INTRODUCTION

Transnational corporations have become central organizers of economic activities in an increasingly integrated world economy.

Since the mid-1980s, world-wide flows of foreign direct investment have grown at unprecedented rates, to reach $225 billion of outflows in 1990. Their nominal annual average growth rate of 34 per cent between 1985 and 1990 exceeded by far that of merchandise exports (13 per cent) and nominal GDP (12 per cent). For many developing countries, foreign direct investment has become the principal source of foreign capital: its share in the total long-term capital inflows from private sources of over 90 developing countries increased from 30 per cent during the period 1981-1985 to 74 per cent during the period 1986-1990. Foreign direct investment also accounts for an increasing share of total investment in most countries. Although, on an economy-wide basis, this share rarely exceeds 10 per cent, in selected (typically key) industries, it is frequently much higher; moreover, transnational corporations have come to account for a substantial part of the assets, employment and trade in selected industries of many host countries.

Investment flows are an underestimating measure of the activities of transnational corporations in host countries. Associated with those flows are transfers of technology from parent firms in home countries to their foreign affiliates in host countries through both equity and non-equity arrangements. A good part of international technology flows, as captured by the payment of licensing and other fees, originates from transnational corporations. Most of those payments are made on an intra-firm basis, that is, as flows between firms belonging to the same corporate ownership system. In fact, a large share of the world's research-and-development activities is undertaken by transnational corporations; the combined expenditures for research and development of the 10 largest United States transnational corporations, for example, exceed those of France or the United Kingdom. Foreign direct investment is also an

important source of such soft technologies as the know-how, training and organizational skills that are of central importance for the production of modern goods and services. By the end of the 1980s, the volume of goods and services sold by foreign affiliates amounted to an estimated $4.4 trillion, almost double that of world exports (excluding a substantial volume of intra-firm trade). In other words, production by foreign affiliates is of greater importance than exports in delivering goods and services to markets world-wide. Foreign direct investment, and the flows of capital, technology, training and trade that are part of it, have become the primary means by which a growing number of countries are integrated in the international economy.

But, as documented in chapters I and II of Part One of the Report, the growth of foreign direct investment has not been evenly distributed. As shown in the *World Investment Report 1991: The Triad in Foreign Direct Investment,* some three fourths of world investment flows take place among developed countries and, in particular, are concentrated in the Triad (the United States, the European Community and Japan). In addition, some two thirds of all investment flows to developing countries are directed to just 10 countries. Despite the growing role of foreign direct investment in the world economy, therefore, most developing countries currently do not receive as much as they need to help stimulate development. At the same time, the amount of investment that developing countries do receive is, for many of them, of relatively high importance, partly because the qualitative impact of such investment often exceeds its quantitative measure. Furthermore, the improved growth prospects of many developing countries, combined with a more favourable macro-environment, liberalization policies and privatization programmes, may make them more attractive for foreign direct investment during the next years. Increased flows to a number of developing countries in Asia and, most recently, in Latin America, suggest that transnational corporations are already increasing their involvement in some developing countries.

Within this overall picture, an important trend is the emergence of foreign-direct-investment clusters, in which foreign direct investment in developing and Central and Eastern European countries is dominated by a single investing country. Those clusters are centred on individual Triad members which, in turn, can become growth poles for the developing countries associated with them, be it informally or in the context of regional integration efforts. In North America, for instance, the affiliates of United States transnational corporations located in Mexico account for nearly 40 per cent of that country's total trade with the United States, Mexico's largest trading partner. In fact, in some cases, regional integration at the policy and institutional levels may be driven by underlying integration at the production level which takes place as a result of the regional strategies of transnational corporations. Where countries are joined in such regional production networks, pressure is likely to mount for deeper integration at the policy level, implying greater coordination and convergence of policies among regional neighbours.

