PART ONE

RECENT TRENDS

Chapter I

TRENDS IN FOREIGN DIRECT INVESTMENT

A. Global trends

Foreign direct investment (FDI) continued to grow in 1990, although at a rate below that of the late 1980s. World-wide FDI *outflows* reached $225 billion (for an *outward stock* of $1.7 trillion). In 1990, the total number of transnational corporations (TNCs) exceeded 35,000, with more than 150,000 foreign affiliates (box I.1). The growth of FDI outflows represented an increase of 7 per cent over 1989 and a decline from the average annual growth rate of 14 per cent for the 1980s (table I.1). At the same time, there was a decline in world-wide FDI *inflows* in 1990, to $184 billion (box I.2). The rate of growth of outflows in 1990 was higher than what might have been expected, given the slow-down in economic growth in a number of large countries and the difficulties experienced by many financial institutions. Preliminary data for 1991 for the five largest outward investors show, however, a sharp decline of outflows (table I.2).

The slow-down in the growth of outflows in 1990 and the expected decline in 1991 can largely be attributed to a slow-down in the growth of outflows from Japan, a possible plateauing of outflows from the United States and a decline in outflows from the United Kingdom (table I.2). Outflows of FDI from developed countries, except for Japan, the United Kingdom and the United States, grew by 27 per cent in 1990, a rate of growth equivalent to the global average for 1983-1990. Outflows from developing countries had grown substantially in the late 1980s, driven by the growth in outflows from the Asian newly industrializing economies, but declined in 1990 when compared with 1989.

Box I.1. How many transnational corporations and foreign affiliates are there?

According to estimates of the Transnational Corporations and Management Division, based largely on official sources, the number of parent TNCs in the world is about 35,000, with some 150,000 foreign affiliates (table 1). The reported number of TNCs and affiliates, however, should be used with great caution, given the

Table 1. The geographical distribution of parent transnational corporations and foreign affiliates
(Number)

Region/economy	*Parent corporations*	*Foreign affiliates* [a]	*Year*
Developed countries	30,900	73,400	1989
of which:			
Austria	880	2,492	1988
Denmark	800	647 [b]	1992
Finland	1,350	1,524 [b]	1991
France	2,000	3,671 [c]	1984
Germany	6,984	10,978 [d]	1990
Japan	3,331	2,884	1990
Norway	1,115	2,799	1989
Sweden	2,750	..	1986
Switzerland	3,000	..	1992
United Kingdom	1,533	3,411 [e]	1981
United States	3,712	13,582	1989
Developing economies	3,800	62,900	1989
of which:			
Brazil	576	7,110	1986
China	553	15,966	1988
Hong Kong	500	2,464 [d]	1982
India	176	926	1988
Malaysia	153	578 [e]	1981
Pakistan	57	560 [f]	1988
Republic of Korea	668	2,821	1988
Taiwan Province of China	405	4,764	1988
Yugoslavia	112	3,949	1991
Central and Eastern Europe	300	10,900	1991
Bulgaria	26	117	1991
Commonwealth of Independent States	68	2,296	1991
Czechoslovakia	26	592	1991
Hungary	66	2,140	1991
Poland	58	2,168	1991
Romania	20	3,527	1991
World total [g]	35,000	147,200	1990

Source: United Nations, Department of Economic and Social Development, Transnational Corporations and Management Division, based on *World Investment Directory* (New York, United Nations, 1992) and national official and secondary sources.

a Represents the number of foreign affiliates as reported by host countries.
b For 1986. c For 1971. d For 1989.
e For 1988. f For 1987. g Includes data for countries not shown in the table.

/.....

The changes observed for 1990 can largely be explained by conditions within the United States. Inflows into the United States fell from $71 billion in 1989 to $37 billion in 1990 as the onset of a recession made investments less profitable. The slow-down of outflows from Japan and the United Kingdom, noted above, is to a significant extent a result of changing economic conditions in the United States, where Japan and the United Kingdom are the largest investing countries, and that trend seems to have continued in 1991 (table I.2). [1] A recession in the United Kingdom and larger domestic investments

(Box I.1, cont'd.)

limitations and discrepancies in the data: several countries do not report the number of TNCs or foreign affiliates, while others report only those affiliates with sales or assets above a minimum size, or exclude affiliates in certain industries. [1] The number of TNCs and foreign affiliates should therefore be considered as an underestimate. The inclusion of non-equity forms of investment (not included in table 1) would further increase the number of foreign affiliates, especially in developing countries.

Most TNCs are small or medium-size companies. A small number of TNCs, however, accounts for the majority of outward FDI in individual countries. For example, the fifty largest TNCs from the Federal Republic of Germany, less than 1 per cent of the total number, account for nearly 60 per cent of the total outward stock. [2] In France, 350 TNCs accounted for 80 per cent of all outward flows during the period 1981-1984. [3] Similarly, eighty TNCs from Finland account for 90 per cent of the total outward stock. [4] For a number of countries, FDI is highly concentrated in a small number of TNCs.

While the great majority of parent TNCs originates in developed countries (about 90 per cent), half of the foreign affiliates are located in developing countries. The concentration of parent TNCs in developed countries mirrors the fact that these countries are the main sources of outward FDI. France, Germany, Japan, the United Kingdom and the United States alone account together for about 70 per cent of world-wide investment outflows and for about half of the total number of TNCs. At the same time, with the rapid growth of FDI from the newly industrializing economies, the number of TNCs from developing countries has risen and can be expected to increase further in the future. The fact, however, that half of the foreign affiliates are located in developing countries is in sharp contrast with the relatively small share of FDI received by these countries. Given that developing countries have been receiving on average less than 20 per cent of world-wide FDI during the 1980s, the foreign affiliates located there are likely to be small or medium-size affiliates.

---

1 For example, the Deutsche Bundesbank includes only affiliates whose assets are at least DM 500,000; the United States Department of Commerce estimates for 1989 exclude banks, as well as affiliates whose assets, sales and net income are below $3 million (although an estimate of such affiliates, based on 1982 data, has been included in table 1); the Ministry of Finance of Japan excludes financial, insurance and real estate companies; and the United Kingdom only includes companies with at least £20 million directly invested overseas.

2 Deutsche Bundesbank, unpublished data.

3 Bank of France, *Bulletin Trimestriel,* No. 60 (1986), p. 51.

4 Suomen Pankki-Finlands Bank, unpublished data.

Table I.1. Inflows and outflows of foreign direct investment, 1986-1990

Country group	1986	1987	1988	1989	1990	1980-1985	1986-1990	1980-1985	1986-1990
	(Billions of dollars)					Share in total (Percentage)		Growth rate (Percentage)	
Developed countries									
Inflows	64	108	129	165	152	75	83	-3	24
Outflows	86	135	161	201	217	98	97	-2	26
Developing countries									
Inflows	14	25	30	30	32	25	17	4	22
Outflows	2	2	6	10	8	2	3	1	47
All countries									
Inflows	78	133	158	195	184	100	100	-1	24
Outflows	88	137	167	211	225	100	100	-2	26

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

by Japanese corporations also contributed to a reduced growth in outflows from those countries. [2] In addition, a decline in world-wide merger-and-acquisition activity (a result of slower growth, rising equity market valuations and uncertainties in financial markets) exerted a dampening influence on FDI outflows.

Among the reasons given for the lower level of FDI in the United States in 1990 was the weakness of its economy owing to the onset of recession. [3] That raises the question of the impact of cyclical fluctuations on the investment outlays of TNCs, as well as the attractiveness of host countries facing a recession. In the past, the volatility of investment flows has been closely related to cyclical fluctuations (figure I.1). [4] In 1990, a year of recession or low growth for many developed countries, FDI continued to grow, although at a considerably lower rate compared to 1989 (table I.2). Since FDI outflows for the five largest home countries declined in 1991 compared to 1990, this would suggest that cyclical fluctuations have contributed to the decrease in the rate of growth of investment outflows. Among the five largest home countries, outflows from Germany increased by about 60 per cent in 1990 from their 1989 level and did not decline in 1991; however, that country grew at a relatively high rate in comparison to the others. Outflows from France jumped 80 per cent in 1990, as changes in government policies stimulated a substantial growth in cross-border mergers and acquisitions by French TNCs, but declined considerably in 1991. [5]

The fact, however, that the combined investment outflows from the five major home countries grew at a modest rate in 1990, [6] a year of slow growth, and that the level of FDI in that year and even in 1991 was above the average level of those outflows during 1987-1989 (a period of high growth) in all of these

countries except the United Kingdom, suggests that TNCs may become less influenced by cyclical fluctuations (or influenced with a time lag). Transnational corporations may be more tuned to long-term global strategic objectives, such as penetrating markets or increasing market share, with one factor explaining that behaviour being the growing realization that global expansion is necessary to increase competitive advantages.[7] By pursuing long-term goals, TNCs are, therefore, less likely to be influenced by cyclical fluctuations. For example, the expansion of TNC activity in Central and Eastern Europe, despite severe weaknesses in many of the economies in that region, attests to the importance of long-term goals in corporate planning. Such considerations would suggest that the recent divergence between the growth rates of FDI and GDP would continue in the 1990s, even if the explosive growth of investment observed in the late 1980s were not repeated. At the same time, it is possible that a slow-down in growth could affect FDI with a lag, with investment continuing to grow slowly or even to decline in 1991 and 1992. In fact, the decline in outflows of FDI from the largest home countries in 1991 (table I.2) indicates that, indeed, recessionary forces continue to exert an impact on investment decisions of TNCs. The fact, however, that the fall in FDI in 1991 is mainly concentrated in Japan and France, which could be attributed to circumstances specific to those countries, might reflect the decreasing importance of cyclical fluctuations on TNC investments. If the recession should spread and deepen, however, slow growth in the short term might influence the long-term plans of TNCs and lead to a temporary decline of investment flows.

Box I.2. The discrepancy between inflows and outflows

Inflows and outflows of FDI should balance, in principle; however, in practice, similar to other balance-of-payments items, they do not. Although this is not a recent phenomenon, the size of the discrepancy between world investment inflows and outflows has been increasing and has become a cause for concern. In 1990, the discrepancy reached $41 billion, a sizeable amount and one that potentially distorts the picture for 1990. The size of the discrepancy is actually higher given the fact that reinvested earnings are not included in outflows reported by Japan. Since Japanese outflows grew rapidly during the late 1980s, reinvested earnings are likely to be sizeable. Several reasons have been cited as the cause of the discrepancy, including differences in the threshold definition between inward and outward investment (which, however, has not been found to be a significant source of discrepancy); differences in the treatment of unremitted branch profits between inward and outward investment; treatment of unrealized and realized capital gains and losses; the recording of transactions of "offshore" enterprises; differences in the recording of reinvested earnings between inward and outward investments; differences in the method of collection and reporting of FDI between countries; and differences in the treatment of real estate and construction investment.[1] The use of outflows for analysing FDI trends is based on the premise that most of those flows originate from a small number of developed countries which have collection systems that are more suited to take the above factors into account than many of the recipient countries and, as such, provide a more reliable picture of the trends.

---

1 For a discussion of the causes of the discrepancy between investment inflows and outflows, see Neil Patterson, "The world statistical discrepancy on foreign direct investment capital flows: provisional comparisons and adjustments", a paper prepared for the third meeting of the Working Party on the Measurement of International Capital Flows, Washington D.C., 13-15 September 1990.

Table I.2. Outflows of foreign direct investment from five major home countries, 1986-1990

Country	1986	1987	1988	1989	1990	1991[a]	1980-1985	1986-1990	1980-1985	1986-1990
	Outflows (Billions of dollars)						*Share in total (Percentage)*		*Growth rate (Percentage)*	
France	5	9	15	19	35	21	6	10	-6	59
Germany, Federal Republic of	10	9	11	14	23	23	8	8	4	22
Japan[b]	15	20	34	44	48	31	10	20	22	35
United Kingdom	18	31	37	36	21	18	20	17	-1	6
United States[c]	14	28	14	29	29	29	26	14	-16	20
Total	61	97	112	142	156	122	69	72	-5	26

Sources: International Monetary Fund, balance-of-payments tape, retrieved in December 1991; Deutsche Bundesbank, *Statistische Beihefte,* No. 3 (March 1992); Bank of Japan, *Balance of Payments Monthly,* No. 306 (January 1992); Central Statistical Office, unpublished data provided by the British Trade Office in New York; United States, Department of Commerce, unpublished data; Ministère d'Economie, des Finances et du Budget, "La balance de paiements en 1991", communiqué of 19 March 1992.

a Preliminary estimates.
b Data for Japan do not include reinvested earnings.
c Excluding outflows to the finance (except banking), insurance and real estate sectors of the Netherlands Antilles. Also excludes currency translation adjustments.

