Chapter III

Globalization, integrated international production and the world economy

Introduction

The two preceding chapters, together with earlier *World Investment Reports*, have documented the growing importance of foreign direct investment (FDI) and the central role that transnational corporations (TNCs) have acquired in the world economy. This chapter raises the question whether these developments, as part of a wider globalization process, are beginning to change the character of the world economy.

The world economy can be described along two distinct, but interrelated, dimensions: *market* exchanges and *production* activities that link consumers, producers and suppliers within and across national economies. The extent to which these economic agents engage in cross-border relations varies with market size and location, technological and other domestic economic advantages, and the openness of the policy framework and the links established through markets or production activities can involve many elements, in particular, capital flows, goods, services, people, technology, information and ideas. International integration describes the spread and deepening of these linkages across national boundaries.

States is now the largest home country, but it is not as dominant as a source of FDI as it used to be during the 1970s, when it accounted for 45 per cent of the world FDI outflows, far above its share of world GDP (36 per cent in 1970) and exports (12 per cent during the 1970s). In 1992, its shares of world FDI outflows, GDP and exports were 19 per cent, 26 per cent and 12 per cent, respectively.

- The share of the United Kingdom, the largest investor during 1986-1988, in world outflows was more than halved between that period and 1992, from 22 per cent to less than 9 per cent. The share of Japan, the largest source of FDI during 1989-1990, fell by half, from 20 per cent in that period to 10 per cent in 1992. Another big gainer in terms of outflows was France, the second largest home country by 1992.
- On the inward-investment side, the United States which, during the 1980s, had become the largest host country, accounting for over 40 per cent of world inflows during 1986-1988, saw its share shrink to 23 per cent in 1990 and to 16 per cent in 1991. By 1992, FDI inflows to the United States were only 2 per cent of world inflows. In that year, disinvestments almost matched new gross inflows and, as a result, the level of FDI inflows was only $3.4 billion — historically, a very small amount. France emerged as the largest host country in 1992, with a share of over 14 per cent of world inflows, about three times above its share during 1986-1988.

Since most other developed countries registered only relatively modest declines in FDI flows during the latest recession, it is the drastic changes among a few of the largest home countries that largely explain the decline in world outflows since 1990 (table II.1). Japan alone was responsible for 44 per cent and 65 per cent of the declines in world FDI outflows in 1991 and 1992, respectively. In fact, Japan's contribution to the decline in worldwide FDI flows in the 1990s was greater than its contribution to the increase in those flows (23 per cent) during the second half of the 1980s (table II.1). Drastic declines of outflows from another major home country, the United Kingdom, had already taken place in 1990 (outflows fell to $19 billion from $35 billion in the peak year of 1988), when world outflows were still surging to reach a historic high of almost $232 billion. Outflows from the United Kingdom continued to fall in 1991, but increased modestly in 1992.

On the inward-investment side, although there was a contraction of inflows to the European Union in 1991 (caused mainly by the halving of flows into the United Kingdom), most of the decline in world inflows during 1991-1992 was caused by the fall in flows into the United States (table II.1).

When FDI outflows are contrasted with inflows, it becomes evident that the dramatic changes in FDI flows were a geographically limited phenomenon observed primarily between Japan and selected Western European countries as home countries, and the United States as a host country. More than 80 per cent of the decline of FDI outflows from Japan during 1991-1992 took place in developed countries; the United States alone was responsible for 70 per cent and 56 per cent of that decline in 1991 and 1992, respectively (table II.2). The largest decline of United Kingdom FDI outflows in 1990 occurred also in the United States, which alone accounted for more than all the decline of the United Kingdom's outflows.

In addition to the changes in relative positions of the principal home and host developed countries, a major development in world FDI flows has been, as noted in chapter I, the continued increase of inflows to developing countries, fuelled in 1992, *inter alia*, by the rise of China to the rank of the world's third largest host country. Developing countries received increasing FDI flows from the United States, as well as from other principal home countries; for example, in 1992, outflows from the United States to developing countries rose by 15 per cent, while those to developed countries declined by 8 per cent. Similarly, outflows from the United Kingdom to developing countries increased in 1992, in a marked contrast to its declining outflows to developed

Table II.1. Annual average changes in world foreign-direct-investment outflows and inflows, by major home and host country and region, 1971-1992

(Millions of dollars)

Home/host country and region	*1971-1980* (Annual average)	*1981-1985* (Annual average)	*1986-1990* (Annual average)	*1991*	*1992*
		FDI outflows			
World	+ 4176	- 206	+ 35564	- 39620	- 20761
Developed countries	+ 4127	- 235	+ 33678	- 36862	- 23066
Japan	+ 204	+ 812	+ 8320	- 17310	- 13500
Western Europe	+ 2270	+ 1058	+ 22233	- 31593	- 6352
European Union	+ 2189	- 339	+ 18474	- 22382	+ 2322
France	+ 272	- 170	+ 6516	- 10890	+ 7062
Germany	+ 311	+ 352	+ 4532	- 6272	- 6550
United Kingdom	+ 955	- 125	+ 1763	- 3475	+ 145
Sweden	+ 41	+ 236	+ 2446	- 7047	- 5583
United States [a]	+ 1164	- 2137	+ 3078	+ 9168	- 11
Developing countries	+ 103	+ 28	+ 1679	- 2729	+ 2288
		FDI inflows			
World	+ 4169	+ 111	+ 30880	- 45789	- 3711
Developed countries	+ 3292	- 428	+ 27286	- 55730	- 18215
Japan	+ 19	+ 72	+ 224	- 390	+ 1350
Western Europe	+ 1714	- 685	+ 18061	- 28401	+ 1706
European Union	+ 1685	- 873	+ 16488	- 27687	+ 6788
Belgium and Luxembourg	+ 123	- 99	+ 1401	+ 1321	+ 1696
France	+ 266	- 138	+ 2118	+ 1966	+ 6694
Germany	+ 27	+ 336	+ 1246	- 1560	- 590
Netherlands	+ 180	- 193	+ 2113	- 6147	- 163
United Kingdom	+ 864	- 929	+ 5391	- 16278	+ 2024
United States	+ 1547	+ 616	+ 5682	- 22976	- 23058
Developing countries, of which:	+ 875	+ 539	+ 3537	+ 7794	+ 12426
China	+ 6	+ 320	+ 366	+ 879	+ 6790

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994, national official sources; and annex tables 1 and 2.

a Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles.

Note: + indicates increase in FDI flows.
- indicates decrease in FDI flows.

countries (table II.2). Although Japanese outflows to developing countries declined, the fall has been considerably smaller than that to developed countries.

Table II.2. Increases and decreases in foreign-direct-investment outflows from Japan and the United Kingdom, by destination, 1988-1992

(Millions of dollars)

Host country/region	*1988*	*1989*	*1990*	*1991*	*1992*
		Japan [a]			
World [b]	+ 14691	+ 9920	+ 3894	- 17298	- 13504
Developed countries	+ 12875	+ 7724	+ 5229	- 15020	- 11291
United States	+ 9328	+ 2269	+ 4346	- 10371	- 6299
European Union	+ 2199	+ 3953	+ 1281	- 3053	- 4604
France	..	+ 292	+ 338	- 564	- 211
Germany	..	+ 257	+ 361	-	- 260
United Kingdom	+ 1870	+ 1328	+ 1384	- 928	- 2827
Developing countries	+ 1816	+ 2196	- 1355	- 2278	- 2213
South, East and South-East Asia	+ 967	+ 2490	- 362	- 2333	- 461
		United Kingdom			
World [b]	+ 5858	- 2031	- 17177	- 1588	+ 1441
Developed countries	+ 5898	- 2635	- 17393	- 253	- 1233
United States	- 1981	+ 490	- 19061	+ 3871	- 1635
Western Europe	+ 5466	- 1080	+ 1151	- 3341	+ 1471
European Union	+ 5937	+ 17	- 563	- 2363	+ 971
France	+ 2836	- 811	- 367	- 1207	+ 281
Germany	+ 563	+ 407	- 973	- 59	+ 670
Netherlands	+ 2057	- 887	+ 1334	- 2287	+ 967
Other Western Europe	- 473	- 1099	+ 1716	- 978	+ 499
Developing countries	- 40	+ 604	+ 216	- 1335	+ 2674
Africa	- 15	+ 1290	- 1126	+ 495	- 381
Latin America	- 197	- 716	+ 931	- 2080	+ 2305
Western Asia	+ 88	+ 133	+ 449	+ 430	- 779
South, East and South-East Asia	- 1	- 50	- 215	- 79	+ 1337

Source: UNCTAD, Division on Transnational Corporations and Investment, based on official national sources.

a Data are based on the balance-of-payments statistics.

b Differences between this table and table II.1 are due to the use of different sources. Data in table II.1 are based balance-of-payments data reported to the International Monetary Fund, while those in this table are based on national official sources.

Note: + indicates increase in FDI flows.
- indicates decrease in FDI flows.