Reflecting its growing importance, foreign direct investment is receiving greater attention as a policy issue. On the global level, a draft of the first-ever multilateral framework governing international transactions in services is nearing completion in the Uruguay Round of GATT, following five years of negotiations. Such an agreement would provide a framework for, among other things, services-sector foreign direct investment, which accounts for 50 to 55 per cent of total outflows from most major home countries. Draft agreements are also being finalized in the Uruguay Round on trade related investment

measures and trade related aspects of intellectual property rights, both of which bear directly on the activities of transnational corporations. On the regional level, the instruments of the Organisation for Economic Co-operation and Development affecting transnational corporations were recently strengthened, especially in the areas of national treatment and the environment. On the bilateral level, the number of treaties for the promotion and protection of foreign direct investment has expanded markedly, with 64 such treaties signed in the first 18 months of the 1990s alone (by comparison, only 199 treaties were signed during the entire decade of the 1980s). Finally, more and more countries have opened up their economies to foreign direct investment, as illustrated by the fact that, of 82 policy changes made in relation to foreign direct investment by 35 countries in 1991, 80 were in the direction of greater liberalization. In addition, privatization programmes in over 70 countries offer new opportunities for foreign direct investment, especially in the services sector; Central and Eastern Europe alone could absorb an estimated $50 billion of foreign direct investment during the course of this decade. These developments, discussed in chapter III of Part One, illustrate that competition among countries for investment is becoming more intense than ever before. At the same time, they show that a more coherent international policy approach towards foreign direct investment is needed and may, indeed, be emerging.

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It is against this background that the *World Investment Report 1992* focuses, in Part Two, on the role of transnational corporations in the economic growth of developing countries. That focus derives its importance not only from the role of transnational corporations in the world economy, but also from a number of other developments, some recent, others more long-standing, which point to a rapidly changing context for economic growth, along with a growing role for transnational corporations in that process. Among them, five (outlined in chapter IV) stand out as particularly important: an increasing emphasis on market forces and a growing role for the private sector in nearly all developing countries; rapidly-changing technologies that are transforming the nature of international production and the organization and location of such activity; the globalization of firms and industries, whereby production chains span national and regional boundaries; the rise of services to become the single largest sector in the world economy; and regional economic integration, involving the world's largest economies as well as selected developing countries.

Transnational corporations are at the centre of all of those trends, which are setting new policy agendas for developing countries. For example, the scope for acquiring technology through arm's-length transactions rather than through foreign direct investment is narrowing, as product life cycles become shorter, the costs of research and development become very high and inter-firm technology networks proliferate. Similarly, global industries are re-defining the ways in which countries develop their manufacturing and services-sector capabilities, such that countries (including developing ones) are increasingly becoming part of multi-country production and service networks, organized and managed by transnational corporations primarily from developed countries.

The growth of foreign direct investment in the context of the new world economy poses a critical question: to what extent can transnational corporations, as central organizers of international economic activities, be engines of growth? This question promises to be a critical issue for the 1990s, because that decade is likely to be characterized by increased competition among countries and yet—somewhat paradoxically—a deepening of cross-national economic ties. It is of particular importance for developing countries which, although they receive less than one fifth of world-wide investment flows, depend more heavily than developed countries on transnational corporations for investment, technology, training, market access, environmentally sound technology and other growth stimuli.

While the context for growth is undoubtedly changing, the basic factors that, taken together, drive economic growth remain the same: a country's ability to save and invest in productive activities; to develop, acquire and utilize technology effectively; to raise the productivity of its human capital; to engage in international trade; and to take adequate environmental safeguards to ensure the long-term sustainability of its growth path. Chapters V through IX look separately at the impact of transnational corporations on each of those key determinants of economic growth. Since the linkages to growth of capital formation, technology, human resource development, trade and the environment are already well established, the analysis in the present Report focuses on the ways in which transnational corporations contribute to each of those linkages and, through them, to growth.