Inflows of FDI to developing countries grew by 7 per cent in 1990. Developing countries received 17 per cent of all inflows in 1990, equal to their share for the last half of the 1980s. Continued strong growth of flows to East, South and South-East Asia and an increase of flows to Latin America and the Caribbean were partially offset by a drop in flows to Africa. The growth in the share of FDI going to developing countries in 1990 was a result of an increase in the size of such flows, as well as a slackening in world-wide flows. Among developing countries, the 10 largest host countries continued to receive approximately two thirds of all inflows. Flows of investment to the least developed countries grew slightly in 1990, to $250 million—equivalent to the inflows to Pakistan. Foreign direct investment to Central and Eastern Europe increased sharply, but remained at low levels.

The sectoral composition of the outward stock of FDI by major home countries at the end of the 1980s is shown in table I.3. [8] The rapid increase in investment flows in the 1980s was accompanied by a shift in the sectoral composition of both flows and stocks towards services. For all but Canada and the

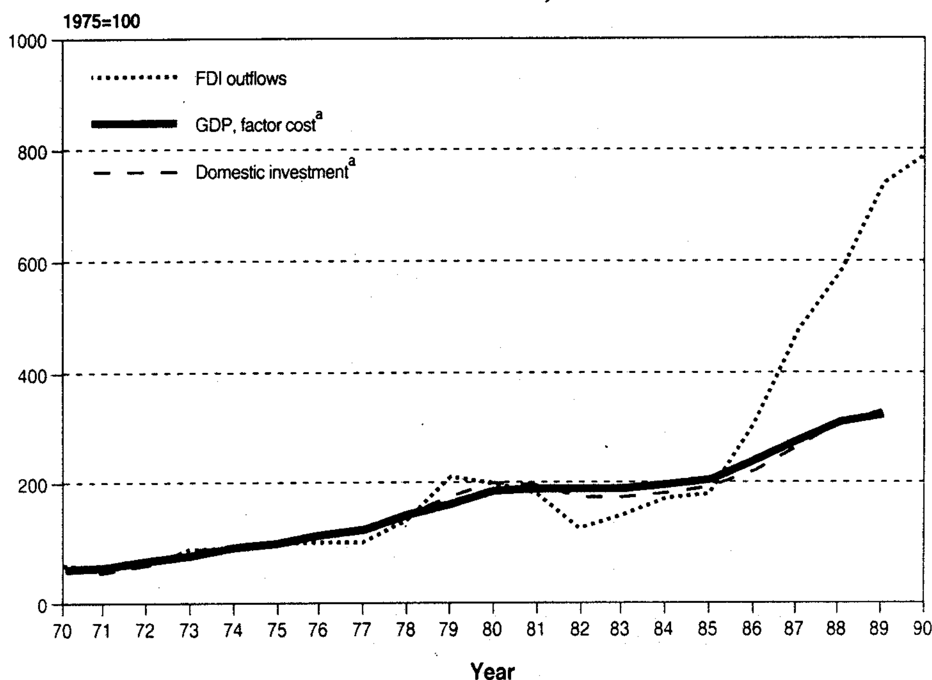
United Kingdom, the services sector continued to be the single largest sector, and reached, for outward investment, over two thirds of the stock of Japan and over 40 per cent of the stock in most of the other countries. In terms of outflows from these countries, the services sector accounted for 50 to 55 per cent of the total during the late 1980s. Despite fluctuations in annual sectoral flows, including a decrease (albeit, from often considerably high levels) in the share of services in outflows from all of the countries in table I.3 (except the Netherlands and France) in the most recent year for which data are available, the shift towards services, reflecting long-term structural changes, seems likely to continue.

B. Regional trends

1. Developed countries

The slow-down in the growth of investment flows to and from the developed countries in 1990 is largely owing to a slowing down of economic activity, especially in the United States, which entered a recession in the middle of the year, and to some extent in Western Europe. [9] The slow-down in growth,

Figure I.1. Foreign direct investment, gross domestic product and domestic investment, 1970-1990



Source: International Monetary Fund, balance-of-payments tape, retrieved in December 1991; World Bank, world tables database.

a Data for 1989 are preliminary.

Table I.3. Sectoral composition of the stock of outward foreign direct investment of major home countries

(Percentage share and annual growth rate of stock)

Country	Period	Sectors			Total
		Primary	Secondary	Tertiary	
Canada					
Composition	1975	9	62	29	100
	1990	6	51	43	100
Growth rate	1975-90	13	14	18	15
France [a]					
Composition	1975	22	38	40	100
	1990	13	38	49	100
Growth rate	1975-90	23	27	29	27
Germany, Federal Republic of					
Composition	1976	5	48	47	100
	1990	2	49	59	100
Growth rate	1976-90	6	10	14	12
Japan					
Composition	1976	28	32	40	100
	1990	6	27	67	100
Growth rate	1976-90	10	21	28	23
Netherlands					
Composition	1975	47	39	15	100
	1989	35	24	41	100
Growth rate	1975-89	6	5	17	12
United Kingdom					
Composition	1984	33	32	35	100
	1988	25	38	37	100
Growth rate	1981-88	2	14	11	9
United States [b]					
Composition	1975	26	45	29	100
	1990	8	44	47	100
Growth rate	1975-90	-	8	12	12

Source: Estimates of Transnational Corporations and Management Division, based on Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992).

a Based on cumulative flows of direct investment from 1972.

b The vertically-integrated petroleum industry is included in the primary sector in 1975. In 1990, only the extractive portion of the industry is included in the primary sector, with processing included in the secondary sector and marketing and distribution in the tertiary sector.

combined with rising private-sector debt burdens and emerging structural weaknesses within the financial systems in a number of countries, was behind a slowing down in global merger-and-acquisition activity, the most important mode of cross-border investment for firms from developed countries. The major exception was France, whose TNCs increased their cross-border mergers and acquisitions in 1990. [10]

There are also indications that 1990 represented a year in which TNCs began to consolidate their positions within North America and Western Europe, as firms approached their desired investment positions after a period of rapid growth. Japanese TNCs expanded investments in domestic production facilities in response to an increased government demand stimulus, as the growth of outward FDI slowed down. [11] The slow-down in Japanese outflows may also be attributed to the substantial direct investments abroad accumulated by major Japanese TNCs during the 1980s in automobile and electronics production, and lesser amounts of finance available for outward FDI as Japanese banks—the key financiers for overseas investments—incurred substantial losses during the crumbling of the stock and real estate markets at the start of 1990, while having to increase their reserves to meet reserve requirements of the Bank for International Settlements.

Flows of FDI to Japan increased in 1990 from negative flows in 1988 and 1989, when a number of foreign investors, including such firms as Chrysler, General Motors and Honeywell, disinvested, apparently, at least in part, to realize capital gains accumulated during the boom in Japan's stock and real estate markets. The stock of FDI from Japan remains high in comparison with that of other large developed countries, when expressed in relation to the stock of inward investment and when the latter is expressed in relation to the level of GDP in the host economy (table I.4). Government restrictions on inward FDI in existence from 1950 through 1980 explain, in part, the low level of the stock of inward investment. But at least some TNCs do not appear to have adopted their most effective competitive stance in approaching the Japanese market. For example, only a few TNCs in the automobile industry, such as BMW, have established their own distribution networks in Japan. At the same time, the competitive advantages of Japanese corporations within their home market continue to raise difficulties for foreign TNCs seeking to operate within Japan. While there are signs indicating that a significant increase in FDI inflows is possible, such an increase has yet to materialize. [12]

The growth of inflows and outflows to and from the non-EC Western European countries (44 and 27 per cent, respectively, during 1985-1990; for values of these flows see annex table 1), combined with the already large amounts of EC inward and outward FDI, is an indication of the emergence of the European Economic Area (EEA) as a powerful economic region. In the case of the Nordic countries, the surge of inward investment after 1984 reflects the determination of Governments to pursue policies more favourable to TNCs prior to the onset of wider European economic integration. [13] Companies from Sweden, as well as other EFTA countries, have launched aggressive merger-and-acquisition offensives inside the European Community to gain a stronger foothold in the Single Market, while firms from within the Community have also invested in EFTA countries. During the period from 1985 to 1989, approximately 51 per cent of total inflows and outflows of investment in and from the EFTA member countries were accounted for by both EC and EFTA members.

Table I.4. Inward and outward foreign direct investment in the largest developed market economies, 1989
(Billions of dollars; percentage share; ratios)

Item	*European Community* [a]	*Japan* [b]	*United States*	*France*	*Germany, Federal Republic of*	*United Kingdom*
Inward stock of FDI	249	28	374	51	74	135
Percentage of world total	22	2	27	4	5	10
Outward stock of FDI	370	156	376	75	122	213
Percentage of world total	32	11	27	5	9	16
Ratio of outward stock to inward stock	1.5	5.6	1.0	1.5	1.6	1.6
Ratio of inward stock to GDP	0.05	0.01	0.07	0.05	0.06	0.17

Source: Calculations by Transnational Corporations and Management Division, based on Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992).

a Excludes intra-EC FDI.

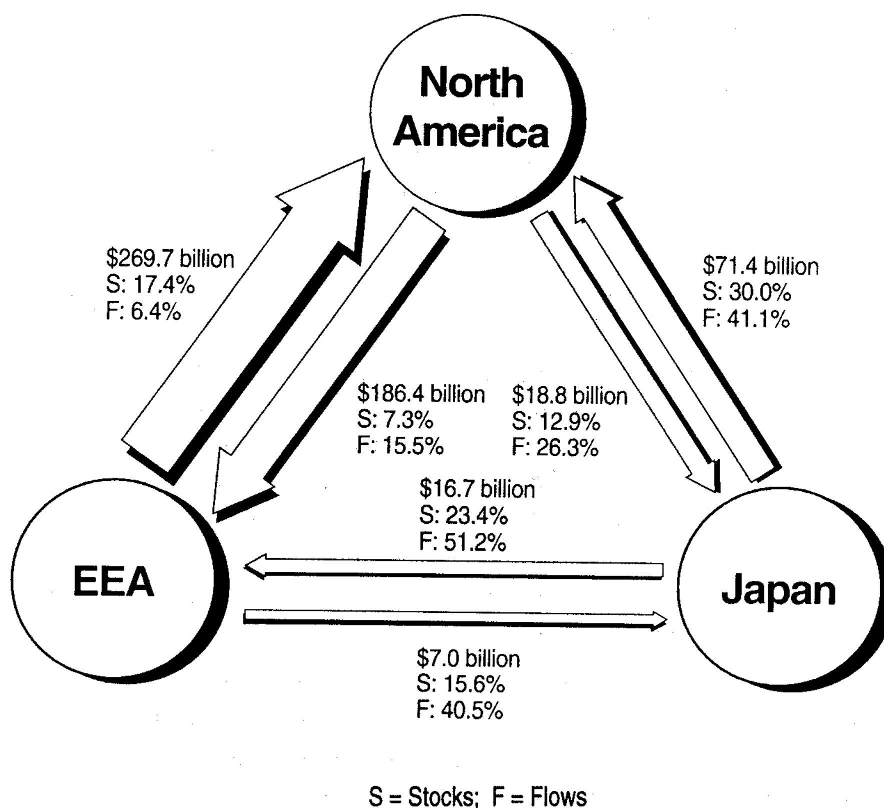
b The stock of FDI in Japan is estimated using data on outward investment from Australia, Canada, the European Community, Norway, Switzerland and the United States.

Despite the decline in FDI inflows into the developed countries, those countries continued to account for more than four fifths of world-wide inflows in 1990. The Triad, consisting of the EC, Japan and the United States, accounted for approximately 70 per cent of world-wide inflows, a proportion unchanged from the average for the decade of the 1980s, and 83 per cent of outflows, a small decline from the average for the 1980s. In the 1990s, the emerging Triad may be more aptly described as including Japan, North America (Canada and the United States) and the European Economic Area (EC and EFTA). Cross-holdings of stocks of FDI within this emerging Triad amounted to $572 billion in 1989 (figure I.2).

The continuing concentration of transnational corporate activity in the Triad has made FDI an increasingly important instrument of global economic integration in these countries. The growth and concentration of FDI in the Triad at the beginning of the 1990s are associated with several structural and cyclical factors. Among the former are sustained technological competition and cross-border, intra-industry production; significant economic developments in those countries, such as the regionalisation of markets with the EC and its extension to EFTA countries; the United States-Canada Free Trade Agreement and the likely inclusion of Mexico in a wider North American Free Trade Agreement;

privatization and deregulation in services industries and their opening to FDI; and fears of rising protectionism as regional markets grapple with their relations with the rest of the world. High growth rates relative to most other regions of the world are among the cyclical factors. The economic slow-down of the early 1990s may have reduced the impact of some of these trends, but it is not likely to alter them in any substantial way.

Figure I.2. Intra-Triad foreign direct investment, 1989



S = Stocks; F = Flows

Source: Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992).

Note: Dollar figures show estimated value of stock of foreign direct investment based on data on inward and outward investment from North America and the European Economic Area (EEA), excluding Iceland and Liechtenstein. Intra-North American investment and intra-EEA investment has been netted out. Percentages show average annual growth rates for stocks (1980-1989) and flows (1985-1990). North America includes Canada and the United States. The European Economic Area includes the European Community (EC) and the European Free Trade Association (EFTA), excluding Iceland and Liechtenstein. S = Stocks; F = Flows.