An important question that arises, therefore, is whether these changes signal a new pattern of FDI flows — that is, the re-configuration of both major home countries and favourite locations for FDI — or whether they are only a temporary phenomenon that will disappear when the recession is over. A partial response to the part of this question concerning the flows to developing countries was given in the preceding chapter: while, quite likely, the growth of these flows will continue, the share of the developing countries will depend on whether the flows to the developed countries will recover when the recession ends. To answer this question, as well as the related question of whether the shifts of positions among major Triad countries, shown earlier in this section, mark the beginning of a new pattern, a closer look is needed at the biggest changes, that is, at the Japanese outflows and the United States inflows, as well as at the other components of flows between major home and host countries. Can Japan regain its leadership position in world outflows or at least recover the level of its outflows? Can the United States do the same on the inflow side? Why did outflows from Japan decline so drastically during the recession, while those from the United States were maintained at a high level and those from the European Union as a group suffered only to a small extent? Is it a new trend in FDI flows or just a break in the trend that has begun in the mid-1980s? These questions will be taken up in the following sections.

2. Outflows from Japan

Japanese FDI outflows, after reaching a peak of $48 billion in 1990, declined by 36 per cent in 1991 and by 44 per cent in 1992, to the level of $17 billion.[1] Having been the largest source country for two years, Japan lost that position not only to the United States, but also fell behind France. Although the decline of Japanese outflows was reflected in all major destinations and industries, the largest decreases were recorded in the areas in which FDI grew relatively fast during the investment boom of the second half of the 1980s: the United States (accounting for 63 per cent of the decline to developed countries during 1991-1992) and in services (accounting for between 60 per cent and 90 per cent of the declines in the United States and Europe during the same period) (table II.3).

The drastic decline in Japanese outflows was caused by a combination of adverse cyclical and special factors, many of which are interrelated. In a clear distinction from Japan, a similar combination of these factors did not exist in other home countries; on the contrary, in a number of home countries, special factors counteracted the adverse consequences of the recession.

As in other developed countries, the recession led to a decreasing profitability of Japanese investments at home and abroad. Reinforced by special factors, the declines in profitability were probably higher in Japan than in other countries. At home, operating profits of Japanese companies declined by 1 per cent in 1991 and 20 per cent in 1992 (Bank of Japan, 1994). The ratio of profits to sales declined to 2 per cent by mid-1993, compared to 4 per cent in 1990. Abroad, profits of Japanese affiliates declined, especially in the United States and Europe. Overall, the level of current profits of Japanese affiliates in March 1992 was only about 30 per cent of that in March 1989, and the ratio of profits to sales was only 0.4 per cent, down from 1.4 per cent.[2] In the United States, Japanese affiliates recorded, in 1991, the largest loss ever, and when compared to affiliates from other home countries (see next section). Profits of Japanese affiliates in Europe decreased to almost zero in the same year. Surveys undertaken by the Japan External Trade Organization (JETRO) show that, in the United States and Europe, more than one-half of Japanese manufacturing affiliates incurred a loss in 1992 and 1993.[3]

Decreasing or negative profitability reduces the propensity of firms to invest because it shrinks the pool of profitable investment opportunities and diminishes earnings for reinvestment, an important source of investment financing. In the case of Japan, the deterioration of the financial position of all companies, including transnational corporations (TNCs), has been further aggravated by a fall in bank lending, as commercial banks have tightened their lending policies in response to the accumulation of bad loans and the need to adhere to international standards on capital adequacy. Outstanding bank loans declined by more than 1 per cent in 1992. Companies, including TNCs, faced shrinking investment opportunities and a capital shortage reduced investments. Thus, in addition to the declining FDI outflows, domestic investment also declined; investment in new equipment, for example, fell by 5 per cent in 1992 and by more than 10 per cent in 1993 (Japan, Economic Planning Agency, 1994). The financial difficulties facing Japanese banks and other financial companies, being prominent outward investors themselves, also contributed to decreasing FDI outflows.

Some of the cyclical factors affecting both domestic and foreign investment for Japan were aggravated by a number of additional special factors, some of which are linked to cyclical swings:

- *Plummeting asset prices.* By 1992, stock prices plummeted to less than a half of their peak in 1989 due to the bursting of the bubble of asset prices triggered by a slow-growing economy. As a result, Japanese TNCs, which could previously finance FDI through capital raised from the sale of corporate bonds and through bank loans against inflated assets, faced increasing difficulties to do the same in the early 1990s. This factor was specific to Japan; in the early 1990s share prices in other major home countries, such as France, the United Kingdom and the United States, increased.[4]
- *A large number of cases of poor investments, in particular in the United States and Europe, in the euphoria of the investment boom of the 1980s without giving due consideration to long-term prospects for profitability.* Recession in host countries exposed the structural weaknesses of these investments and resulted in heavy losses, leading to disinvestment and to an unwillingness to undertake new investments in certain industries, even though their prospects regarding profitability were likely to improve. A case in point are the large investments in real estate in the United States that lost value as a result of the recession, leading to plummeting flows of FDI in that industry in 1992, which accounted for three-quarters of the decline of total flows to the United States (table II.3).
- *The completion of an investment round of establishing production facilities in developed countries, initiated in the mid-1980s.* According to a study on the link between FDI and structural transformation of Japanese economy, Japanese TNCs undertook overseas investment in four major waves. Each wave was characterized by types of FDI corresponding to the stages of industrial upgrading (figure II.1 and Ozawa, 1993). The third wave that centred on the establishment of assembly-transplanting FDI operations has just been completed in North America and Western Europe, the major host areas for Japanese FDI. This is especially evident in some manufacturing industries, notably automobiles, in which there appears to be, at the moment, no need to expand investments further (Ozawa, 1993). A recent survey of Japanese TNCs showed that this was the most important reason for not undertaking FDI or reducing it.[5] This also appears to be the case in services: for example, 73 per cent of the decline of flows to the United States in fiscal year 1991 was accounted for by services, especially by Japanese TNCs. Investments by Matsushita Electric Industrial Co., Ltd. and Sony Corporation in the entertainment industry were completed by 1990; thereafter the industry ceased to be a significant investment destination (table II.3).

In summary, the recent dramatic decline of Japanese FDI outflows is deeply rooted in a number of special factors that have been exacerbated by cyclical factors. In lieu of new investment, many Japanese parent firms embarked upon a massive restructuring of their foreign affiliates aimed at regaining profitability, even at the cost of losing market shares, traditionally an important consideration in the strategies of Japanese TNCs (box II.1).

The process of restructuring often involves considerable divestment, leading to further reductions in FDI outflows. The intensity of these divestments can be seen from the data concerning the longevity of foreign affiliates. In general, only one-half of Japanese foreign affiliates stand a chance to survive longer than 15 years (table II.4). The United States appears to be a market where Japanese TNCs face the most competition because the survival rate of Japanese affiliates is the lowest there, compared to other regions. Recently, closures of affiliates have increased in relation to all affiliates or newly-established affiliates. During 1991-1992, Japanese TNCs ceased operating or liquidated some 460 foreign affiliates, corresponding to 28 per cent of the number of newly-established foreign affiliates, compared to, respectively, about 190 closed