As these chapters show, the contribution of transnational corporations to each growth determinant varies considerably. Foreign direct investment contributes to capital formation in host countries, particularly in those industries that are important for growth (for example, technology-intensive manufacturing and services industries). It is also frequently accompanied by the supply of new plant and equipment, which embody advanced technology and can raise the productivity of both the existing and new stock of capital. Higher rates of labour and capital productivity of foreign affiliates can positively impact the effectiveness of domestic investment and trigger greater efficiency on the part of domestic firms through competitive pressures, demonstration and learning effects and backward and forward linkages with local suppliers and consumers. But the contribution of transnational corporations is perhaps strongest in the areas of technology and trade because, in those areas, firms can draw on their firm-specific advantages, especially in relatively high-technology, globalized industries. Indeed, transnational corporations are major actors in the development of technology. Fifty transnational corporations, for example, accounted for more than one-quarter of all United States patents granted to firms during the 1980s. Transnational corporations have also made a significant contribution to technology transfer to developing countries through increased research-and-development expenditures, higher factor productivity and diversification of output and exports in favour of technology-intensive products with high growth potential. In the area of trade, foreign affiliates account for upwards of 50 per cent of manufactured exports from several developing countries, thus permitting levels of production and efficiency that could not be sustained solely by domestic demand. Transnational corporations also facilitate the growth of exports through their far-flung trading networks, and alleviate potentially growth-retarding supply shortages through the import of capital goods. Foreign affiliates can also impact the development of human resources of host countries, especially by providing vocational training for manual and skilled workers, formal and informal training for managerial staff and by raising the level of employment.

Finally, by observing environmental standards that can be higher than those enforced by Governments of host countries and by introducing environmentally sounder technologies, transnational corporations can contribute to sustainable long-term growth.

Important as those individual contributions are, it is a distinguishing characteristic of foreign direct investment that it combines, often in a synergistic manner, capital, technology, training, trade and environmentally sounder practices. In other words, as discussed in chapter X, transnational corporations bring an integrated *package* of tangible and intangible assets to host countries, which operates as a growth stimulus. Moreover, to the extent that foreign affiliates are linked to the local economy through forward and backward linkages, demonstration and learning effects as well as various other mechanisms, these growth stimuli can directly enhance the growth potential of firms in host countries. Thus, transnational corporations are not only responsible for a substantial share of international flows of capital, technology, skills and trade, but they also integrate those flows within their equity and non-equity networks of affiliates, make them subject to unifying corporate strategies and link them to local economies. It is, above all, the organizational and managerial capacity to integrate the factors and conditions of production on a world-wide scale that make transnational corporations potentially very efficient productive agents.

In fact, the growth of cross-national production networks of goods and services of some 35,000 transnational corporations and their more than 150,000 foreign affiliates is beginning to give rise to an international production system, organized and managed by transnational corporations. In terms of economic impact, therefore, transnational corporations play a critical role in the allocation of resources world-wide, in improving the competitiveness of both host and home countries in the new world economy and in stimulating processes of economic integration. As central wealth-creating organizers of international economic activities, transnational corporations can be important engines of growth.

The role of transnational corporations as integrating agents for a broad spectrum of economic activities also means that host-country policies in a correspondingly wide range of areas need to be sensitive to the potential contributions of those firms. Indeed, all chapters in Part Two highlight the importance of host-country market and factor conditions, within an enabling national policy framework, as key determinants of the extent to which transnational corporations can contribute to economic growth. In particular, economic policies need to be seen in the light of their impact on the strategic decisions of firms. Typically, policymakers have focused on trade and financial policies to govern their external economic relations; now much greater attention needs to be given to the coordination of all policies that affect the contribution of transnational corporations to host countries within a holistic policy framework that explicitly and prominently pays attention to foreign direct investment. At a minimum, policies relating to foreign direct investment need to be re-defined and broadened, to take into account the expanding role of transnational corporations as integrating and growth-promoting agents in the world economy.