2. Developing countries

Foreign direct investment to developing countries grew in 1990, reaching a total of $32 billion, thus continuing the substantial growth in inflows to developing countries that began in the mid-1980s (table I.5 and annex table 1). The Asian region attracted the majority (61 per cent) of inflows to developing countries. Flows to Latin America and the Caribbean grew in 1990 (to reach a share of 32 per cent), as a number of countries in that region were showing signs of a significant economic revival. Flows to Africa (7 per cent) and to the least developed countries (0.7 per cent) have remained at low levels, and show no signs of significant growth.

While the quantity of flows to developing counties as a whole, and Asia and the Pacific and Latin America and the Caribbean in particular, continued to increase, the share of FDI going to developing countries declined over time, reflecting strategies of TNCs that increasingly favour the locational advantages of developed countries. (The share of inflows to developing countries increased in 1990, largely owing to the sharp drop in inflows to the United States, the size of which is not likely to be repeated in succeeding years.) Among developing countries, a large proportion of inflows of investment was directed to a small number of countries (annex table 2). Thus, while FDI flows to developing countries as a whole increased, those flows were not evenly distributed.

(a) Asia and the Pacific

In 1990, the position of East, South and South-East Asia and the Pacific as the leading recipients of FDI flows among developing countries was further consolidated, with Asia and the Pacific accounting for almost 60 per cent of total flows to all developing countries in that year.[14] At the same time, that group of countries accounted for an overwhelming share of investment outflows from developing countries (about 86 per cent in 1990), with the Asian newly industrializing economies being the leading source. Moreover, the Republic of Korea and Taiwan Province of China have become net exporters of investment and, along with the other Asian newly industrializing economies, are responsible for an increasing share of all investment flows to Asia.

East, South and South-East Asia and the Pacific, having overtaken Latin America and the Caribbean as the largest recipients of investment among developing regions in 1986 (on average, during 1989-1990, investment *inflows* have been almost twice as large in Asia and the Pacific as in Latin America), continued to surpass all other developing regions in terms of the size of inflows. Flows of investment to Asia and the Pacific continued to grow in 1990, reaching approximately $18 billion, an 18 per cent increase over the previous year. Attracted by high rates of domestic growth, relatively low production costs and increasingly lucrative domestic markets due to rising consumer purchasing power, investment flows to those countries have grown at the highest rate among all developing regions: by 20 per cent throughout the 1980s and by 29 per cent during the period 1986-1990. Flows of FDI to East, South and South-East Asia are likely to continue on an upward path, given that China has reconfirmed its open policy and

Table I.5. Average inflows of foreign direct investment to developing regions, by region, 1970-1979, 1980-1985 and 1986-1990

Host region and economy	*1970-1979*	*1980-1985*	*1986-1990*	*1970-1979*	*1980-1985*	*1986-1990*	*1970-1979*	*1980-1985*	*1986-1990*
	(Billions of dollars)			*(Share of all inflows) (Percentage)*			*(Annual growth rate) (Percentage)*		
All countries	22	50	150	100	100	100	16	-1	24
Developing countries	5	13	26	24	25	17	21	4	22
Latin America and the Carib-bean	3	6	9	13	12	6	20	-5	17
West Asia	0.3	0.4	0.5	1	1	0.4	..	53	37
East, South and South-East Asia	1	5	14	6	9	9	16	7	28
Oceania	0.02	0.1	0.1	0.1	0.3	0.1	28	-1	-5
Africa	1	1	3	3	3	2	22	52	6
Other [a]	0.03	0.04	0.05	0.1	0.1	0.03	15	-8	..
Least developed countries	0.1	0.2	0.2	0.5	0.4	0.1	27	-16	116
Ten largest host countries [b]	1970-1979: 4	1980-1990: 13		1970-1979: 16	1980-1990: 13		1970-1979: 23	1980-1990: 11	

Sources: Estimates of Transnational Corporations and Management Division, based on International Monetary Fund, balance-of-payments tape, retrieved in December 1991; OECD estimates; and Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992).

a Malta and Yugoslavia.

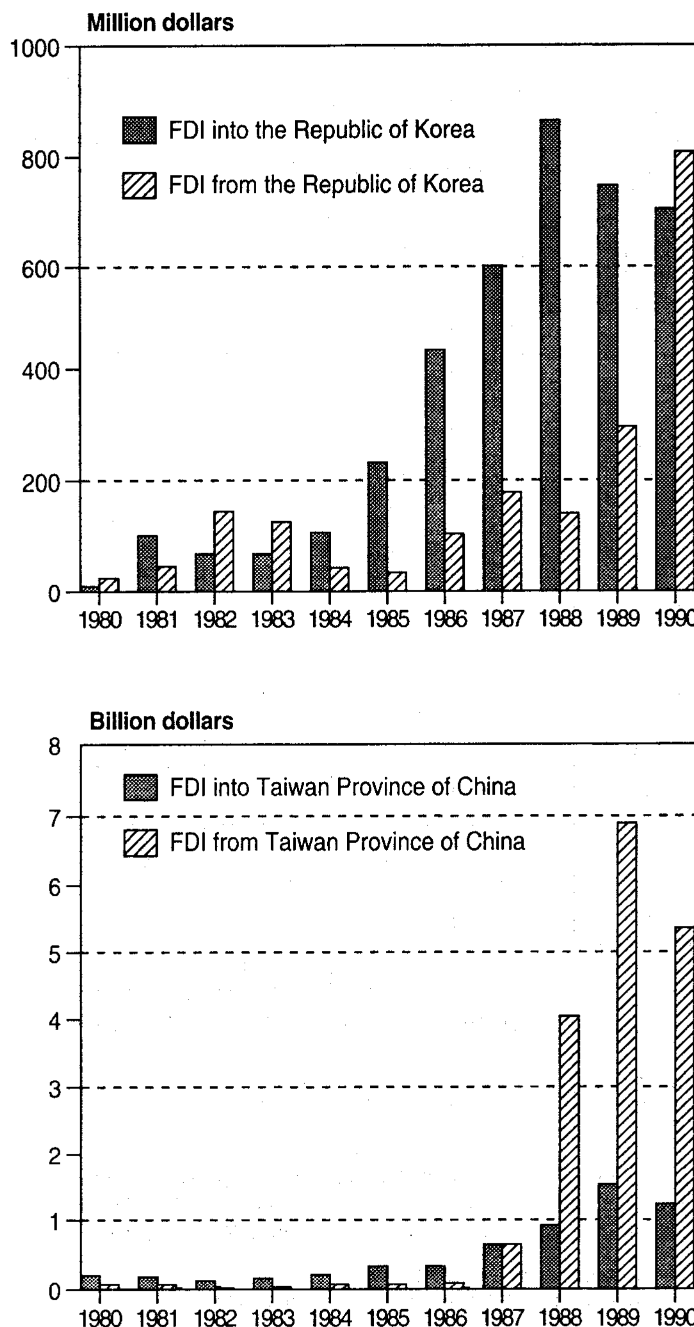
b For a list of these countries, see annex table 2.

continues to attract substantial investments and given the substantial liberalization of India's FDI regime and other changes in the economy of that country. (See also the box on India in chapter III.) [15]

The share of Western Asia in total FDI inflows to developing countries continued to decline during the second half of the 1980s compared to the first half, although, in absolute terms, inflows increased. Oil exporting countries have been the major recipients of FDI, accounting for roughly two thirds of those investments to Western Asia. In 1990, Cyprus experienced its highest inflow of investment capital over the past two decades and accounted for over half of all flows to non oil-producing countries of that region.

Investment *outflows* from East, South and South-East Asia, valued at almost $8 billion in 1990, fell slightly from the previous year's record high of over $8 billion. On average, investment outflows from Asia grew by 47 per cent during the 1980s and 75 per cent during 1986-1990. In the cases of both the Republic of Korea and Taiwan Province of China, outflows have exceeded inflows, a pattern usually reserved for developed countries (figure I.3). China has also emerged as a major investor from that region during the past decade, with investment outflows reaching $830 million in 1990 (an annual average growth rate of 17 per cent since 1986), reflecting the efforts on the part of Chinese TNCs to penetrate new markets and to acquire technology and management skills. [16]

Figure I.3. Foreign-direct-investment inflows and outflows, Republic of Korea and Taiwan Province of China



Source: International Monetary Fund, balance-of-payments tape, retrieved in December 1991.

This unprecedented growth of FDI from the East, South and South-East Asian region, overwhelmingly from the newly industrializing economies in which a growing number of domestic firms have become global competitors, can be attributed to the "push" factors of the appreciation of national currencies and labour shortages exerting upward pressure on domestic production costs, the large current account surpluses experienced by some of these countries and the removal of restrictions on outward capital flows. In addition, the loss of generalized system of preference status for those economies is likely to have contributed to the increase of outward investment and influenced its pattern, particularly regarding the location of investments by TNCs in the industries most affected by the removal of that status, such as electrical equipment and food processing. The main "pull" factors have been protectionist threats by developed countries, which have encouraged firms from those economies to invest in North America and Europe in order to secure market access and maintain a presence in their main export markets. Another important factor was access to technology, which enables firms to upgrade their production processes and move up the value-added chain to retain export market shares and increase the capital intensity of output in the face of domestic labour shortages.

Most of the total FDI stock from the newly industrializing economies in developed countries (64 per cent of total outward stock for Taiwan Province of China in 1990) is concentrated in the North American and European markets. In those regions, FDI is concentrated in the manufacturing sector, although the services sector has also attracted a significant share of investment from those economies.[17] At the same time, TNCs from the newly industrializing economies are increasingly focusing on Asia as a low cost production base for supplying the region and the rest of the world[18] and as a means of diversifying export markets in the face of growing protectionism in developed countries.[19] As a result, intraregional flows of investment in East, South and South-East Asia and the Pacific expanded rapidly during the second half of the 1980s (mostly in manufacturing) and account for a growing share of the inward investments of the recipient countries (table I.6). In particular, the newly industrializing economies accounted for an increasing share of total annual average investment

Table I.6. Investment flows to South and South-East Asia, China and the Asian newly industrializing economies from the Asian newly industrializing economies, 1983-1986 and 1987-1990 [a]

(Percentage share of total average annual inflows)

Host economy	*1983-1986*	*1987-1990*
South and South-East Asia		
India	1	3 [b]
Indonesia	11	19
Malaysia	19	41
Philippines	6	18 [c]
Thailand	13	31
Newly industrializing economies		
Republic of Korea	3	5 [b]
Taiwan Province of China	10	14
China	55	66 [b]

Source: UNCTC, *World Investment Directory 1992, Vol. I, Asia and the Pacific* (United Nations publication, Sales No. E.92.II.A.11).

a As reported by the host economy.
b 1987-1988.
c 1987-1989.

flows to countries in South and South-East Asia and to other newly industrializing economies. While outward investment from those economies is driven primarily by supply factors (low production costs and the need to retain export competitiveness), investments in the latter are motivated by the growth in domestic demand.

(b) Latin America and the Caribbean

The resurgence of economic growth in a number of countries in Latin America and the Caribbean, policy changes that have allowed foreign investors greater access to the region's resources and markets, and stronger efforts to achieve regional economic integration are leading to a revival of FDI in the region. The proposed North American free trade agreement, if concluded, will enhance the locational advantages of Mexico as a host country for FDI, a process that has already begun and which is further discussed in section D. At the same time, outflows of investment from the region declined substantially. Transnational corporations from Latin America and the Caribbean, with a few exceptions, have not developed into international competitors. The role of import-substituting trade and industrialization strategies in the region may have contributed to the slow expansion of TNCs from Latin America and the Caribbean. [20]

Successes in managing external debt burdens, combined with concessions to debtor countries through the Brady debt initiative, allowed indebted countries to adopt more stimulative economic policies, increased the confidence of both foreign and domestic investors and helped to stimulate FDI inflows to a number of countries in the region. Debt-for-equity swaps have been important in facilitating FDI flows, especially in Chile, Brazil and Venezuela (table I.7). [21] Economic policy changes, especially in Argentina, Chile and Mexico involving a greater liberalization of policies towards TNCs and more of an outward orientation of economic policies have been manifested in the privatization of State-owned

Table I.7. Total foreign direct investment and foreign direct investment financed through debt-equity swaps, 1985-1989

(Millions of dollars)

	Total investment flows		*Foreign direct investment through debt-equity swaps* [a]	*Foreign direct investment through debt-equity swaps as percentage of total foreign direct investment*
Country	*1980-1984*	*1985-1989*	*1985-1989*	*1985-1989*
Argentina	2 195	3 646	731	20
Brazil [b]	10 499	7 687	4 529	59
Chile [c]	1 210	3 947	3 160	80
Mexico	7 497	10 098	3 053	30

Source: Transnational Corporations and Management Division, *Debt-Equity Swaps and Development* (New York, United Nations, forthcoming).

a Includes only that portion of swaps which corresponds to foreign direct investment.

b Excludes informal conversions.

c Excludes chapter XVIII transactions.

privatization of State-owned enterprises, including in such services industries as telecommunications, banking and public utilities, the lowering of trade barriers and greater efforts to control fiscal deficits (box I.3). A number of countries in the region have stepped up efforts at fostering regional integration, in part with the objective of enlarging markets and attracting larger amounts of FDI.