Figure II.1. Japan's structural upgrading and foreign direct investment

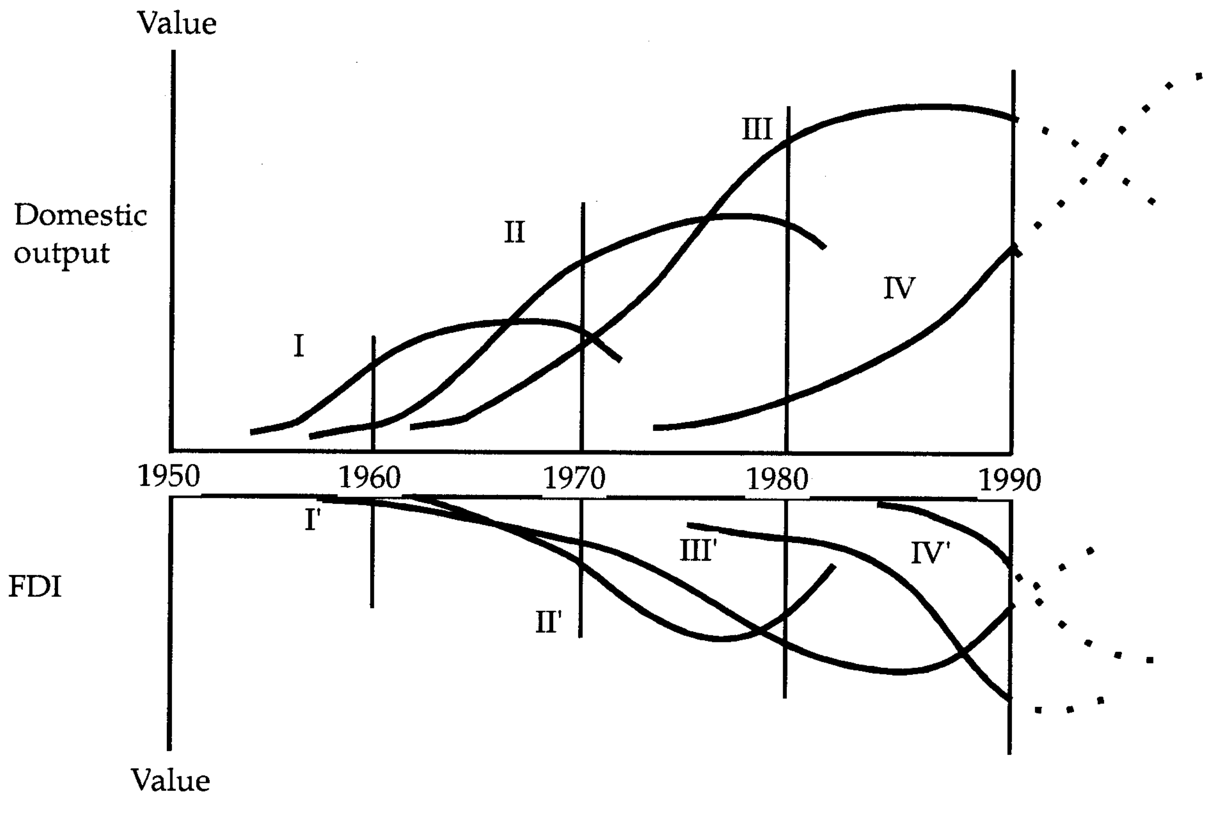
Stages of industrial upgrading

I. Labour-driven industrialization

II. Heavy and chemical industrialization

III. Assembly-based manufacturing

IV. Innovation-driven flexible manufacturing



Types of FDI

I'. Low-wage labour-seeking FDI

II'. Resource-seeking and house-cleaning FDI

III'. Assembly-transplanting FDI

IV'. Strategically networking (alliance-seeking) FDI

Source: Ozawa, 1993, p. 132.

Table II.3. Major industries responsible for decreases in Japanese foreign-direct-investment outflows to the United States and Europe, fiscal years 1991 and 1992[a]

(Millions of dollars and percentage)

Industry	*1991*	*1992*
United States		
Changes in FDI in all industries (Millions of dollars)	- 8 102	- 4 207
(Percentage)		
All industries [b]	- 100.0	- 100.0
Manufacturing	- 10.2	- 42.2
Electric machinery	- 18.9	- 3.2
Transport equipment	+ 1.6	- 1.9
Non-manufacturing [c]	- 89.7	- 57.3
Banking and insurance	- 8.2	- 0.1
Services [d]	- 72.8	+ 40.5
Real estate	- 4.3	- 76.4
Europe		
Changes in FDI in all industries (Millions of dollars)	- 4 923	- 2 310
(Percentage)		
All industries [b]	- 100.0	- 100.0
Manufacturing	- 38.7	- 25.5
Electric machinery	- 36.6	- 2.9
Transport equipment	+ 3.5	- 14.5
Non-manufacturing [c]	- 55.6	- 65.2
Banking and insurance	- 36.4	- 29.9
Services [d]	- 2.0	+ 0.1
Real estate	- 26.8	- 15.5

Source: Japan, Ministry of Finance, "Heisei 4 -nendo ni okeru taigai oyobi tainai chokusetsu toshi jokyo", press release, 3 June 1993.

a Data are based on notifications and are, therefore, different from those reported in the balance-of-payments statistics in table II.2.

b Includes branches that are separately reported. Thus, the total does not add to 100 per cent.

c Includes also the primary sector (agriculture, forestry, fishery and mining).

d Includes business services, hotels, films and other entertainment and broadcasting.

affiliates and a 20 per cent share during 1987-1988.[6] Nearly two-thirds of affiliates that were discontinued in Europe and the United States in 1991 and 1992 had been established during the investment boom of 1986-1990. Although it is normal that the life of many newly-established affiliates is not very long, this withdrawal rate is high, compared to the rate of less than one-third for the affiliates closed in 1987 and 1988 that were established during 1981-1985 (Toyo Keizai Shimposha, 1993, pp. 94-97). In terms of value, Japanese TNCs divested more than $10 billion in 1992, an amount equal to about one-third of FDI notified for outward investment in that year.[7]

Developing countries have also been affected by the declining Japanese outflows, but to a much lesser extent than developed countries. Within the developing countries, the least affected were those in South, East and South-East Asia. Outflows to that region registered the smallest

Box II.1 Restructuring of Japanese foreign affiliates

The restructuring of foreign affiliates can take various forms, ranging from simple closure through relocation to the strengthening of affiliates. For example, NEC Corp. not only stopped producing, but also selling television sets in the United States in 1993; Fujitsu Ltd. withdrew from the semiconductor business by shutting down its semiconductor affiliate in the United States in 1993; it also withdrew from the facsimile business in that same year. Hitachi, Ltd. closed a plant in California and shifted the production of video-tape recorders to Mexico and Malaysia; Seiko Epson Corp. stopped producing personal computers in Singapore in 1992; and Nissan Motor Co., Ltd. stopped producing cars in Australia in 1992.

As part of expanding operations in host countries and overall corporate strategy, many TNCs have strengthened their research-and-development capacities in existing affiliates or created new research-and-development centred affiliates. In January 1990, for example, only 14 per cent of Japanese manufacturing affiliates in Western Europe had research-and-development facilities; that share increased to 36 per cent by January 1994. Similarly, the number of independent research-and-development affiliates tripled during this period (from 22 to 65).[a]

Restructuring has not been limited to the manufacturing sector. Transnational corporations in the services sector, especially in construction, banking and securities industries, are also attempting to rationalize operations of foreign affiliates. For example, Shimizu Corp., a large general construction company, liquidated four real estate development affiliates in Australia in 1992 and most of its 17 affiliates in the United States. Kumagai Gumi Co., Ltd., another large general construction company, will shed about 40 per cent of foreign assets in five years by 1997, and liquidate more than 10 foreign affiliates. Japanese banks started to restructure affiliates in North America and Latin America: the Bank of Tokyo closed a representative office in Toronto, Canada; and the Japan Long-Term Credit Bank closed one in Rio de Janeiro, Brazil. Securities companies are also engaged in the restructuring of their foreign financial services operations. Kosei Securities Co., Ltd., a medium-sized company, had closed all foreign affiliates by 1992. Another medium-sized company, New Japan Securities Co., Ltd., liquidated five foreign affiliates in 1992. All big four securities companies, Daiwa Securities Co., Ltd., Nikko Securities Co., Ltd., Nomura Securities Co., Ltd., and Yamaichi Securities Co., Ltd. also restructured their foreign affiliates, especially in New York and Europe. For example, Yamaichi's London affiliate now employs only 40, down from the peak of 350. A Swiss affiliate of Nomura has now only about 20 employees, down from more than 200 not long ago.

One of the outcomes of the restructuring of foreign affiliates is, according to a JETRO survey, a decrease in the number of new affiliates established: for example, the number of manufacturing affiliates that started operating in 1992 in the United States was only 17, about one-eighth of the number in 1990 (145) (JETRO, 1993a). Similarly, in Western Europe, it was only about 19 in 1993, compared to 113 in 1990.[b]

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a JETRO, "Outline for the 10th survey of European operations of Japanese companies in the manufacturing sector", press release, 24 March 1994.

b Ibid.

decline among all regions (15 per cent in 1992), and have been among the first to recover: on a notification basis, outflows increased by 8 per cent during fiscal year 1992, ending in March 1993.[8] However, these increases were directed mostly to China and Indonesia, while the remaining countries in that region continued to experience decreasing flows.

Despite the economic upturn in many countries host to Japanese FDI, Japanese outflows did not recover in 1993, but declined further by another 29 per cent: their level in 1993 was $12 billion, about 28 per cent of the peak level of 1989. This lends support to the distinctive nature of the

Table II.4. Survival rate of Japanese foreign affiliates during the period of 1975-1990[a]

(Percentage)

Industry	*World*	*United States*	*Europe*	*South, East and South-East Asia*	*Latin America and the Caribbean*
Manufacturing	47	35	48	49	46
Chemicals	54	25	50	59	50
Electric machinery	57	40	55	59	53
Transport equipment	51	67	43	57	53
Commerce	62	54	65	61	69
Banking and insurance	58	56	65	64	68
Services [b]	45	39	42	53	41
All industries	50	48	59	50	51

Source: *Weekly Toyo Keizai*, 10 April 1993, p. 91.

a The ratio of the number of affiliates that operated between 1975 and 1990 to the total number of affiliates that existed in 1975. The figures are overestimated because affiliates that changed their names or merged with others included in the statistics are also considered to be withdrawn.

b Includes business services, hotels, films and other entertainment and broadcasting.

difficulties facing Japanese TNCs: while foreign investors from other home countries (e.g., the United States) reacted immediately to improved economic conditions by investing abroad, Japanese TNCs continued to restructure their operations.