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Beyond the immediate implications for national policies, however, the emergence of an international production system for goods and services raises a much broader question, namely, from which perspective should international economic transactions be viewed? And, ultimately, what international governance framework is most appropriate for the new world economy?

Traditionally, trade has been considered to be the driving force of international transactions, and an international framework that reflects that perspective was established. But in a world in which the sales of foreign affiliates are more important than exports in serving international markets, and in which technology and other flows are associated with foreign direct investment, international economic transactions need to be seen from the perspective of international production by transnational corporations. *Foreign direct investment, as managed by transnational corporations, is increasingly the driving force of international economic transactions.* Trade and technology transfers are being more and more structured by foreign direct investment. A fundamental *change of perspective* is needed to understand the new world economy fully and to devise policies that are appropriate for it. In Part Three of the present Report a few important policy issues are explored from that vantage point, in a first attempt to view the world economy from the perspective of foreign direct investment, transnational corporations and international production.

For example, as discussed in chapter XI, international policy discussions have typically focused on how investment policies might influence trade flows in a distortive manner, as reflected in the fact that trade related investment measures (TRIMs) are an important subject of the Uruguay Round. By the same token, trade policies can have a significant impact on the locational decision-making of transnational corporations and, hence, on the global patterns of investment flows. From that perspective, investment related trade measures (IRTMs) are as important, if not more so, as TRIMs for the international allocation of resources; yet, IRTMs have not even received conceptual recognition, let alone become a subject of international discussions or negotiations. Similarly, strategic trade policies have been the subject of extensive academic analysis, and have also found their way into policy discussions. But very little, if any, attention has been given to strategic foreign-direct-investment policies, be it on the basis of a narrow rent-snatching or a broader developmental approach. Such is the importance of the perspective from which international economic transactions are viewed.

Quite naturally, if one takes an international production perspective, the institution central to it, the transnational corporation, comes into focus. And so do the problems that arise if and when a transnational corporation fails. Given the great number of transnational corporations, such incidents are likely to happen from time to time, as the recent examples of BCCI and Maxwell Communications Corporation illustrate. Yet, the international community is utterly unprepared to deal with such occurrences in a cooperative, equitable and efficient manner.

A changed perspective would also have important institutional implications. Trade-supporting measures, aimed at encouraging exports, for instance, are quite common and, at the international level, have found their expression in the creation of UNCTAD nearly 30 years ago. In the investment area, however, little is being done to promote outward investment beyond insurance and protection guarantees. Perhaps what is needed are foreign-direct-investment facilities at the national and international levels,

aimed at accelerating the flow of investment to developing countries and enhancing its growth-promoting role. In that regard, it may also be useful to increase the transparency of national foreign-direct-investment regimes and to introduce multilateral reviews of foreign-direct-investment policies. This would allow Governments to disseminate information about their own policies and to learn from each others' experiences, and it would make it easier for foreign investors to obtain information important for decision-making—in brief, it would facilitate a better functioning of the international market mechanisms.

In the longer run, as suggested in chapter XII, however, a more comprehensive governance system may be needed. Given the growing role of international production, a stable, predictable and transparent international framework that defines, in a balanced manner, the rights and responsibilities of Governments and investors, would greatly assist the smooth functioning of the new world economy. Equally important, a multilateral institutional focal point may be needed, especially to safeguard competition in a world of globalizing firms and industries and interwoven international economic transactions. Such an institution would finally realize the vision that stood at the beginning of today's international institutional arrangements.

In summary, the international public policy framework needs to keep pace with the rapid globalization of firms and industries that is now under way, and with the emergence of a highly competitive world foreign-direct-investment market. Bold steps are needed to ensure that the emerging international production system functions smoothly, with a view to creating the best possible framework within which transnational corporations can act as engines of growth, especially for developing countries. Some possibilities in this regard, along the lines indicated above, are sketched in Part Three of the present Report, in order to stimulate thinking and discussion about how the international community can best meet the challenges it now faces.