Box I.3. Foreign direct investment in Argentina

Inflows of FDI to Argentina began to increase in the late 1980s, particularly in gas and petroleum, food processing, tourism, motor vehicles, petrochemicals and the financial industry. The recent increase in FDI inflows can be largely attributed to the efforts of the Government of Argentina to boost foreign equity participation in the country's economy.

Investment in the petroleum sector increased significantly, following the broad deregulation of the sector initiated by the so-called Houston Plan of 1985. Foreign oil companies were invited to participate, through concession contracts, in the exploitation of several of Argentina's marginal oil fields (*areas secundarias*). Since 1990, foreign oil companies have also been awarded concession rights in some of the country's richest oil fields (*areas centrales*).

Investment in the food-processing and automotive industries was greatly encouraged by the signing of a Complementarity Agreement between Argentina and Brazil in 1986. This trade agreement led to a major restructuring of the automotive sector, including the merger of two of the largest TNCs, Ford and Volkswagen, into a joint venture, Autolatina. Autolatina, whose goal is to rationalize and integrate its Argentine and Brazilian operations, has since set up a wholly-owned subsidiary, Transax, to produce gear boxes for export to Brazil. The Complementarity Agreement has also boosted investment in the agro-industrial sector, including significant commitments by the Swiss firm Nestlé.

In addition, Argentina operated a formal debt capitalization scheme during the period 1987-1989 with a view to promoting new investments through the direct conversion of bank debt. Investment projects approved under the debt-conversion scheme were heavily concentrated in agri-business, tourism, automobiles and pharmaceuticals. Since 1988, there has also been growing foreign participation in the country's telecommunications market, particularly in cellular telephone and data-transmission services.

Since 1989, the policy of stimulating FDI has gathered increasing momentum. The new administration amended the already liberal investment law of 1980, gave new impetus to the full-scale privatization of State-owned companies and implemented several policy reforms aimed at easing trade and exchange restrictions and restoring macroeconomic equilibrium. The new FDI law of 1989 made approval of foreign investments virtually automatic. Registration is now required only for statistical purposes. Limits on profit and dividend remittances were lifted, and so were restrictions on foreign ownership of local companies. The new law also reduced the tax burden on foreign investors and increased their access to domestic financing. The only areas in which FDI is not permitted are defence-related industries and the mass media. In addition, changes were introduced in the mining code, allowing national and provincial Governments to call for international bids for the exploration and exploitation of mineral reserves held by the State.

The new administration has also embarked upon a massive privatization programme. It involves the sale of some of the largest State-owned companies through the ample use of debt-equity swaps. For that purpose, a law passed in 1989 gave the executive branch of the Government extraordinary powers to take all appropriate

/.....

The proposed free trade agreement being negotiated by Mexico with the United States and Canada (and discussed further in section D below) has already increased the attractiveness of Mexico as a low-cost production location for the entire North American market. Majority-owned foreign affiliates of United States companies planned to increase capital spending by 20 per cent in 1991 in Mexico, as of July 1991, as compared to a planned 9 per cent increase for the region as a whole, and up from a 6 per cent planned increase in December 1990, in response to the prospect of the free trade agreement and an improving investment climate. [22] Although investment inflows into Mexico declined by $405 million in 1990, a number of indications point to the rapid expansion of FDI in the next years. For example, actual inflows of FDI were about $5 billion in 1991. [23]

The implementation of the North American free trade agreement is likely to have long-term impacts on countries in Central America and the Caribbean. Some of the export-oriented labour-intensive investments presently being undertaken in Central American and Caribbean countries and geared towards the North American market may be diverted to Mexico. Countries in the region appear to have benefited from policies of the Government of the United States designed to stimulate trade with the United States market. The creation of twin plants for production-sharing between Puerto Rico and its Caribbean neighbours, such that labour intensive operations are carried out in a Caribbean or Central American country and final processing is performed in Puerto Rico, have allowed United States and other foreign producers to tap into the region's low-cost, abundant labour force, with low turnover rates and rapid turnaround potential. [24] Transnational corporations from the Asian newly industrializing economies,

(Box I.3, cont'd)

steps to privatize public sector companies fully or partially, without the need to obtain congressional approval. A salient feature of the Argentine privatization programme is that, from its very inception, foreign investors were targeted as a priority. The law allows majority foreign ownership and control in most sectors, reserving only the media and defence-related industries for local companies.

Several privatizations took place during the first two years of the programme, including those of ENTEL (telecommunications), Aerolineas Argentinas (the country's flag carrier airline) and several petrochemical firms. The sale of ENTEL involved a debt-equity swap of over $5 billion, the largest so far in Latin America. In most cases, the participants are foreign consortia involving a transnational bank, a foreign company and several local groups which plan an important role during the bidding process. Additional privatizations are scheduled in 1992-1993. They include most public utilities (electricity, water and gas), the national road and railway networks, ports and shipping and petrochemical companies. Also included are the giant state concerns SOMISA and Altos Hornos Zapla (steel), as well as YPF (oil), the largest Argentine company. Foreign participation in future privatization deals is being actively encouraged.

During March 1991, the Presidents of Argentina, Brazil, Paraguay and Uruguay signed the Treaty of Asunci6n creating the Southern Cone Common Market (Mercosur), the goal of which is the establishment of a single external tariff and the elimination of non-tariff barriers by 1995. Furthermore, Argentina is concluding negotiations with IMF for an extended fund facility. The expected inclusion of Argentina in the Brady Plan in 1992 could lead to a significant reduction in the country's foreign debt. Together, those factors may well create additional incentives for FDI in Argentina.

especially the Republic of Korea and Taiwan Province of China, have located some of their labour-intensive manufacturing in Caribbean countries, partly because of the latter's free trade status with the United States. [25] While the proposed free trade agreement will increase the attractiveness of Mexico as a location for such export-oriented industrial FDI, those investments will not enjoy the locational advantages of the Central American and Caribbean countries that emerge from their preferential access to the EC through the Lomé Convention. In addition, those countries would continue to be an important host area for investment in agro-business by TNCs.

Outflows of FDI from Latin America and the Caribbean were $1.1 billion in 1990, a 59 per cent increase from the previous year. The largest sources of FDI from that region are Brazil and Venezuela. Investment outflows from Latin America and the Caribbean grew by 14 per cent during the period 1986-1990 in comparison to 75 per cent for South and South-East Asia. The slower growth of outflows from Latin America and the Caribbean in comparison to East, South and South-East Asia may be explained by the earlier trade and industrialization strategies adopted by the two regions. The emphasis placed on greater outward orientation and economic growth through export expansion in a number of Asian countries, particularly the newly industrializing economies, may have contributed to the greater competitiveness of their firms in trade and international production. That has resulted in larger amounts of exports and, later, export-oriented outward investment from Asia. By contrast, the emphasis on greater inward orientation and economic growth through domestic demand in a number of Latin American countries may have contributed to the relatively slower growth of Latin American firms that are internationally competitive in either trade or international production. In addition, the slower pace of growth in Latin America owing to macroeconomic difficulties, including debt-servicing problems, helps to explain why the growth of TNCs from Latin America and the Caribbean has been surpassed by the more rapid development of Asian TNCs in recent years. [26]

(c) Africa

Flows of FDI to Africa fell to $2.2 billion in 1990—slightly more than what Portugal received in that year—a decrease of 50 per cent from 1989. Although investment inflows were significantly lower in 1990, their level was similar to that reached during most years in the late 1980s, implying that the 1989 level was exceptionally high. The fall in investment inflows was experienced primarily by the oil exporting countries in Africa, particularly Nigeria and Egypt, whose share of the total fell from 80 to 66 per cent between 1989 and 1990. For the latter, the impact of political tensions in the Persian Gulf on the investment climate is the main explanatory factor. Non-oil exporting countries in Africa, most of which are classified as least developed countries, received on average less than $0.5 billion per year during the second half of the 1980s—roughly what Papua New Guinea alone attracted during the same period. [27]

The low levels of FDI flowing to Africa underline the increasing marginalization of the region. Continuing uncertainty regarding prospects for economic development have deterred investments by TNCs from the major home countries, as those companies favour countries with high growth rates or

large domestic markets. [28] The low level of new investments in Africa by TNCs from the major home countries, indicated by the small proportion of equity capital in total FDI outflows to that region reported by those countries (less than 10 per cent during the late 1980s), further illustrates that most investment is undertaken by affiliates that already have investments in Africa. There are also examples of large TNCs acquiring existing foreign-owned companies without contributing to the overall amount of FDI. [29]

In recent years, a number of countries in Africa have sought to attract greater amounts of FDI, primarily by reducing or removing legal and regulatory restrictions on the activities of foreign companies. Despite those extensive efforts at liberalization, the quantity of FDI flowing to the region has remained small, largely because, as indicated above, the economic advantages of the countries in the region appear not to be sufficient to attract larger flows of new investment. Thus, a greater involvement by national and international agencies may be needed to help attain the necessary economic conditions and infrastructural requirements to attract significant amounts of FDI.

3. Central and Eastern Europe

The number of joint ventures and wholly-owned affiliates registered in Central and Eastern Europe more than doubled between the beginning of 1991 and January 1992, to reach a total of over 34,000. Foreign equity participation committed to those enterprises as of October 1991 amounted to over $9 billion (table I.8). [30] The amounts actually invested, however, remain small by international standards. Divergence in the economic performance of Central and Eastern European countries and political uncertainty regarding the future of the members of the Commonwealth of Independent States led to changes in the pattern of investment in the region. By the beginning of 1992, Hungary and Romania had become the largest host countries in terms of the number of registered joint ventures and wholly-owned foreign affiliates.

Table I.8. Foreign investment registrations in Central and Eastern Europe, by number and value of foreign equity participation, beginning of 1992

Country	*Number*	*Foreign equity*[a] *(Millions of dollars)*
Bulgaria	900	300
Commonwealth of Independent States	5 400	5 650
Czechslovakia	4 000	480
Hungary	11 000	2 089
Poland	5 100	670
Romania	8 022	231
Total	34 422	9 420

Source: Transnational Corporations and Management Division and ECE, *World Investment Directory 1992, Central and Eastern Europe* (New York, United Nations, 1992).

[a] As of 1 October 1991.

While most companies that invest in Central and Eastern Europe are attracted by the size of the

the domestic market, companies from particular industries, such as automobiles and electrical goods, consider that region (primarily Czechoslovakia, Hungary and Poland) as an extension of Western Europe and are establishing production facilities there with a view to supply the entire European market (box I.4). In the automobile industry, a number of Japanese, United States and Western European manufacturers have established plants in Central and Eastern Europe to supply both domestic and foreign markets. [31] Similar examples can also be found in electrical machinery and consumer goods, with TNCs setting up plants in Eastern Europe to serve all of the European market. [32] Viewing Central and Eastern Europe in the context of a regional core network strategy on the part of TNCs is likely to increase further the locational advantages of that area, such as proximity to Western Europe, the availability of a skilled labour force and relatively low labour costs. With improvements in the overall economic situation of these countries, this is likely to lead to sizeable increases in FDI. Although benefits to existing investments may not materialize in the short run, possible "first-mover" advantages and long-term prospects have already induced many companies to invest there.

Economic and political developments in the members of the Commonwealth of Independent States place those countries increasingly apart from the other countries in the region. Transnational corporations are less likely to include these countries in their regional core network strategies, not only owing to continuing political and economic uncertainties, but also to the distance of a number of those countries from Western Europe, combined with a lack of infrastructural facilities and distribution channels and the regulatory and administrative infrastructure required for the functioning of a market economy. It would be unlikely, therefore, that TNCs would invest in a major way in the Asian part of the former Soviet Union to supply the European market. It is only in natural resources (where distance plays a less

Box I.4. Foreign investments in automobiles in Central and Eastern Europe: an example of regional core network strategies

Several automobile manufacturers, including Fiat (Italy), General Motors (United States), Volkswagen (Germany) and Suzuki (Japan), have already invested, or are in the process of investing, in the manufacture of automobiles or automobile components in Central and Eastern Europe. Those investments are examples of regional core network strategies on the part of those automobile manufacturers. Transnational corporations, encouraged by the desire of Central and Eastern European countries to integrate themselves with Western Europe, view their investments in that region as part of a wider regional strategy of supplying both the potentially sizeable domestic markets of those countries as well as the markets of other European countries. For example, General Motors' recently established plant in the eastern part of Germany incorporating the latest production technology, and its new engine plant and a small automobile assembly operation in Hungary may be considered as part of the regional core network strategy of that company aiming at supplying components or finished products to the whole European market. Some companies, notably Fiat, have had a long-term involvement in automobile manufacturing activities in the region through licensing and production agreements and have benefited considerably from the experience gained in negotiating with those countries and in solving particular difficulties. Nevertheless, even late-comers have moved rapidly to establish a strong presence in the region by acquiring existing companies, committing funds for the modernization of existing plants and providing technical and managerial assistance, and by capitalizing on their existing marketing networks.

significant role) that some TNCs have shown a strong interest.[33] On the other hand, those natural resources, as well as skilled labour and large potential markets, make these countries attractive locations for FDI in the future. Their proximity to TNCs from developing countries in Asia and from Japan has encouraged some of those companies to invest in the Asian part of the former Soviet Union (including the Nakhodka Free Trade Zone), as a means of penetrating the potential markets of the members of the Commonwealth of Independent States, as well as using them as a base for exporting to the rest of the region.[34]

Although the present levels of FDI in Central and Eastern Europe are small by international standards—about the same level as the FDI flows to Belgium and Luxembourg in 1990—investments in that region could expand significantly. To a large extent, this will depend on the success of Governments to implement market reforms and remove remaining legislative obstacles, and on the degree of commitment on the part of Western countries to provide financial and technical assistance to the region as a whole. By one estimate, cumulative FDI in Central and Eastern Europe could rise to $75 billion-$100 billion by the late 1990s; other estimates arrive at similar figures.[35] Using, for comparative purposes, FDI flows in the 1980s to Brazil, Mexico and Portugal—countries with levels of per capita GDP similar to those of many of the countries in the region—cumulative investment flows could surpass $50 billion by the end of the 1990s.