It is very likely, however, that Japanese outflows will recover, though they may not soon reach again the record levels of the late 1980s. One reason is that Japanese TNCs are likely to approach re-emerging investment opportunities much more cautiously. Such opportunities are emerging quickly in the fast-growing neighbouring South and South-East Asian region, providing attractive locations for market-seeking FDI. Japanese investors can not afford to forgo these opportunities for too long without the risk of losing them to competitors, for example, United States TNCs that have intensified their investment efforts in that region.[9]

The continued appreciation of the yen and the resulting decline of profitability for export-oriented business was another factor that played a role in locational investment decisions of Japanese TNCs. The dollar fell from 240 yen per dollar in 1985 to 145 yen per dollar in 1990; and, during that period, Japanese outward FDI increased rapidly (figure II.2). According to the Economic Planning Agency, only 15 per cent of exporting firms can make profits under an exchange rate of 110 yen per dollar, while the exchange rate in early 1994 was moving in the direction of 100 yen per dollar.[10] Furthermore, although trade frictions are no longer such a strong motivation for Japanese FDI as they were a few years ago, they have not disappeared altogether: the avoidance of such trade barriers as voluntary export restrictions and anti-dumping measures constitute an investment motive for 15 per cent of Japanese manufacturing TNCs wishing to invest abroad during 1993-1995 in the United States and for 13 per cent of those that consider investing in Western Europe.[11] And, finally, the level of transnationalization of Japanese TNCs is still much lower than that of their principal competitors (United States and many Western European

TNCs),[12] indicating a potential, in the long term, for further transnationalization. And, indeed, the number of TNCs planning new overseas investment is growing: a survey by the Export-Import Bank of Japan undertaken in mid-1993 suggests that some 63 per cent of Japanese TNCs plan to invest abroad in the next three years; that result is 10 percentage points higher than that of the survey undertaken in mid-1992.[13]

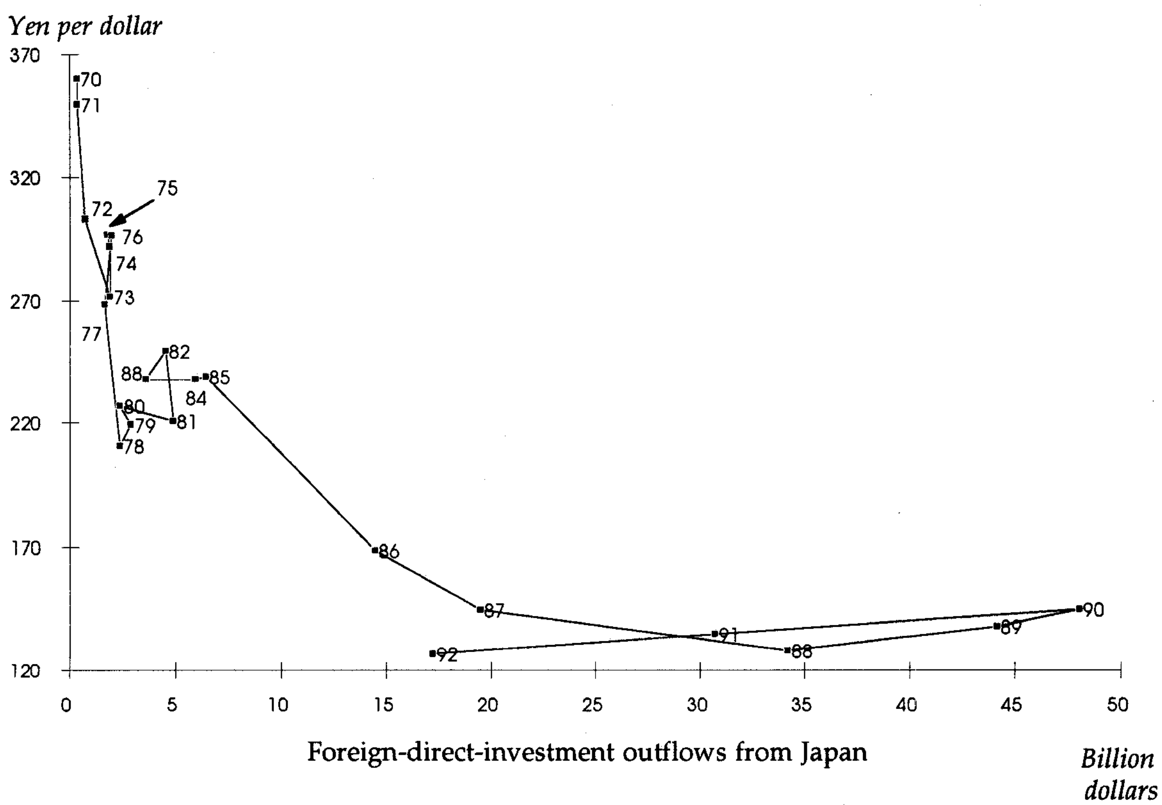
3. Inflows into the United States

United States inflows, after reaching a peak of $69 billion in 1989, then declined by more than $20 billion every year (table II.1), to reach a low point of less than $4 billion in 1992. That decline largely contributed to the fall in worldwide inflows. While losing its position of being the largest single host country in terms of inflows, the United States has kept its position as the largest host country in terms of stock ($420 billion in 1992), still well ahead of the United Kingdom and Canada.

The decline of Japanese FDI flows to the United States is a major reason for the drastic decline of FDI flows into the United States: in 1992, Japanese FDI was only one-fifth ($4 billion) of its level

Figure II.2. Japanese foreign-direct-investment outflows and exchange-rate fluctuations, 1970-1992

(Movement of yen against the United States dollar)



Source: UNCTAD, Division on Transnational Corporations and Investment.

Note: Plot figures represent years.

in the peak year of 1990. The significant reduction of FDI in the United States was also caused by European investors: European FDI inflows, at $8 million, were virtually non-existent in 1992. The United Kingdom accounted for the largest decline in United States inflows in 1992, followed by Japan, France and Canada. For most countries that decline was largely in services; for Japan, it was in wholesale trade and business and other services; for France and Canada, in financial services; and for the United Kingdom in business and other services. These industries alone accounted for between two-fifths and four-fifths of the overall decline of inflows from these home countries during 1991-1992 (table II.5).

The large size of the FDI stock in the United States may be one of the reasons why the declines in inflows during the recession were so substantial. Usually, the larger and more diversified the stock of FDI, the larger are the inflows needed to maintain or expand the existing stock. A good part of these inflows is typically financed from reinvested earnings generated by the existing stock. Conversely, during a recession, the larger the stock of FDI and the more it is oriented towards the domestic market and widely spread across the host economy, the higher is the likelihood that a large part of it will be affected by the recession. This seems to have been the case with the flows into the United States, where most FDI is oriented towards the domestic market.[14] When profit expectations and rates of return began to decline, reinvested earnings became negative and eventually turned into losses (tables II.6 and II.7), and the number of write-downs, closures or sales of assets of foreign affiliates multiplied. Reinvested earnings turned negative in 1989 and remained so until 1992, thus depriving foreign affiliates of an important source of investment finance.

The declines in FDI inflows between 1989 and 1992 were widely spread across all major industries. Moreover, industries responsible for the declines during that period were different from those during 1991-1992 (table II.5). In most cases, but not all, divestments in an industry or the decline of inflows to almost zero levels were preceded by losses, that is, by negative incomes. In the manufacturing sector, large divestments in 1992 were registered in machinery, with inflows of -$2 billion — a decline of $10 billion from their peak level in 1989 ($8 billion).[15] All important industries in the services sector — an important contributor to the FDI stock in the United States during the second half of the 1980s — experienced declines in income and FDI inflows between the period 1989-1990 and 1992 (or negative inflows). Retail trade, finance other than insurance and banking and real estate fared worse than the average for the services sector as a whole.

Recession or slow growth explains much of the declining flows into the United States, but not all. As discussed above, special additional factors influencing Japanese outflows to the United States added to that decline. This is clear not only from the drastic decline of flows from Japan into the United States, which were larger than from most of the other major home countries, but also from the data on investment income showing that Japanese losses were the highest of all countries (table II.6).

The recession does not explain another drastic decline of inflows: that from the United Kingdom, from $19 billion in 1989 to $4.5 billion in 1990, since it occurred before the recession took hold. The decline was mainly in manufacturing, and was not preceded by losses: on the contrary, the United Kingdom FDI stock has been one of those few stocks which, overall, have not suffered losses at all, even during the recession (another was that of the Netherlands). The explanation in this case is that the United Kingdom TNCs — linked to the United States market by traditional long-term ties — were very active participants in the wave of cross-border acquisitions of United States companies, which was triggered by the reduced prices of United States assets following the rapid dollar depreciation after the Plaza Accord in 1985 (United States, Department of Commerce, 1993d, pp. 9-10). Once the purchases of the targeted companies ended, FDI flows, buoyed by these purchases, subsided.

