupled associations between legally separate firms, but with a common set of goals.
- Value chains and production networks
  - Dominant firms within a chain exert control on the location, profits and employment of suppliers (Dicken and Yeung).

HOME COUNTRY HOST COUNTRY



The break-up of the MNEs value chains

- few locations host all parts of the value chain of one product subsequent spatial redistribution of their value chains led to a downgrading of subsidiaries in terms of scope and competence
- some – rather few – locations have seen a reduction in the scope, but an increase in the competence levels towards R&D units. Only very few have seen a shift towards strategic centres, or indeed maintained a multi-activity unit.
- Rationalisation of activities within the single market has, in many cases, led to a downgrading of activities from truncated replica to single activity affiliates. MNEs have taken advantage of the EU single market to rationalize production capacity in fewer locations to exploit economies of scale at the plant level, especially where local consumption patterns are not radically different to justify local capacity and where transportation costs are not prohibitive.

What we dont know

- What are the threshold levels of MNE activity to promote growth, perhaps focusing on the industrialisation ‘failures’ which are sometimes located in the same geographical space as ‘successes’?
  - Why has India been unable to move away from light manufacturing towards more innovation-intensive manufacturing, unlike China, or Brazil?
- there is considerable variety in the nature of services –there are few studies that evaluate benefits of investments in tertiary sectors, relative to primary or secondary sectors.
  - E.g., investments in telecommunications may provide relatively few <u>backward</u> spillovers and linkages to domestic firms in the least developed countries, compared to (say) banking? Why, or why not? Do the forward linkages make up for it?

But what of the political, social and institutional milieu?

- economists pay too little attention to the political and sociological aspects. The politics of reform and the social and political costs of structural adjustment and institutional change are seldom taken into account.
- The extent to which external (non-national) organizations and countries determine national outcomes can also affect the efficiency with which *de facto* reforms have taken place.
- Nation states experience increasingly ‘fuzzy’ policy boundaries because policy space is limited by other non-national economic actors

Rapid internationalisation and MNE activity: will development also increase pace?

- **There is no reason to believe that countries will move any quicker through the stages of the IDP simply because MNE activity has increased.**
- Efficiency gains
- Possibility for crowding-in – negative competition effect
- Depends on whether MNE advantages are transferable (assuming domestic firms have the absorptive capacity)
    - Low marginal cost of asset due to multinationality
    - No local loyalties
- economists pay too little attention to the political and sociological aspects

Policy implications

- DCs have reacted passively to globalisation.
- few have an explicit or well-considered industrial policy, often applying principles that belong as part of a more closed, import-substituting era.
- Industrial policy integrated with trade and FDI policy are more important.
- MNE activity needs to be evaluated by considering the kinds of externalities that are generated; whether and how domestic actors can internalise them; and what kinds of L advantages may be required to achieve this.
- the ‘success stories’ of MNE-assisted development have sought to attract MNEs, but have also built up domestic absorptive capacities in tandem.
- They have then tried to upgrade their L advantages to encourage MNEs to both deepen and broaden their local value adding activities.

Policy roles and issues
‘Physician, heal thyself’

.

- The role of governments in improving the quality of human capital and infrastructure cannot be over-emphasised.
- However, the presence of a highly skilled labour force is not *a sine qua non* for improved innovativeness, although it is certainly a necessary condition.
- It is no accident that firms often locate R&D facilities in physical proximity to locations with the best knowledge infrastructure.
- But needs to be done systematically: Sustaining or strengthening firm-level innovatory capacity requires developing the capacity of the non-firm sector.
- Encourage the cross-border movement of skilled manpower
- Promote start-ups and small firms without pandering to large ones