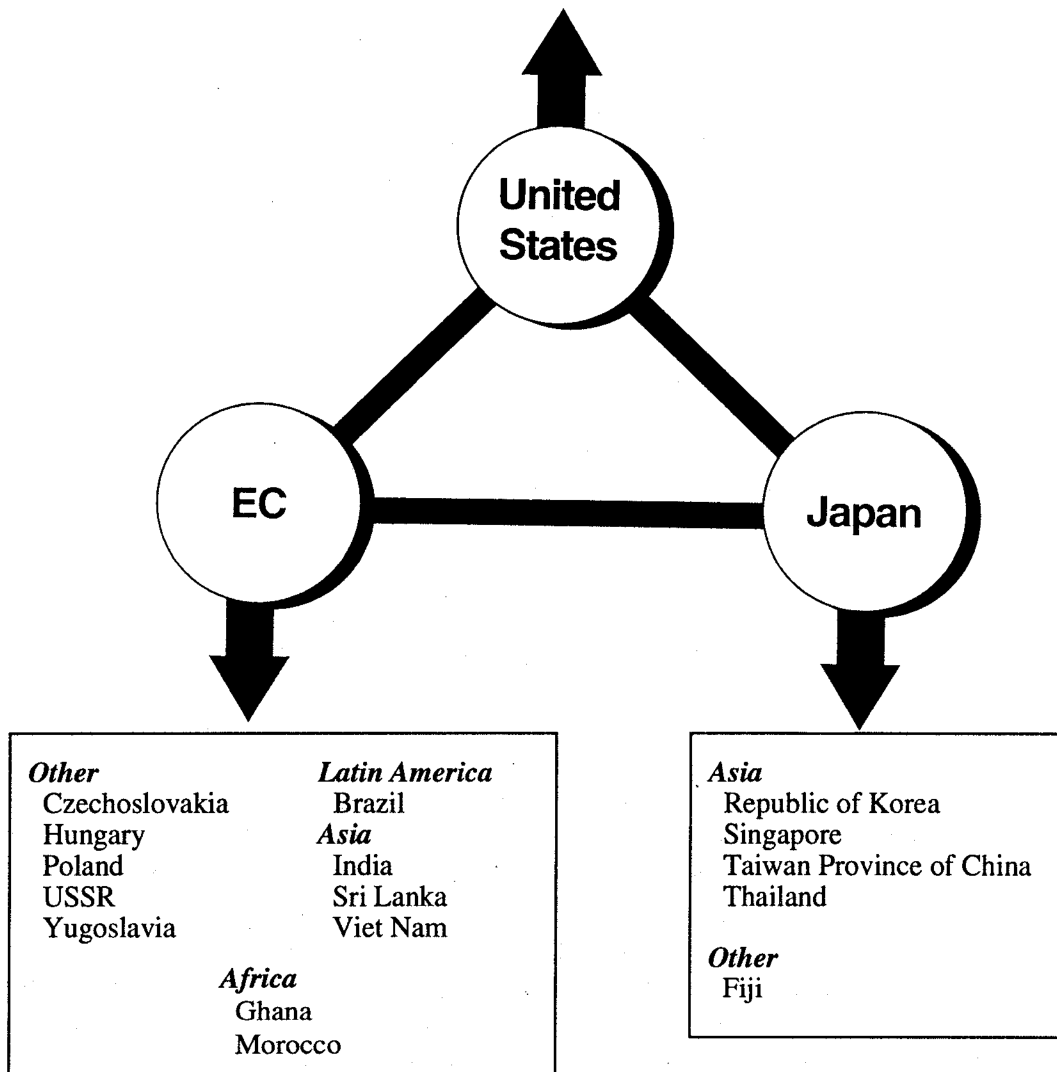
C. Foreign-direct-investment clusters of the Triad members and newly industrializing economies

The clustering of Central and Eastern European and host developing countries around one or more Triad members, as determined by FDI stocks and flows, was discussed for the first time in the *World Investment Report, 1991*, which found that, from the perspective of a large number of host countries, most FDI originates from one or more Triad members. It was also found that, between the early and late 1980s, the clustering of FDI had become more pronounced, with host countries tending to be clustered around a single Triad member located in the same geographical region. That pattern was consistent with the emerging strategies of TNCs to build regional core networks of affiliates centred on their home country.

Updating FDI stock and flow data to 1989 shows that the pattern is not significantly different from that which was described in the *World Investment Report, 1991* (figure I.4 and annex table 3). The distribution of host countries around Triad members shows that the United States continues to be the dominant investor in most Latin American countries and in a few Asian countries. In terms of FDI flows, which better than stocks reflect recent shifts, the position of Japan as a source of FDI for Asia was further strengthened as Singapore and Taiwan Province of China were added to its cluster. The European Community continues to be the dominant investor in Central and Eastern Europe, Africa and a few Asian countries, where its member countries have strong historical ties. The newly industrializing economies continue to be dominant in China and in a few other Asian countries; the number of countries in that

Figure I.4. Foreign-direct-investment clusters of Triad members, 1986-1989
(Economies in which one Triad member dominates
average annual investment inflows)

Latin America		*Asia*	*Other*
Argentina	Guatemala	Bangladesh	Papua New Guinea
Bolivia	Mexico	Pakistan	Saudi Arabia
Chile	Panama	Philippines	
Colombia	Paraguay		
El Salvador	Venezuela		



Source: Annex table 3, based on Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992).

cluster might be expected to increase in view of the fact that Taiwan Province of China was the largest source of FDI in Indonesia and Viet Nam in 1991.[36]

The stability of the pattern described above is not surprising. Adding two years to FDI flows and stocks is not likely to alter significantly the relationship between host countries and Triad members. The most notable observation is the continuing consolidation of Japanese TNCs in Asia. The observed pattern reflects the regional core network strategies of Japanese TNCs, a phenomenon that is likely to become more visible for TNCs from the United States and the European Community, respectively, in South America and Central and Eastern Europe. Moreover, there is evidence that TNCs from each Triad member are expanding their FDI in the host countries clustered around the other Triad members, in order to remain competitive throughout the Triad. To a certain extent, this is a response to growing regional links and to the impending formation of trade and investment blocs in Latin America (NAFTA) and Europe (EEA). Transnational corporations from the newly industrializing economies are pursuing similar strategies, as evidenced by their investments in Latin and Central America (especially in Mexico) and in Central and Eastern Europe, in order to ensure access to the markets of the United States and the European Community. The trend of TNCs from one Triad member investing in countries clustered around another Triad member is likely to continue as efforts towards regional integration become stronger. One implication of that might be the weakening of the pattern of FDI clusters of host countries around a single Triad member and an increase in the incidence of shared dominance by two Triad members.

D. Regionalization: issues and analysis

1. Policy-led versus investment-led integration

The regionalization of FDI in developing countries centred around a single Triad member described above underlies, to a certain extent, the acceleration of regional economic integration, particularly in North America, Europe and Asia. An analysis of trading patterns in the 1980s reveals that trade within regions has outpaced world trade to a large extent; intraregional trade in goods now accounts for 61 per cent, 41 per cent, and 35 per cent of the total trade in goods of the European Community, Asia and North America, respectively.[37] It is likely that there is a close relationship between the growth of intraregional FDI and rising intraregional trade. More specifically, the strategies of TNCs to build regionally-integrated, independently sustainable networks of overseas affiliates around each of the three poles of the Triad is likely to be an important factor in the growth of intraregional trade. In recent years, for example, intra-EC FDI has grown faster than intra-EC trade and, by 1988, EC countries themselves accounted for one third of the EC's total outward FDI, up from one-quarter in 1980.[38] In the Asian region, intraregional trade (including Japan) has grown by 23 per cent a year during the period 1986-1989.[39] Much of this growth is likely to have been driven by rapidly rising intra-Asian FDI, which grew even faster, at about 25 per cent a year in terms of stock in the 1980s. In many Asian countries, as noted earlier, FDI from other Asian countries (including Japan) now accounts of upwards of 50 per cent of total

inward FDI. In North America, the United States accounts for about two-thirds of total Canadian outward FDI stock and, reflecting the relative size of their economies, Canada accounts for one-fifth of total United States outward FDI. [40] Clearly, the investments that flow within a region are a key element in understanding the nature and extent of economic integration in that region. While current moves towards regional integration are occurring more or less simultaneously, they differ in several respects, among which is the relationship between integration at the policy level and integration at the production level. Differences in respect to that relationship may be critical in determining the ultimate success of an integration effort. Hence, it is useful to examine integration efforts from that perspective, in order to understand current trends in the area of regionalization, the role of TNCs in those trends and the potential for success of integration agreements. [41]

Most integration programmes aim at improving the economic performance of their member States by providing them, at the very least, with increased opportunities for trade and stimulating greater economic competition. In addition, regional integration is often meant to encourage firms to expand their operations in the region so as to attain economies of scale which may have been constrained by the small size of domestic markets. As firms expand across national borders, intraregional FDI flows increase, as do the trade flows associated with it. The result is integration at the production level.

The development of a regional production system based on intraregional FDI requires a far greater degree of policy co-ordination between States than does increased intraregional trade. Regional trade integration involves mostly the liberalization of barriers to cross-border flows of goods and services; it remains, therefore, relatively "shallow". Regional production integration goes beyond trade integration and extends to the liberalization of barriers to cross-border flows of capital, technology, skills and, to some extent, people; it is, therefore, relatively "deep". More specifically, the policies that allow for such movements go much further in integrating national economies and regulatory systems than policies designed to support intraregional trade, since adjusting to a regional production system implies harmonizing (or, at least, recognizing and coordinating) a wide range of national practices and policies, rather than only liberalizing trade. Indeed, policies to promote a regional production system may extend to the harmonization of fiscal, monetary and industrial policies among member countries and the adoption of common standards in a variety of fields, such as labour, health and safety. It appears that successful regional integration involves a combination of integration at the levels of both policies and production. However, many regional integration programmes fail to reach this stage of deep integration, that is, a regionalized production system governed by a regional policy framework, and, therefore, often do not last.

Policy-led integration programmes are those in which initiatives at the policy level initiate the economic integration of participating States. Typically, the policy measures focus on reducing barriers to trade among member States, usually by liberalizing trade between member countries, to create a free trade area and, if a customs union is formed, by adopting common external trade policies *vis-à-vis* third countries. Integration policies may go even further towards harmonization, if a given level of cross-border trade has already been reached. The essential characteristic of such integration efforts is that the institutional framework for integration precedes actual integration at the production level.

In contrast, FDI-led integration (or TNC-led integration) occurs when the activities of firms, not policies, serve as the principle drivers of regional integration, that is, TNCs perceive advantages to integrating their operations across countries in the region. Such advantages may include country and process specialization, and the economies of common governance over a set of geographically-dispersed activities. While liberal trade policies may encourage firms to implement regional strategies (which often entail intra-firm, intraregional trade), such integration may also occur in the absence of specific regional integration policies. In other words, the integration of States in a region may be thought of as originating from one of two possible starting points: from the regional integration policies of States or from the regional integration strategies of TNCs—assuming, of course, an overall enabling framework.

In practice, the line between policy-led and FDI-led integration is not so sharp. As noted above, policy-led integration is often geared towards promoting intraregional trade in the initial phases of an integration process, by reducing trade barriers. Once a given level of intraregional trade has been reached, firms within the region may adjust to the larger market by making cross-border investments, thus beginning to form a regional production system. Indeed, a minimum level of cross-border trade within a region is likely to be necessary before intraregional FDI flows begin to grow. At some stage, however, the efforts of firms to create efficient operations on a regional scale may be hampered by the lack of an appropriate regional policy framework. For example, non-tariff barriers (such as different national technical standards) may block attempts to integrate production at a regional level. Furthermore, disputes may arise between member States regarding the treatment of firms that have established regional operations. Thus, the degree of production integration already achieved may create pressures to deepen the integration programme at the policy level to bring about an environment that would allow for further integration at the production level. Regional policies at this stage may cover such areas as harmonized standards *vis-à-vis* firms and their output, a common company law and even closer integration of fiscal and monetary policies. In this manner, policy-led integration triggers a process of FDI integration, which in turn leads to further integration measures at the policy level. Thus, while it is difficult to classify regional integration efforts as being purely policy-led or FDI-led (most tend to fall between the two extremes) the ways in which integration programmes evolve have different implications for the subsequent degree and nature of regional integration.