Table II.5. The largest home countries and industries responsible for decreases in the United States foreign-direct-investment inflows, 1989-1992 and 1991-1992

(Millions of dollars)

Home country/region	*Decreases in FDI inflows*		*Two largest industries responsible for the decline in FDI inflows* [a]	
	1989-1992	*1991-1992*	*1989-1992*	*1991-1992*
Europe	- 43038	- 13039	Chemicals and allied products (- 10135) Machinery (- 8383)	Insurance (- 5628) Machinery (- 4136)
United Kingdom	- 21547	- 6990	Food and kindred products (- 5936) Chemicals and allied products (- 4612)	Business and other services [b] (- 2992) Other manufacturing [c] (- 1631)
Netherlands	- 8814	- 2497	Chemicals and allied products (- 3235) Machinery (- 2619)	Insurance (- 1984) Finance, except banking (- 1778)
Switzerland	- 4656	- 962	Machinery (- 1612) Insurance (- 655)	Banking (- 862) Machinery (- 525)
France	- 3212	- 4930	Chemicals and allied products (- 656) Finance, except banking (- 624)	Finance, except banking (- 2811) Insurance (- 1158)
Germany	- 2349	- 778	Chemicals and allied products (- 1480) Petroleum (- 1094)	Insurance (- 1547) Chemicals (- 986)
Japan [d]	- 14693	- 6700	Finance, except banking (- 3774) Real estate (- 2871)	Wholesale trade (- 2350) Business and other services [b] (- 1846)
Canada	- 3937	- 4527	Finance, except banking (- 1981) Other manufacturing [c] (- 1484)	Finance, except banking (- 2983) Other manufacturing [c] (- 640)
Developed countries	- 60930	- 23868	Chemicals and allied products (- 11287) Machinery (- 9469)	Insurance (- 6001) Business and other services [b] (- 4708)
World	- 65622	- 22058	Finance, except banking (- 11312) Chemicals and allied products (- 11094)	Insurance (- 6165) Machinery (- 4018)

Source: United States, Department of Commerce, 1993b.

a In the order of magnitude.

b Hotels and other lodging places, business services, motion pictures, engineering, architectural and surveying services, accounting, research management and related services, and health services.

c Manufacturing, excluding food and kindred products, chemicals and allied products, primary and fabricated metals and machinery.

d It should be noted that data reported by the United States are different from those reported by Japan on which tables II.2 and II.3 are based. The differences arise mainly because Japanese data exclude reinvested earnings (both tables II.2 and II.3) or are on a notification basis and do not reflect actual transactions (table II.3).

Other reasons for the decline not linked to the recession could include concerns regarding regulatory developments in the area of taxation of foreign companies in the light of the pending unitary taxation court case between Barclays Bank and the state of California and proposals made during the election campaign in 1991 to raise substantial amounts in additional taxes from TNCs. These could have caused the postponement or even cancellation of investment projects until the case was decided and the Government stance cleared, thus adding to the declining inflows in 1991 and 1992.[16] Furthermore, Germany, a major home country for FDI in the United States, diverted some of its investment focus in the years following unification from the United States market towards Europe and the huge investment needs of the expanded domestic market.[17] Also, telecommunications, an industry undergoing a massive consolidation on a global scale in the early 1990s (in which large United States companies are major players), was bypassed by FDI, among other reasons perhaps because United States regulations limit foreign companies to 20 per cent of the equity in most of the largest companies in that industry.[18]

The drastic three years decline of FDI inflows to the United States raised concerns during 1992 and the beginning of 1993, similar to those in some Western European countries, about whether the United States was losing its attractiveness as a location for FDI. These concerns were, however, alleviated when inflows started recovering as the economy picked up in 1993 and

Table II.6. Income on foreign direct investment [a] in the United States, by major home country, 1982-1992

(Millions of dollars)

Country	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*
Canada	- 596	10	304	348	390	778	589	- 855	57	- 1105	- 60
Japan	403	1013	1884	1561	1009	612	1355	670	-996	- 2085	- 1794
Europe	2934	4473	7054	5240	5701	7720	10604	8485	4400	2085	4639
France	- 385	- 416	- 178	- 157	54	137	345	209	- 915	- 462	- 264
Germany	- 491	151	803	605	- 23	- 5	414	305	- 147	- 714	- 457
Netherlands	1578	1890	3113	2131	2179	1906	2464	2027	179	381	1333
United Kingdom	1851	2128	2298	2127	2611	4208	5591	4726	5593	4078	3703
World	3155	5598	9229	6079	5379	8659	12774	7491	2936	- 1791	2470
Memorandum:											
Rate of return [b]	2.7	3.9	6.3	4.3	3.7	3.6	4.4	2.2	0.8	- 0.4	0.6

Source: United States, Department of Commerce, *Survey of Current Business*, various issues.

a Direct investment income is defined as earnings (distributed and reinvested earnings) after deduction of withholding taxes on distributed earnings plus net interest (payments of foreign affiliates in the United States less their receipts).

b Direct investment income divided by the average of the beginning and end-of-year direct investment positions.

reached that year an amount close to $32 billion, reinstating the position of the United States as one of the major host countries. Two major investment projects initiated by Mercedes-Benz and BMW in the United States in 1993 added to this optimism. These two projects were of important symbolic value in the discussions about attractiveness because they were undertaken by companies that until then had been able to operate successfully from their home country. Once they decided that, in order to maintain their competitiveness, they had to start building factories abroad, they could have done so in many locations in the world. They chose the United States for its large (and recovering) and competitive market, relatively low labour costs,[19] a large supply of skilled labour and a very good infrastructure, permitting easy distribution of cars in that large market and, if needed, their export — all very important locational advantages which, in addition

Table II.7. United States foreign-direct-investment inflows and outflows, by type, 1981-1992

(Millions of dollars)

Year	*Total*	*Equity capital*	*Reinvested earnings*	*Intra-company debt*
		FDI inflows		
1981-1985 (average)	19 063	12 695	435	5 933
1986	34 091	25 086	- 2 293	11 298
1987	59 581	34 319	579	24 683
1988	58 571	45 046	1 963	11 562
1989	69 010	51 776	- 7 390	24 624
1990	48 422	56 239	- 14 156	6 339
1991	25 446	41 931	- 18 450	1 965
1992	3 388	22 467	- 11 573	- 7 506
		FDI outflows [a]		
1981-1985 (average)	10 928	1 544	11 784	- 2 400
1986	13 782	- 194	10 392	3 584
1987	28 033	6 057	19 079	2 897
1988	14 324	- 3 545	13 281	4 584
1989	33 826	7 529	12 413	13 884
1990	23 932	9 359	18 960	- 4 387
1991	33 100	17 292	15 915	- 107
1992	33 089	8 007	17 361	11 495

Source: UNCTAD, Division on Transnational Corporations and Investment, based on United States, Department of Commerce, 1993b and 1993c, and UN-TCMD, 1993b, p. 485.

a Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles except for equity capital and intra-company debt in 1992.

to political and economic stability, make the United States a location that foreign investors cannot afford to bypass. Important, although not a decisive factor in attracting FDI to the United States, is the growing readiness of individual states to offer various incentive programmes. For example, the state of Alabama offered Mercedes-Benz an incentive package amounting to $253 million, almost matching the size of the investment ($300 million). The package included $30 million for a training centre and $77 million for training its workers. Training programmes have become a very popular incentive that is now offered by 46 out of 50 states, and is apparently appreciated by TNCs.[20] Other incentives include direct loans (offered, for example, by Georgia, Illinois, Louisiana, Massachusetts, New Jersey, South Carolina, Texas, West Virginia), state tax exemptions and credits (e.g., Arizona, Georgia, Illinois, Louisiana, Massachusetts, New Jersey, South Carolina, Tennessee, Texas, West Virginia), or the establishment of foreign trade zones (e.g., New Jersey, Oregon, Texas).[21]

4. Outflows from the United States

The large decline of Japanese outflows helped the United States regain its position as the largest home country. In a marked contrast to most other home countries, the outflows of which declined during the recession, United States outflows remained, except for one year (1990), at the consistently high level of $33 billion annually during the period 1989-1992 (table II.7). In 1993 they increased to some $50 billion. Apparently, United States TNCs have been successful in finding some profitable investment opportunities abroad in spite of the recession at home and the prolonged economic slowdown in their host developed country markets.

Several factors have contributed to this performance:

- The impact of recessionary conditions in Western Europe on United States FDI stocks and flows (and, for that matter, on any other FDI stock, including that of Western Europe and Japan) was not as large as the impact of the United States recession on Japanese and Western European FDI in the United States. The recession in Western Europe was milder and unevenly spread among countries and across time, thus permitting FDI declines in one country to be compensated by FDI increases in other countries.
- United States TNCs have not been burdened as much by special problems similar to those facing Japanese TNCs: their income on FDI was maintained at a high level despite the recession, while that of TNCs from Japan and some Western European countries suffered losses. Therefore, United States TNCs, not being distracted by problems with their foreign affiliates, could take advantage of the emerging investment opportunities that existed in spite of the recession.
- As the United States FDI stock abroad continued to generate significant income despite the recession, continued FDI outflows could be supported by reinvested earnings, traditionally a large source of financing FDI outflows from the United States (table II.7): more than one-half of outflows during 1990-1992 came from reinvested earnings. In 1989 and 1992, intra-company loans, one of the other two remaining components of FDI flows (which can move either way between parent companies and foreign affiliates), accounted, respectively, for 41 per cent and 35 per cent of total outflows. The direction and size of intra-company loans are determined by many factors among which the configuration of the differences in the interest rates in the United States and abroad, fluctuations of exchange rates and tax and profit-accounting considerations of TNCs are the most important.

All in all, United States TNCs were better positioned than their Japanese counterparts to exploit the investment opportunities during the recession, in various countries and industries. These opportunities were further enhanced by such developments as that of NAFTA, economic reforms in Latin America, growth in South, East and South-East Asia, the opening up of Central and Eastern Europe to FDI and the worldwide reorganization of some service industries, such as telecommunications, on a global basis.

The increases in United States FDI outflows between 1990 and 1991 and 1992 occurred almost evenly in developed and developing countries (table II.8). More specifically, Europe, Latin America and to a lesser extent South, East and South-East Asia accounted for almost all the increases in FDI outflows between 1990 and 1992. Both in developed and developing countries, such increases took place predominantly in the services sector (table II.8), which is not surprising because the Single Market programme of the European Union and recent liberalization efforts of developing countries were concentrated in this sector.

As regards Western Europe, the largest developed-country location for United States FDI, outflows reached a peak in 1989 (owing largely to the take-over wave), and after that fluctuated at a lower level, but without a clear downward trend. During the recessionary years, United States outflows to Western Europe actually increased when compared to 1990 (table II.8). The impact of the creation of the Single Market on restructuring and adjustment of all TNCs, including United States TNCs, through, *inter alia*, increased FDI, could have compensated partly for the decreases caused by the recession.

Among the developing-country regions, a noticeable change took place in the outflows to Latin America which has again become attractive to United States TNCs after the region began market-oriented economic reforms and growth resumed (see next section on Latin America and the Caribbean). The anticipation of NAFTA triggered large United States outflows to Mexico, which in the 1990s became the largest host country in Latin America after Bermuda, attracting annual average flows of $1.8 billion during the period of 1990-1992 and surpassing Brazil, traditionally the largest recipient (after Bermuda) of the United States FDI in Latin America and the Caribbean, which received on average $1.4 billion of inflows annually during the same period.

United States outward stock grew fastest in South, East and South-East Asia: 18 per cent annually during 1990-1992, compared to 12 per cent increases in Latin America and 6 per cent in Europe. As a result, the share of South, East and South-East Asia in total United States FDI outward stock increased in 1992 to 7 per cent, from 5 per cent in 1990. The fast growing Asian market (see next section) generated the highest rate of return on the United States FDI: 23 per cent during 1990-1992, nearly twice the average rate of the 12 per cent in the world as a whole during the same period (table I.14). If the fast growth of United States outflows to South, East and South-East Asia continues, it may eventually lead to a reconfiguration of FDI clusters (chapter III), measured by FDI stock, which have been traditionally dominated in this region by Japanese TNCs. Until recently the volume of FDI outflows from the United States to many countries of this region was smaller than that from Japan but also that from Hong Kong, the Republic of Korea and Taiwan Province of China. Since 1990, however, the United States has been, in terms of flows, the largest investor in the Republic of Korea and Singapore and, since 1991, in Taiwan Province of China. In Thailand — where investment applications from major home economies, such as Japan, Taiwan Province of China, Hong Kong and some European countries, have decreased since 1990 — those from the United States have been increasing. In Indonesia and Malaysia, the United States moved to a higher position in the ranking of investors. In India, where inflows of FDI started growing rapidly after the 1991 liberalization, United States TNCs have taken the top position from the very beginning, with the share of total actual FDI inflows amounting to 17 per cent during the period 1991 to January 1994 (see section B, box II.6).

As already mentioned, the increasing United States FDI outflows to developing countries went largely into the services sector, reflecting not only the increasing importance of that sector in the economy, but also the change in attitudes of these countries towards many important service industries closed until not long ago to foreign investors (UNCTAD-DTCI and World Bank, 1994).

Typical in this regard is the change in the attitudes of governments towards the telecommunications industry, especially in Latin America. The first telephone systems in a number of countries in that region were established by United States TNCs in the 1920s. However, after the depression of the 1930s, they were nationalized. Recently, both developing countries and the formerly centrally planned economies have awakened to the fact that modern communications are vital to almost every aspect of their economies and that they have fallen far behind in communications technology. As a result, they are now looking towards TNCs as a source of the combination of technology and large amounts of capital needed to catch up in this area.[22] Hence, the United States FDI stock in telephone and telegraph communications industry in the world grew at an annual rate of 141 per cent during 1989-1992, the highest rate of growth among all industries.[23]

Another service industry in which the change has been remarkable is the banking and other financial services industry (but not yet insurance): this accounted for the bulk of the increases in FDI outflows in 1991 and 1992 to both developed and developing countries. The emergence and development of capital and financial markets in the growing number of developing countries have facilitated foreign investment, including direct investment, in these areas. Banking and other financial industries accounted for most of the increases in FDI outflows in 1992 compared to 1990 (table II.8).

5. Investment flows and Western Europe

Western European FDI flows experienced considerable changes during 1990-1992, but not as drastic as Japanese outflows and United States inflows (table II.9). Inflows declined from $110 billion in the peak year 1990 to $81 billion in 1991, and then recovered slowly to $82 billion in 1992. Investment outflows fell for two consecutive years from their peak level of $144 billion in 1990 to $112 billion in 1991 and to $106 billion in 1992 before they began to recover in 1993 ($109 billion). For the European Union, that decline lasted one year, and recovery has been more pronounced (table II.1).

Declines of inflows into Western Europe were mostly the outcome of recession or slow growth. However, the timing of the recession and, consequently, the timing of the decline in inflows, differed among countries; as a result, inflows continued to grow in some Western European countries (e.g., Belgium and Luxembourg) during the early 1990s (table II.1). Moreover, in a number of countries such as, for example, Germany and the Netherlands, the appreciation of their domestic currencies against the dollar by some 17 per cent between 1989 and 1992 modified the adverse impact of recession on FDI inflows by altering the dollar values of these inflows.

The major change in the pattern of FDI in Western Europe was the emergence of France as both the largest home and host country; the United Kingdom had held both these positions before the recession. While flows into France were consistently increasing, its outflows decreased in 1991 but maintained a high level of $31 billion in 1992. Flows to and from the United Kingdom suffered the largest absolute declines among Western European countries (table II.1 and table II.9). The decline of United Kingdom outflows (mainly to the United States) is partly attributable to the waning wave of cross-border mergers and acquisitions. The sudden drop in United Kingdom inflows was also caused partly by fewer mergers and acquisitions (chapter I); in fact, the United Kingdom had been, by far, the largest target country for mergers and acquisitions, accounting for almost 50 per cent of the value of cross-border mergers and acquisitions in Europe during 1989-1990, the peak years of that activity (also the peak years of United Kingdom FDI inflows).[24] Another factor behind the large declines of FDI in the United Kingdom was its recession, which was deeper and longer than in most other countries.[25]

In France, the Government's attitude towards FDI had changed towards a welcoming one, and included the relaxation of FDI regulations.[26] Cross-border mergers and acquisitions in France jumped by 61 per cent in 1992 to the level of 91 billion French francs from 57 billion French francs in 1991 — one half of that was accounted for by the TNCs from the European Union countries (JETRO, 1994, p. 273). These factors, combined with France's central geographical location, an excellent infrastructure and a skilled labour force have played a role in generating a better performance in terms of FDI inflows in spite of the recession.[27] On the outflow side, French TNCs have been the most active participants in cross-border mergers and acquisitions in Europe. Between 1988 and mid-1992, French TNCs accounted for 21 per cent of the value of cross-border mergers and acquisitions involving companies in the European Union, followed by the United States (17 per cent) and the United Kingdom (11 per cent).[28] In the United States, French TNCs were responsible for the largest volume of merger-and-acquisition deals in 1992 ($3.9 billion), a share of 22 per cent of the total value ($17.6 billion), followed by Japan ($3.3 billion) and Germany ($1.6 billion).[29]

Both Germany and France increased their FDI flows to the countries of Central and Eastern Europe, from $58 million and $16 million, respectively, in 1989 to $989 million and $339 million in 1992. Outflows to developing countries have remained stable or increased slightly: flows to developing countries from Germany, France and the United Kingdom in 1992 were $0.4 billion, $1 billion and $4.9 billion, respectively, compared to $0.6 billion, $1 billion and $3.8 billion in 1989.