An examination of various regional integration policies sheds light on the relationship between policy-led and TNC-led integration. The 1989 United States-Canada Free Trade Agreement provides an example in which early integration measures (such as the Automotive Pact) and years of intraregional tariff-lowering led to a large degree of integration at both the trade and the production levels. Indeed, trade in automobiles was low before the 1965 Automotive Pact removed tariffs on automobiles between the two countries; thereafter, automotive trade, most of it intra-firm, grew rapidly, as did flows of FDI in the industry. Furthermore, tariffs between the two countries had been substantially lowered even before the 1989 Agreement, and there was already a great deal of FDI between Canada and the United States. However, it was argued that firms were unable to reap the full benefits of cross-border integration because of the lack of a policy framework which would assure an open trading environment and closer policy coordination between the two countries. The 1989 Agreement thus promoted further TNC integration by including many FDI-related issues, such as national treatment, performance requirements, screening

procedures and FDI and trade in services. The signing of a bilateral agreement in and of itself signalled to firms that their integration across national borders would be assured in the long term. Similarly, in the case of the current integration efforts between the United States and Mexico, there has also been a significant degree of pre-existing integration at both the trade and production levels (see the section 2(a) below on NAFTA). Any agreement which emerges, therefore, is likely to focus explicitly on ratifying current integration at the production level, and promoting increased FDI in the future. It is thus likely that the current activities of TNCs will play a significant role in determining the outcome and eventual success of the agreement.

The European Community presents an interesting case of the relationship between policy-led and FDI-led integration. In that case, early policy efforts (beginning in 1957 and continuing until about 1985) focused mainly on removing intraregional barriers to trade, although the right of establishment and national treatment were early principles governing Community relations (largely excluding, however, services industries). Indeed, intraregional trade did grow rapidly following the formation of the Common Market. At the same time, integration at the production level also occurred, but the primary actors in that process were, for a variety of reasons, United States manufacturing TNCs; many TNCs from the Community remained relatively national in orientation. A major aim of the 1992 Single Market programme was to address this imbalance, by promoting region-wide integration at the production level by Community TNCs in both the industrial and the services sectors. In particular, the 1992 Single Market programme included, for the first time ever, an extensive opening up of services markets to FDI, thus permitting regional strategies by transnational services corporations. Not surprisingly, therefore, major Community TNCs were among the key proponents of the 1992 programme during its inception period, precisely because they perceived their international competitiveness to be hampered by the lack of a unified regulatory regime in their home region. Some of the policy measures taken encouraged a regional production system directly (that is, by adopting a system to develop EC-wide industrial standards and adopting an EC-wide competition policy), while others encouraged regionalization of production indirectly (by, for example, harmonizing certain fiscal policies and placing limits on government subsidies to firms and industries). Through those and other measures, the 1992 Single Market programme—the best example of far-reaching integration at the policy level—facilitated intraregional FDI flows and encouraged the further regionalization of production, as witnessed by the rapid growth since 1985 of intra-EC (mostly services) FDI. The case of EC, therefore, represents a situation in which early moves in the policy arena triggered economic integration in the area of trade and FDI, which in turn promoted further policy measures to facilitate integration of member States at the production level. As a result of this process, which has been evolving for over three decades, the Community represents a case of deep integration, in which regional (rather than national) economic policies and a regional (rather than national) production system are beginning to dominate.

The admission of the EFTA countries into the framework of the European Community through the creation of the European Economic Area (EEA) is another case of deep integration (box I.5). In the area of trade, the Community is the largest trading partner of EFTA, accounting for 58 per cent of the latter's exports and 61 per cent of its imports in 1990.[42] Similarly, EFTA is the largest trading partner of the Community, accounting for about one quarter of the latter's imports and exports (excluding intra-EC

trade). Regarding FDI, EFTA countries are rapidly integrating their economies with the EC, although the reverse may not be the case. Average annual FDI outflows from EFTA to the EC during the period 1985-1987 were 38 per cent of the former's world-wide outflows; that share rose to 56 per cent in 1988 and to 69 per cent in 1990 (the latter figure represents Sweden and Switzerland only). On the other hand, average annual FDI outflows from EC to EFTA between the periods 1985-1987 and 1988-1989 rose from 5 to 6 per cent of world-wide outflows from the former (most FDI from the EC goes to the United States and to the EC itself). [43] From a host country perspective, however, the EC is the dominant foreign investor in EFTA countries, accounting from 38 per cent of total inflows to EFTA in the period 1985-1988. The 1992 programme has prompted a great deal of FDI, both offensive and defensive, from

Box I.5. The European Economic Area

In late 1991, the countries of the European Free Trade Association (EFTA) and the EC concluded negotiations to create a "European Economic Area" (EEA), with an agreement scheduled to enter into force on 1 January 1993. [1] Even before the new agreement, free trade in goods had been established between the two groupings following the creation of a free trade area in 1972. The EEA agreement creates, among other things, a single space for intra-European FDI flows, and it is likely to encourage further integration between EFTA and the EC at the production level.

Under the framework of the EEA, EFTA countries will join the EC internal market by removing a variety of mostly non-tariff barriers to the intraregional flow of goods, services, capital and people, to create a common economic space of approximately 380 million people in 19 countries. In addition, the EFTA countries will participate in a number of EC regional programmes and projects, such as those in the areas of research and development, the environment and education. The EFTA countries will also be able to participate on an expert level in the formulation of new legislation in relevant areas ("decision shaping" as opposed to the formal "decision making").

Despite their participation in the single market, EFTA countries will not take part in several key policy areas. Specifically, EFTA will not adopt EC's external policies *vis-à-vis* third parties (including the common trade policy and development cooperation), nor will it entail economic, fiscal and foreign policy coordination. EFTA will also be excluded from the common agricultural and fishery policies of EC.

The EEA agreement contains a number of provisions that will have a direct bearing on FDI. It establishes provisions for the free movement of capital, by removing all remaining restrictions and regulations relating to payments, investments, capital-market flows and other types of capital movements, although the EFTA countries have been allowed a safeguard clause to limit capital movements temporarily in the event of serious imbalances. In that area, the EEA framework goes further than the OECD Codes on the Liberalisation of Capital Movements because it provides for complete elimination of restrictions by all signatories, whereas the OECD Codes basically provide for a standstill and contain only a political commitment to further liberalisation (rollback).

Closely linked to capital movements are the rights of establishment and national treatment. The EEA agreement will require EFTA countries to adopt a number of EC Directives to replace regulations and controls

/.....

EFTA members (particularly Sweden). Under the framework of the EEA, further production integration between the two groupings will be encouraged, as FDI flows between them are being liberalized.

An example of TNC-led integration is currently under way in the Asian region, even though initiatives at the level of regional policy have been relatively weak. Intraregional FDI and trade are significant, and regional core networks of TNCs centred on Japan have emerged. The openness of Asian trade regimes and the complementarity of their economies explain in part the dynamism of intra-Asian FDI. A certain degree of regional production integration appears to be beginning in the absence of a regional policy framework. At some stage, however, further production-level integration in Asia may be hampered by the lack of a regional policy framework that would ratify the integration that has been taking

(Box I.5, cont'd)

that had earlier constituted barriers to the right of establishment. EEA companies will be free to establish subsidiaries, branches and agencies in all other EEA countries, whether through new investment or acquisition, and will be granted the same treatment as accorded the host country's citizens. In this context, the agreement allows EEA business persons and companies to buy real estate for the purposes of their activities, including forests and other natural resources.

In the area of services, the agreement provides for national treatment for service companies throughout the EEA. This is likely to increase the flow of cross-border FDI in the services sector. In the area of financial services, a certain minimum EEA-wide harmonization of legislation has been established. Apart from that, affiliates of EEA based transnational banks, insurance companies and securities firms in the EEA will be subject to the rules and regulations of their home, rather than their host country, in areas such as disclosure of information and required equity ratios.

Cross-border flows of FDI in services, many of which rely on specialized personnel, will be assisted by the mutual recognition of diplomas and certificates, along with the free movement of persons. Under these measures, a person from any EEA country has the right to move between, to work and to live in, all other EEA countries. The labour market will be governed by common elements regarding the social security system.

Finally, the EEA will indirectly affect FDI by extending the competition policy of EC to the whole EEA territory. For that purpose, a new regional institution, the EFTA Surveillance Authority, will be created. Under this framework, the two surveillance authorities have, among other things, the right to examine and eventually block a merger that they deem to affect competition in the EEA if the total turnover of a combined business entity exceeds a certain amount (at present, 5 billion ECUs).

In sum, the EEA provides for a liberal FDI regime that eliminates a number of barriers to the movement of factors of production, including capital and labour. Such liberalization is likely to contribute to a further expansion of FDI flows within the EEA and to result in an even deeper integration at the production level across Western Europe.

---

1 EFTA members are Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, Switzerland. The agreement was signed on 2 May 1992. Before entering into force in 1993 the agreement will have to be ratified by Parliaments in all signatory States as well as the European Parliament.

place and that would allow for further intraregional activity; indeed, signs of such efforts have become visible in recent years. The resulting framework would bring into balance TNC-led integration efforts with the policy framework and advance deep integration among member countries, going beyond harmonization of trade policies to extend to a broad range of national regulatory areas.

In contrast to the above examples, many integration efforts among developing countries, both past and ongoing, are primarily policy-led. At best, they occur in the context of weak intraregional trade flows; and typically they involve very little FDI. It is unlikely that, in the absence of underlying integration at the production level, integration policies will lead to a unified regional economy. Such regional groupings would have to consider national policies to promote increased cross-border investment as a precondition for lasting deep regional economic integration.

2. Foreign direct investment and regional integration in North America: the possible impact of a North American Free Trade Agreement

(a) Foreign direct investment-led integration in North America

A rapid process of regional economic integration is taking place in North America, with TNCs at the forefront. In January 1989, the United States and Canada entered a Free Trade Agreement, which removes the remaining barriers to the free movement of goods and services between the two countries. The United States, Canada and Mexico are presently negotiating a North American Free Trade Agreement (NAFTA) under "fast-track procedures".[44] The NAFTA negotiations may be a first step in the eventual creation of a Western Hemisphere free trade zone extending from Alaska to Tierra del Fuego, envisioned in the "Enterprise for the Americas Initiative" proposed by the United States. To that end, the Government of the United States has already signed bilateral trade and investment framework agreements with twelve Latin American States.[45] Even though these agreements do not contain substantive trade and investment provisions, they represent a starting point for future substantive bilateral arrangements which, together, could lead to a regional framework centred on the United States. They may become particularly important if the Uruguay Round will not be concluded successfully.

When assessing the likely impact of a NAFTA agreement on economic integration between Mexico and the United States, one has to bear in mind that substantial economic integration already exists between the two countries, similar to what existed between the United States and Canada before their 1989 Agreement. Regional integration in North America can, therefore, be characterized as being primarily FDI-led rather than policy-led. Indeed, a great deal of TNC-led integration occurred between the United States and Mexico during the 1980s, whereas policy integration has only become an issue in the past two or three years. On the level of trade, Mexican exports to the United States increased by 70 per cent from 1982 to 1990, excluding exports from the *maquiladora* industries. By 1990, 71 per cent of Mexico's exports were destined for the United States (against 53 per cent in 1982). Exports from the United States

to Mexico increased by 105 per cent in the same period, from 6 to 7 per cent of total United States exports.[46]

The growing trade integration between the two countries is largely prompted by FDI.[47] From 1982 to 1989, United States affiliates operating in Mexico increased their share of Mexican exports to the United States nearly fourfold, to over one-quarter of total (table I.9). At the same time, the proportion of United States affiliates in Mexico's imports from the United States increased to over 40 per cent. Nearly all of that trade is on an intra-firm basis. Much of that increase was due to a more liberal trading environment, but policies in this regard were of a global nature rather than couched specifically in the context of a regional integration programme. As early as the 1970s, United States TNCs in the automobile industry increased their intra-firm exports from Mexico to the United States. However, it was not until trade was liberalized between the two countries in 1984 that such exports expanded rapidly, to be followed by further trade policy liberalization in 1989.