Table II.8. Change in United States foreign-direct-investment outflows between 1990 and 1992, by region and industry

(Millions of dollars)

Host region	All industries	Petro-leum	Manu-fact-uring	Non-manufacturing: Total	Whole-sale trade	Banking	Finance (except banking), insurance and real estate	Services[a]	Others
Developed countries	+ 4027	- 3408	+ 440	+ 7151	+ 2770	+ 1540	+ 3576	- 91	- 644
Europe	+ 4865	- 3029	+ 200	+ 7695	+ 1851	+ 1455	+ 4175	- 201	+ 415
Japan	+ 23	+ 150	- 57	- 70	+ 492	+ 97	- 907	+ 21	+ 227
Canada	- 214	- 394	- 206	+ 590	+ 197	- 151	+ 219	- 53	+ 378
Others	- 647	- 135	+ 503	- 1064	+ 230	+ 139	+ 89	+ 142	- 1664
Developing countries[b]	+ 4845	- 899	+ 452	+ 5373	+ 696	+ 1170	+ 3423	+ 32	+ 52
Africa	- 589	- 740	+ 44	+ 145	- 30	- 20	+ 85	+ 28	+ 82
Latin America[b]	+ 3903	- 47	+ 666	+ 3284	+ 313	+ 882	+ 2698	- 18	- 591
South, East and South-East Asia	+ 1481	- 63	- 187	+ 1782	+ 420	+ 294	+ 557	- 69	+ 580
Western Asia	+ 50	- 49	- 71	+ 162	- 7	+ 14	+ 83	+ 91	- 19
World[b]	+ 9157	- 4111	+ 894	+ 12373	+ 3466	+ 2710	+ 6999	- 152	- 650

Source: United States, Department of Commerce, 1993c.

a Hotels and other lodging places, business services, motion pictures, engineering, architectural and surveying services, accounting, research management and related services, and health services.

b Excluding outflows to the finance (except banking), insurance and real estate industries of the Netherlands Antilles.

Note: + indicates increase in FDI outflows.
- indicates decrease in FDI outflows.

Foreign-direct-investment inflows in Western Europe did not decline significantly despite recessionary conditions, partly because of a number of countervailing forces. These included the continued adaptation of corporate strategies and structures to the ongoing re-configuration of the Western European markets arising from the emerging Single Market, the expected extension of the European Union to three Nordic countries and Austria, a further liberalization of trade between the European Union and the European Free Trade Area, association agreements of some countries in Central and Eastern Europe with the European Union on the road to full membership, and the opening up of Central and Eastern Europe to FDI and trade.

Despite the economic recession, the rationalization of international production associated with the formation of the Single Market and the requirements of global competition have continued, limiting the decline of FDI flows especially within the European Union. The Single Market has, on the one hand, created opportunities for TNCs to produce for a much larger market and, on the other hand, has led to increased competitive pressures on firms (UN-TCMD, 1993d), magnified by the recession. Both opportunities and pressures triggered a change in the market orientation and organizational structures of companies, including TNCs, towards a more pan-European perspective. The Single Market is thus providing the framework in which TNCs can adopt complex forms of integrated international production strategies within the region, allowing substantial economies of scale. It has been estimated that 80 per cent of the economies of scale to be derived from the Single Market will be attained through industrial restructuring and only 20

Table II.9. Declines in foreign-direct-investment flows during the recent recession, major home and host countries in Western Europe
(Billions of dollars and percentage)

Country	Peak level		Bottom level		Difference	
	Billions of dollars	*Year*	*Billions of dollars*	*Year*	*Billions of dollars*	*Bottom as share of peak*
			Outflows			
Western Europe	144	1990	106	1992	- 38	74
European Union	117	1990	94	1991	- 22	81
Germany	29	1990	16	1992	- 13	55
Netherlands	15	1990	12	1992	- 3	80
United Kingdom	37	1988	16	1991	- 21	43
Finland	3.3	1990	0.4	1992	- 3	12
Sweden	14	1990	1.4	1992	- 12.6	10
Switzerland	9	1988	5	1992	- 4	56
Memorandum:						
Japan	48	1990	17	1992	- 31	35
Australia	5	1987	- 0.3	1992	- 5.3	..[a]
			Inflows			
Western Europe	110	1990	81	1991	- 29	74
European Union	100	1990	72	1991	- 28	72
Germany	11	1989	7	1992	- 4	64
Italy	7	1988	2.4	1991	- 4.5	34
Netherlands	12	1990	6	1992	- 6	50
Spain	14	1990	8	1992	- 6	57
United Kingdom	32	1990	16	1991	- 16	50
Switzerland	5	1990	1	1992	- 4	20
Memorandum:						
United States	69	1989	3	1992	- 66	4
Australia	8	1988	5	1992	- 3	63

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; and annext tables 1 and 2.

a Not reported owing to negative flows.

per cent through increases in output (Cecchini, et al., 1988). The need to realize these economies is a powerful incentive for cross-border rationalization of production, leading to a reallocation of resources within a region consistent with a greater degree of economic integration (Thomsen and Woolcock, 1993, p. 35).

While the rationalization of international production usually leads to new FDI flows, there are also instances when production is relocated back to home countries. This may be triggered by differences in labour costs. As an example, Bowater, a United Kingdom-based packaging group, shifted production back to the United Kingdom from France and Italy, owing to considerations regarding employment costs.[30] Another example is IMI, an engineering company based in Birmingham, United Kingdom, that shifted production of drinks-dispensing machines from Germany to the United Kingdom, citing the view that there was a more co-operative and flexible work force, as well as lower social costs in the latter.[31] In another case, a number of German companies, after considering new locations for their production, opted to continue producing at home, citing the central location of Germany within Europe and the presence of abundant skilled labour suitable for high-technology production as the most important reasons for their decisions.[32]

Another reason for restructuring in Europe is related to the emergence and adoption by TNCs of more flexible, yet systemic, methods of production which in turn lead to cross-border investments through mergers and acquisitions and inter-firm collaboration in the form of strategic alliances, networks, cross-shareholdings and joint ventures. These forms are becoming increasingly popular among TNCs because they enable them to: share the escalating costs of research and development and cope with shortening product life cycles; exploit and further develop their core competence while permitting access to complementary competencies of other firms; combine their core strengths with those of other firms in order to penetrate new markets with existing products and technologies; and overcome weaknesses in static or declining markets.[33]

The adjustment of TNCs to a new configuration of markets and competition has been the most powerful factor countervailing the decline of FDI flows in Western Europe. As the recession recedes, that factor will again become important since the restructuring process in response to the Single Market is far from being completed.

Conclusions

The early 1990s have been unusual years for FDI flows. The steep decline of FDI outflows from Japan and of inflows to the United States and some Western European countries have changed considerably the pattern of major home and host countries that had emerged from the boom in investment flows in the second half of the 1980s. However, all indications are that these changes are temporary, and that these countries will return to the groups of major home and host countries, respectively, though not necessarily exactly to their previous positions within these groups. The full recovery of outflows from Japan may, however, take some time since, in addition to the recession, Japanese TNCs still have to cope with additional problems of a special nature. France has emerged, during the recession, as the largest home and host country of the European Union, replacing the United Kingdom. Overall, the recession has intensified competition among developed countries to attract FDI inflows.

B. Developing countries

Introduction

Decreasing FDI flows in the early 1990s have been accompanied by changes in their geographical pattern. The outstanding feature of that pattern has been the rapid growth of FDI in developing countries, culminating in inflows of $51 billion in 1992 and an estimated $80 billion in 1993 (table I.4). The *share* of developing countries in FDI inflows has continued to increase since 1989 and reached 32 per cent in 1992 and an estimated 41 per cent in 1993. Asia and the Pacific and Latin America and the Caribbean have received the bulk of these investments, while Africa and the least developed countries in all regions have lagged behind other developing countries as recipients of FDI inflows (table II.10). Regional differences between and within developing regions are discussed here. This discussion is prefaced by a brief review that places FDI flows in the broader context of net resource flows to all developing countries and a special focus on the least developed countries — a group of countries largely bypassed by foreign investors.

1. Net resource flows into developing countries

The rapidly increasing flows of FDI into developing countries have taken place at the same time as the rapid growth of portfolio investment flows. The growth of these two types of financial flows, as well as the re-emergence of private loans, have brought about considerable changes in the composition of net resource flows to developing countries. Not only have net resource flows grown rapidly in the 1990s (they increased by almost a quarter in only one year, 1992), but their composition has changed entirely from official flows to private flows (table II.11). Among the latter, foreign direct and portfolio investments have become the largest and most dynamic components.[34]

Increases in long-term net resource flows to developing countries as a whole reflect good economic performances, improved or continuous access to international capital markets, as well as progress in the development of local equity markets. These characterize the economies of two sub-regions East and South-East Asia and Latin America.[35] As a result, South, East and South-East Asia and Latin America and the Caribbean (including these sub-regions) increased their share of the total net resource flows to developing countries from 42 per cent and 20 per cent in the second half of the 1980s to 51 per cent and 25 per cent in 1992, respectively (table II.11). A big change took place in Latin America and the Caribbean where the net transfer of resources (subtracting interest payments and other net resource-service expenditures from resource inflows) turned positive in 1991 for the first time since the outset of the debt crisis (CEPAL, 1992), both reflecting and encouraging further the reopening of that region's capital markets.

For South, East and South-East Asia as a whole, the share of FDI in all resource flows increased from 27 per cent during 1986-1990 to 34 per cent in 1992 (figure II.3); that of portfolio investment rose from 8 per cent to 13 per cent. A considerable change occurred again in Latin America and the Caribbean: during the late 1970s and early 1980s, prior to the debt crisis, all financial flows to that region consisted mainly of bank credits lent to, or guaranteed by, governments of borrowing countries, or both (Mortimore, 1989; UNCTC, 1990a). In the early 1990s, the dominant form of external finance was foreign investment, either direct or portfolio (especially equity), aimed at the private sector (table II.11).