Thus, the trade of United States affiliates operating in Mexico with the United States is almost entirely intra-firm, that is, between affiliates and their parent companies, indicating that many United States-based TNCs have integrated their operations across the United States-Mexican border during the 1980s. Indeed, the fact that United States affiliates account for a growing share of Mexico's exports to the United States is a result of both new export-oriented greenfield investments in Mexico by United States

Table I.9. Mexico-United States trade, by United States affiliates in Mexico, 1982 and 1989[a]
(Millions of dollars and percentage)

Item	*1982*	*1989*
Mexican exports to the United States	11 315	15 776
of which: Exports by United States affiliates (Percentage of total Mexican exports to the United States)	774 (7)	4 268 (27)
of which: Intra-firm exports to the United States parent (Percentage of total affiliate exports to the United States)	727 (94)	4 198 (98)
Mexican imports from the United States	8 959	15 755
of which: Imports by United States affiliates in Mexico (Percentage of total imports from the United States)	2 328 (26)	6 640 (42)
of which: Intra-firm imports from the United States parent (Percentage of total affiliates' United States imports)	2 095 (90)	5 996 (90)

Sources: Comercio Exterior, vol. 6, No. 11 (February 1984) and vol. 41, No. 4 (April 1991); United States, Depatrment of Commerce, *U.S. Direct Investment Abroad: 1982 Benchmark Survey Data* (Washington, D.C., 1985), tables III.E.1., III.E.4., III.G.3. and III.G.5.; and *U.S. Direct Investment Abroad: 1989 Benchmark Survey, Preliminary Results* (Washington, D.C., 1991), tables 40, 42, 68 and 69.

a Excludes trade relating to *maquiladora.*

TNCs, as well as the restructuring of existing United States affiliates in Mexico towards a greater emphasis on exports. This is reflected in the fact that the export propensity of United States affiliates operating in Mexico has increased from 7 per cent in 1982 to 26 per cent of sales in 1989.[48]

A number of non-United States TNCs are also increasingly utilizing their Mexican affiliates to supply the United States market.[49] In the automobile industry, for example, Volkswagen decided that, from 1990, the successor to the Golf and Jetta models would be exported exclusively to the United States from its Mexican plant. Nissan has announced that, from the summer of 1992, the company will ship 200,000 engines a year to the United States from its Mexican subsidiary.

The booming *maquiladora* industry along the Mexican—United States border is another indication of FDI-based economic integration between the two countries. (The *maquiladora* programme allows foreign investors to set up in-bond assembly plants in Mexico; United States tariffs are only paid on the value-added generated in Mexico, if the products assembled originate from the United States.) From 1986 to 1988, *maquiladora* exports nearly doubled, from $5.6 billion to $10.1 billion, and their value-added increased from $1.3 billion to $2.3 billion. If NAFTA reaches an accord on duty free access of goods between Mexico and the United States, and Mexico further eases restrictions on FDI, there would be no need for a continuation of the *maquiladora* programme in its present form.

The above discussion underlines that, by the time moves on the policy level were taken for a NAFTA, TNCs had already engaged in a substantial amount of cross-border regional production integration an example of TNC-led integration. As such, the policy framework that is emerging is likely to ratify and advance the integration that is already taking place at the level of production. The following section examines how this process is currently occurring, and analyses the possible impact of a NAFTA on economic integration in the region.

(b) The possible impact of a North American Free Trade Agreement

A NAFTA would, above all, establish a firm and stable framework within which trade and FDI could prosper. At the same time, it would further strengthen the pre-existing process of regional economic integration through FDI. The NAFTA negotiations are taking place under six headings: market access, trade rules, services, investment, intellectual property and dispute settlement.[50] In the area of trade, the incentive for the United States to enter a NAFTA agreement with Mexico is to achieve rapid export growth in areas in which Mexico still has trade protection or high tariffs. While the United States is relatively open to Mexican exports, the average Mexican tariff is 12.5 per cent, with maximum rates of 20 per cent, and other products under quota (such as electronic equipment, automotive products, steel, textiles and services).[51] Given the low level of Mexican tariffs, the principal aim of NAFTA is to facilitate the rationalization of production by TNCs by providing a stable regulatory framework and access to the North American market. To that end, a NAFTA will create new investment opportunities in Mexico that will allow North America-based TNCs to further gear their production in Mexico towards serving the North American market. Mexico offers low-cost and high-quality labour, which could improve the international competitiveness of United States and Canadian TNCs. By further liberalizing trade in a

regional policy framework, NAFTA would allow North American TNCs that have not yet already done so to incorporate their Mexican affiliates into a regional network strategy, which entails a significant amount of cross-border trade. Such a free trade arrangement could raise the locational advantages of Mexico as a host country for a number of activities, and could result in a shift of some investment in Asia aimed at sourcing of labour-intensive products and components to North America. In one recent example, the Zenith Electronics Corporation, a TNC from the United States producing television sets, announced that it will close down its manufacturing facilities in Taiwan Province of China, and move the production to Mexico. The move may be explained by lower labour costs in Mexico and the prospects of NAFTA. [52]

NAFTA could attract FDI not only from the United States and Canada, but also from Europe and Asia. The agreement, depending on how it is structured, could provide non-United States TNCs with an important incentive to build an export capacity in Mexico, as it would assure long-term, duty-free access to the United States market. In that respect, one of the key issues in the negotiations related to FDI concerns rules of origin and local content, which set the minimum amount of North American value-added to qualify for duty-free status. On this issue, pre-existing regional economic integration at the production level is affecting the shape of integration at the policy level, and thus is an illustration of TNC-led regional integration influencing subsequent integration policies. In the automotive industry, the three United States car manufacturers, all of which already operate in Mexico (General Motors, Ford and Chrysler), are promoting local-content requirements of 60 to 70 per cent for goods in this industry to qualify for duty-free access to the NAFTA countries. That would place most European and Asian car manufacturers in a disadvantaged position because they would not be able to rely on sourcing from their home countries in order to qualify for duty-free status in NAFTA. However, in more globalised industries, such as the electronics and business-equipment industries, United States TNCs are *not* in favour of high local-content requirements, because they source many of their parts and components outside of North America. [53] While high local-content requirements could discourage foreign investors in some industries from establishing themselves in North America, such requirements might benefit Mexico if they served to attract additional FDI; they might also ensure that foreign investors do not only locate assembly ("screwdriver") activities in Mexico.

Apart from high local-content requirements, United States car manufacturers are also urging that separate rules should apply to firms already established in Mexico versus rules applying to newcomers. [54] They have suggested that, for the five companies with Mexican plants, cross-border tariffs should be eliminated immediately and the local-content requirements reduced. Newcomers to Mexico, however, should comply with the existing tariffs and local-content requirements for the next five years, with the existing barriers to be lowered gradually over a 10-year period.

To date, moves towards NAFTA appear to have already increased the locational advantages of Mexico. However, the expansion of FDI in 1990 is largely owing to increases in portfolio investment following the liberalization of the foreign investment regulation in May 1989, which eased restrictions on foreign participation in the Mexican stock market. Despite the fall in FDI inflows in 1990, the upward revised plans of United States affiliates to increase capital spending in Mexico point to the growing attractiveness that country has for FDI. German TNCs have also pledged large investment projects in

Mexico: Hoechst has announced that it will invest $800 million in a Mexican petrochemical plant; Mercedes-Benz is considering building an assembly line for luxury cars in Mexico; and other German companies plan to invest $600 million in the tourism industry.[55] Volkswagen, which (as mentioned above) had already planned to make Mexico its production location for the Golf and Jetta models, recently announced that it would increase its Mexican production capacity by 60 per cent, to 390,000 cars a year by 1994.[56] Nissan plans to invest $1 billion in its plant, which supplies both the Mexican and United States markets, while other Japanese automakers which do not already have Mexican operations, are waiting for the outcome of the NAFTA negotiations before considering investments in that country.[57]

Closer economic integration in the region is also likely to increase Mexican investment in the United States in industries in which Mexican firms enjoy comparative advantages. Some of the large Mexican conglomerates, like Vitro (glass) and Cemex (cement), are building production plants in the United States in order to expand into that market. With sales reaching $2.5 billion in 1990, Vitro is one of the world's leading glass container manufacturers. In 1990, Vitro consolidated its position in the United States market by acquiring Anchor Glass Container and Latchford and, in 1991, the company entered an agreement with Corning, the United States glass group, to form an $800 million joint venture for consumer housewares.[58] Such investment in the United States by Mexican firms is likely to increase if NAFTA opens up the Mexican market to increasing competition, which may induce Mexican firms to invest directly in the United States.

3. Regional integration in the 1990s: building blocs or stumbling blocs?

The accelerating trend towards regionalization has raised concerns that new regional groupings might pose a threat to the GATT principles of an open, multilateral trading system and replace it with a small number of large, relatively closed regional blocs. Policies such as rules of origin, managed trade arrangements and harmonization of standards may be constructed in such a way as to discriminate against countries not included in an integrating region. Regional blocs may thus deviate from principles contained in the GATT framework, which seek to promote liberalization on a multilateral basis, thus allowing countries to benefit equally from reductions in trade barriers. Hence, regional integration programmes in EC and North America are sometimes viewed as "stumbling blocs" for the multilateral system.

In the area of FDI, however, no multilateral framework exists to provide a benchmark from which to deviate and against which to judge policy changes in the context of regional integration. In the context of FDI, therefore, regional integration programmes may be seen as building blocs towards a multilateral system, since they combine the regulatory FDI regimes of individual countries; in fact, deep integration, as described above, entails a certain amount of harmonization of policies and practices regarding TNCs. At a minimum, national treatment—a principle often contained in free trade arrangements—ensures that firms from one member country will be granted the same treatment as domestic firms, while national regulatory environments may still remain quite different in other respects. Deep integration will often go further and entail the harmonization policy regimes of member countries. Such policy convergence among groups of countries may be achieving at a regional level what has not yet been achieved at an

international level, namely, an agreed set of principles and norms that govern the international activities of firms. Achieving cooperation among a small number of regional groupings is likely to be more feasible than among a large number of countries with very different regulatory regimes.

Regional integration may also exert pressures on non-member countries to bring their policies in line with those adopted by regional members. This is particularly true of countries which may ultimately wish to join an integrated grouping, such as EFTA and Central and Eastern European countries *vis-à-vis* EC, and Central and South American countries in regard to NAFTA. Other countries, too, may find it necessary to move towards the policy standards adopted by regional groupings with which they have significant economic relations, in order to maintain and deepen economic ties with the integrating region. It may well be that regional integration presents a challenge to the multilateral system in the area of trade; but in the context of FDI, regionalisation may serve as a first step towards creating such a system.

Finally, the increasingly global activities of TNCs may also exercise certain pressures to harmonize FDI policies on the global level, stemming from the fact that TNCs are engaged in extensive FDI across regions in addition to increasing FDI within them. For example, TNCs from the European Community have invested more in the United States than they have in other EC countries, while Japanese TNCs invest more in the United States and Europe than they do in Asia. Such activity is leading to increasing economic integration on a global level, such that production systems are in some cases extended not only within regional boundaries but also across regional blocs. Just as FDI-led regional integration creates pressures for the emergence of regional policy frameworks, FDI-led global integration may increase pressures to harmonize policies across regional blocs. In particular, competition policy is likely to need to converge to some extent in order to reflect the impact of competitive conditions in one region on those of another. In other words, TNC-led integration is not confined to a regional context only, but may, increasingly, extend to the multilateral level. Regarding developing countries, globalisation may increasingly place pressure on many of them to bring their policy frameworks in line with those of developed countries, in order to increase their participation in the international economy. The strong trend towards the liberalization of many developing countries' policy frameworks, documented in chapter III, may in part be a result of that process. In the future, developing countries may have to go beyond liberalization and increasingly align their policy frameworks and national standards with those of developed countries in order to keep pace with the increasing globalisation of economic activity. The growing international interdependence brought about by globalization may thus provide the basis for increasing convergence and harmonization of policies on a multilateral level.

E. Conclusions

The continued growth of world-wide FDI flows in 1990, while at a rate below that of the late 1980s, occurred in a context of reduced economic growth in a number of large economies. The willingness of TNCs to expand investment despite a slow-down in profits and adverse economic conditions attests to the increasing global nature of business operations, which, at least to a certain extent, are becoming

somewhat less dependent on the performance of specific markets. It is not clear, however, how robust this willingness is, since FDI flows have declined in 1991. Nevertheless, the rapid growth of FDI during the second half of the 1980s has made TNCs central actors in the world economy.

While FDI continues to be concentrated in the developed market economies, and especially within the Triad members, the continuous growth of FDI in developing countries in Asia and, more recently, the increase of FDI in Latin America and the Caribbean, is an important development. In addition, a number of developing countries in Asia are themselves becoming important home countries to TNCs. Foreign direct investment in the countries of Central and Eastern Europe continues to grow, but FDI to Africa and to the least developed countries continues to stagnate. The pattern of distribution of host countries, whereby host developing, Central and Eastern European countries are clustered around a single Triad member located in the same geographical region, remains stable. That pattern underlies the FDI-led integration of international production in North America and Asia, which strengthens initiatives for the formation of regional blocs in those regions. In this context, NAFTA as an example of the emerging policy framework strengthening the pre-existing integration at the production level led by TNCs. NAFTA is likely to increase investment in Mexico from United States TNCs seeking to rationalize production further and from European and Asian TNCs seeking access to the North American market.

Notes

[1]Jim Carlton, "Outlook for Japanese spending on U.S. real estate is bleak", *The Asian Wall Street Journal Weekly,* 6 January 1992; "Japanese investment in Midwest increased in slower pace in '91", *The Wall Street Journal,* 7 February 1992.

[2]A reduction in inter-company loans between United Kingdom TNCs and their foreign affiliates accounts for much of the decline in FDI outflows from the United Kingdom. Some of those changes may reflect United Kingdom firms disinvesting from foreign affiliates in response to home country financial difficulties. See Bank of England, *Quarterly Bulletin,* vol. 31 No. 4 (November 1991), p. 529.

[3]Eduardo Lachica, "European firms slow investment activity in U.S.", *The Wall Street Journal,* 24 September 1991. In this context, a period of recession is defined as two consecutive quarters of decline in real GNP.

[4]See DeAnne Julius, *Global Companies and Public Policy* (London, Pinter Publishers, 1990), and "Foreign direct investment: the neglected twin of trade", Group of Thirty, Occasional Paper No. 33 (Washington, D.C., Group of Thirty, 1991). Julius found a positive correlation between real growth of FDI and real growth of GNP over the period 1963-1988 for France, the Federal Republic of Germany, Japan, the United Kingdom and the United States, taken together. She also found that the volatility of FDI was three to four times higher than that of GNP. Actual FDI growth during the period 1983-1989 was six to eight times higher than that of GNP, suggesting that factors besides the economic recovery in those countries after the recession of the early 1980s played a role.

[5]William Dawkins, "Groups pause for reflection", *Financial Times,* 22 October 1990.

[6]Investment outflows grew substantially in certain industries. For example, outflows from the United States into communications and public utilities and in business services increased considerably between 1989 and 1990, reflecting long-term factors influencing the decisions of TNCs to invest abroad.

[7]Committee for the Study of the Causes and Consequences of the Internationalization of United States Manufacturing, *The Internationalization of U.S. Manufacturing: Causes and Consequences* (Washington, D.C., National Academy Press, 1990). As an illustration, United States outflows in 1990 (a year of recession) at $29 billion were the same as in 1989.

[8]For a discussion of the role of TNCs in natural resources and services see, respectively, Bruce McKern, ed., *Transnational Corporations and Natural Resources. United Nations Library on Transnational Corporations* (London, Routledge, forthcoming), and Karl P. Sauvant and Padma Mallampally, eds., *Transnational Corporations and Services. United Nations Library on Transnational Corporations* (London, Routledge, forthcoming).

[9]For a detailed overview of FDI trends in developed market economies, see Transnational Corporations and Management Division, *World Investment Directory 1992: Developed Countries* (New York, United Nations, 1992).

[10]Randall Smith, "French firms pass British, Japanese as leading acquirors of U. S. concerns", *The Wall Street Journal*, 24 April 1991.

[11]Dennis M. Engbarth, "Japanese investment drops, hitting US the hardest", *Business International*, 22 July 1991; Edward Balls, "Expansion abroad curtailed", *Financial Times*, 15 July 1991; "Japan foreign investment falls", *The Wall Street Journal*, 3 June 1991; and Stefan Wagstyl, "Japanese overseas investment in first fall since 1983", *Financial Times*, 4 June 1991.

[12]Dennis J. Encarnation and Mark Mason, "Neither MITI nor America: the political economy of capital liberalization in Japan", *International Organization*, vol. 44, No. 1 (Winter 1990), pp. 25-54.

[13]Robert Taylor, "Sweden eases foreign ownership restrictions", *Financial Times*, 29 October 1991; John Burton, "Sweden to lift curbs on foreign ownership", *Financial Times*, 13 February 1991; Enrique Tessieri, "Finns to clear path for foreigners", *Financial Times*, 14 February 1991; Charles Leadbeater, "Politicians follow where business has been forced to tread", *Financial Times*, 23 October 1991.

[14]For a detailed overview of FDI trends for Asia and the Pacific, see UNCTC, *World Investment Directory 1992, Vol. I, Asia and the Pacific 1992* (United Nations publication, Sales No. E.92.II.A.11).

[15]According to *The Wall Street Journal*, FDI approved in the past two and a half years in China exceeded the total reached in the previous ten years ("China attracts investment", 10 March 1992). By the end of 1991, cumulative FDI in operation in China was about $23 billion, including joint ventures for oil exploration; Suman Dubey, "GE is raising level of business in India", *The Wall Street Journal*, 6 March 1992.

[16]For a discussion of the motives of Chinese TNCs to invest abroad, see Ye Gang "Chinese transnational corporations from Shanghai", *Transnational Corporations*, vol. 1, No. 2 (forthcoming).

[17]By 1990, cumulative investments in the manufacturing sector of Western Europe and North America by the Republic of Korea and Taiwan Province of China, were 47 per cent and 55 per cent of their respective total outward investments; the corresponding shares for the services sector were 39 per cent and 45 per cent, respectively. UNCTC, *World Investment Directory 1992, Vol. I, Asia and the Pacific* , op. cit.

[18]UNCTC, *World Investment Report, 1991: The Triad in Foreign Direct Investment* (United Nations publication, Sales No.E.91.II.A.12).

[19]Kim Soo Mi, "Auto makers in South Korea set plant plans", *The Wall Street Journal*, 11 November 1991.

[20]For a detailed overview of FDI trends for Latin America and the Caribbean, see, Transnational Corporations and Management Division, *World Investment Directory 1992: Latin America and the Caribbean* (New York, United Nations, 1992).

[21]Damian Fraser, "Venezuelan debt swap for project investment," *Financial Times*, 5 July 1991.

[22]Mahnaz Fahim-Nader, "Capital expenditures by majority-owned foreign affiliates of U.S. companies, revised estimates for 1991", *Survey of Current Business*, vol. 71, No. 9 (September 1991), pp. 32-38; Raymond J. Mataloni, "Capital expenditures by majority owned affiliates of United States companies, latest plans for 1991", *Survey of Current Business*, vol. 71, No. 3 (March 1991), pp. 26-33.

[23]Banco de Mexico, unpublished data.

[24]Santiago Fittipaldi, "CB II holds promise for Caribbean Basin, serves as model for Andean initiative", *Business Latin America*, 3 December 1990.

[25]Shelly Emling, "Asian tigers leap into Central America", *Business Latin America*, 16 December 1991; and Che-Hung Chen, "Taiwan's foreign direct investment", *Journal of World Trade Law*, vol. 20, No. 6 (November-December 1986), pp. 639-664.

[26]Some of the other factors that foster international production in the case of the Asian newly industrializing economies are the need to take advantage of greater geographical proximity or preferential trading status of host countries to important export markets (as in the case of host countries in the Caribbean) and, in the case of Hong Kong, the need to overcome uncertainty surrounding the return of the territory to China. See Paz Estrella E. Tolentino, *Technological Innovation and Third World Multinationals* (London, Routledge, 1992).

[27]For a detailed overview of FDI trends for Africa, see, Transnational Corporations and Management Division, *World Investment Directory 1992: Africa and Western Asia* (New York, United Nations, 1992).

[28]For example, a recent survey of overseas investment plans of Japanese firms showed that, for the period 1991-1993, the European Community, ASEAN and the Asian newly industrializing economies will be the most popular destinations of these firms (The World Bank, Debt and International Finance Division, "Financial flows to developing countries: current developments", *Quarterly Review*, March 1991, p. 8). At the same time, Japanese companies seem to have selected South Africa as the place to invest in the region (*Africa Analysis*, No. 129 (23 August 1991), p. 5.)

[29]Laurence Cockcroft and Roger C. Riddell, *Foreign Direct Investment in Sub-Saharan Africa*, Policy, Research, and External Affairs Working Papers (Washington, D.C., The World Bank, 1991), p. 27.

[30]See Transnational Corporations and Management Division and ECE, *World Investment Directory 1992, Central and Eastern Europe* (New York, United Nations, 1992), for an analysis of FDI trends in that region.

[31]Nicholas Denton, "GM puts further DM100m into its Hungary venture", *Financial Times*, 6 November 1991; and "Hungary: UT Automotive's new European plant site", *Business Eastern Europe*, 22 April 1991, p. 123.

[32]*Business Eastern Europe*, 22 April 1991, p. 126.

[33]Ariane Genillard, "Japanese, Slovaks to link up for Russian oil search", *Financial Times*, 12 November 1991; John Lloyd, "Western companies await decision by Soviets on oil", *Financial Times*, 15 May 1991; and Leyla Boulton, "The lure of oil's final frontier", *Financial Times*, 6 March 1992. Foreign investment in the oil sector in the former Soviet Union was put at $200 million. In the Russian Republic, which accounted for 80 per cent of the former Soviet Union's crude oil output, only 16 joint ventures operate in the oil sector.

[34]Preston Torbert, "First Soviet free zone will give firms access to Pacific Basin markets", *East Asian Executive Reports*, 13 (March 1991), pp. 9, 16-17; James Rupert, "Central Asia's ties that bind", *International Herald Tribune*, 2 December 1991. On free economic zones in Russia in general, see, UNCTC, *The Challenge of Free Economic Zones in Central and Eastern Europe: International Perspectives* (United Nations publication, Sales No. E.90.II.A.27).

[35]John Dunning, "International direct investment patterns in the 1990s". A paper prepared for the UNCTC Symposium on Globalization and Developing Countries, The Hague, 30 March 1992 (forthcoming); *The Economist* ("Business in Eastern Europe", 21 September 1991) estimated investments of $7 billion per year into the region until 1995. This would give a total of $28 billion between 1992 and 1995 and, assuming the same annual increase, about $63 by the end of the 1990s.

[36]"Foreign investment in Indonesia", *The Wall Street Journal*, 13 February 1992; and Urban C. Lehner, "Japanese prepare for Vietnam gold rush", *The Wall Street Journal*, 21 February 1992.

[37]The corresponding figures for 1980 were 56 per cent, 37 per cent, and 27 per cent, respectively. Asia includes Japan; North America consists of the United States and Canada only. United Nations, Department of International Economic and Social Affairs, *Monthly Bulletin of Statistics*, vol. XLV, No. 6 (June 1991).

[38]UNCTC, *World Investment Report, 1991: The Triad in Foreign Direct Investment*, op. cit.

[39]Asian Development Bank, *Asian Development Outlook 1991* (Manila, Asian Development Bank, 1991), p. 43.

[40]Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992).

[41]For a review of research on this subject, see Peter Robson, ed., *Transnational Corporations and Economic Integration. United Nations Library on Transnational Corporations* (London, Routledge, forthcoming). More generally, see Miroslav N. Jovanovic, *International Economic Integration* (London, Routledge, 1992).

[42]Estimates of the European Free Trade Association Secretariat, Economic Affairs Department.

[43]Transnational Corporations and Management Division, *World Investment Directory* (New York, United Nations, 1992). FDI data for EFTA represent Finland, Norway, Sweden and Switzerland. FDI data for EC represent Denmark, France, Germany, the Netherlands and Spain.

[44]Under "fast-track procedures", the United States Congress can only vote "yes" or "no" on the final agreement, that is, cannot amend it.

[45]See chapter III.B below.

[46]See *Comercio Exterior,* March 1984 and April 1991. See also International Monetary Fund, *Direction of Trade Statistics Yearbook, 1983* and *1991.*

[47]For details, see UNCTC, *Foreign Direct Investment and Industrial Restructuring in Mexico* (United Nations publication, Sales No. E.92.II.A.9).

[48]The export-to-sales ratio is calculated from United States, Department of Commerce, *U.S. Direct Investment Abroad: 1982 Benchmark Survey Data* (Washington, D.C., 1985), tables II.D.3, II.E.4, and *U.S. Direct Investment Abroad: 1989 Benchmark Survey* (Washington, D.C., 1991), tables 32 and 42.

[49]See UNCTC, *Foreign Direct Investment and Industrial Restructuring in Mexico,* op. cit.

[50]See "Mexican minister expects US free trade deal soon", *Financial Times,* 12 July 1991. Even though the negotiations currently are well under way, a 1992 signature of the treaty is uncertain, because of the recession and the November 1992 presidential elections in the United States. See "Mexico guards its precious oil business", *The Wall Street Journal,* 20 January 1992.

[51]See Rudiger Dornbusch, "North American free trade: what it means", *Columbia Journal of World Business,* vol. 26, No. 2 (Summer 1991), pp. 73-76.

[52]See *The Wall Street Journal,* 12 November 1991.

[53]Bernard Simon, "Vehicle dispute drives a wedge through NAFTA talks", *Financial Times,* 25 October 1991, p. 6.

[54]See UNCTC, *Foreign Direct Investment and Industrial Restructuring in Mexico,* op. cit.

[55]*Financial Times,* 4 July 1991.

[56]Kevin Done, "VW steps up Mexico output by 60 per cent", *Financial Times,* 6 March 1992.

[57]"Detroit South", *Business Week,* 16 March 1991.

[58]*Financial Times,* 7 August 1991.