Weak FDI flows and an almost total absence of portfolio equity investment during the early 1990s distinguish both Africa and Western Asia from other regions in terms of the structure of external financial flows: they both continue to rely on grants and official loans. In Africa, this is especially the case with sub-Saharan Africa, where FDI — the only private flows of meaningful size — accounts for only some 12 per cent of total net resource flows (table II.11). Also in South Asia, which accounted for only 16 per cent of all net resource inflows to South, East and South-East Asia in 1992, official lending and grants are the most important instruments of external financing; accounting, on average, for 48 per cent and 39 per cent, respectively, of these resource flows in 1992. South Asia has not yet attracted much private direct or portfolio investment. In contrast, private resource flows into East and South-East Asia accounted for 71 per cent of all net resource flows in 1992. In that subregion, China has become the single largest recipient of net resource flows among developing countries, estimated to have attracted more than one-third of these flows into South, East and South-East Asia and some 15 per cent of net resource flows into all developing countries in 1993 (The World Bank, 1993a, p. 5).

Table II.10. Foreign-direct-investment inflows to developing countries, by region, 1981-1992 [a]

(Billions of dollars and percentage)

Region	1981-1985 (Annual average)	1986-1990 (Annual average)	1991	1992
Developing countries [b]				
Total	13.1	24.9	39.1	51.5
Share of the world total (Per cent)	26.3	16.0	24.1	32.5
Total without least developed countries	12.9	24.4	38.7	51.2
Africa				
Total	1.7	2.8	2.7	3.0
Share of developing-country total (Per cent)	12.9	11.4	7.0	5.9
Total without least developed countries	1.5	2.3	2.4	2.8
Latin America and the Caribbean				
Total [c]	5.9	7.7	15.0	17.7
Share of developing-country total (Per cent)	44.7	30.9	38.5	34.4
Total without least developed countries	5.8	7.7	15.0	17.7
Western Asia				
Total	0.4	0.4	0.5	0.7
Share of developing-country total (Per cent)	3.4	1.7	1.3	1.5
Total without least developed countries	0.4	0.4	0.5	0.7
South, East and South-East Asia				
Total	4.9	13.6	20.2	29.4
Share of developing-country total (Per cent)	37.6	54.8	51.8	57.1
Total without least developed countries	4.9	13.6	20.2	29.4
Memorandum:				
Least developed countries				
Total	0.2	0.5	0.3	0.3
Share of world total (Per cent)	0.4	0.3	0.2	0.2
Share of developing-country total (Per cent)	1.4	2.1	0.9	0.6

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of the Organisation for Economic Co-operation and Development; and annex table 1.

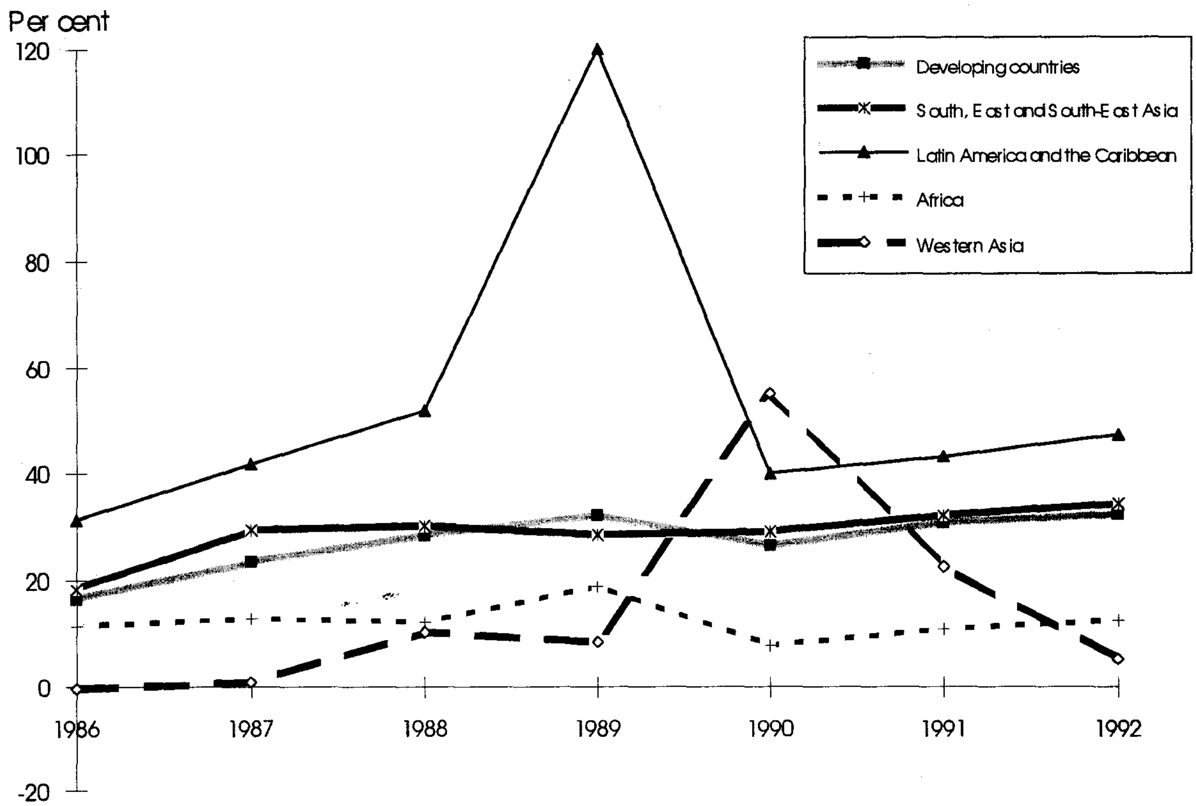
a Due to differences in regional composition, the data reported here are slightly different from those in table II.11.

b Includes developing countries in Europe (Gibraltar, Malta and the former Yugoslavia) and the Pacific Islands.

c Data in this table differ from those in table II.11 mainly due to the inclusion of Bermuda in the former.

Figure II.3. The share of foreign direct investment in total net resource flows, 1986-1992

(Percentage)



Source: The World Bank, 1993a.

In summary, FDI and portfolio investment flows have grown rapidly in East and South-East Asia and Latin America, reflecting the enormous needs of those regions for external financing. It has been estimated that South, East and South-East Asia alone will need more than $1 trillion to finance infrastructure and industrial projects over the next decade.[36] To satisfy those needs, these countries are increasingly borrowing from international and local capital markets. In the Eurobond market alone, Asian firms (excluding Japanese ones) issued bonds worth $14.7 billion in 1993, more than six times the 1992 volume.[37] Latin America and the Caribbean have re-established access to international capital markets, but their pattern of external financing is different from the one that preceded the debt crisis. Countries in that region receive more portfolio investments (especially equity investments) and FDI; thus they rely mostly on non-bank investors in private-sector enterprises, rather than on bank loans to public sector borrowers.

2. Least developed countries

One country group that has not benefited from the increase of FDI flows into developing countries continues to be the least developed countries.[38] Their share of FDI flows into all

Table II.11. Net resource flows into developing countries, by region and type, 1986-993 [a]

(Billions of dollars)

Type of flow	*1986-1990 (Annual average)*	*1991*	*1992*	*1993* [b]
Africa				
Foreign direct investment [c]	2.6	2.5	2.9	..
Portfolio investment [d]	- 0.5	- 0.5	0.1	..
Private loans [e]	1.7	- 2.5	- 2.8	..
Official loans and grants [f]	16.8	23.3	23.0	..
Total	20.5	22.9	23.2	..
Latin America and the Caribbean				
Foreign direct investment [c]	6.4	12.4	14.5	17.5
Portfolio investment [d]	- 0.8	8.9	5.5	..
Private loans [e]	0.2	1.1	7.4	..
Official loans and grants [f]	7.4	6.4	3.4	6.3
Total	13.2	28.8	30.8	37.5
Western Asia				
Foreign direct investment [c]	0.3	0.5	0.3	..
Portfolio investment [d]	-	-	-	..
Private loans [e]	0.9	- 2.9	..	
Official loans and grants [f]	4.1	1.8	2.3	..
Total	5.4	2.2	5.5	..
South, East and South-East Asia				
Foreign direct investment [c]	7.5	14.5	21.1	26.1
Portfolio investment [d]	2.2	4.3	8.1	..
Private loans [e]	2.8	8.9	15.0	..
Official loans and grants [f]	15.0	17.8	17.7	21.1
Total	27.5	45.5	61.8	72.3
Total, developing countries [g]				
Foreign direct investment [c]	16.9	30.0	38.9	..
Portfolio investment [d]	0.8	12.7	13.7	..
Private loans [e]	5.0	6.7	22.4	..
Official loans and grants [f]	43.1	48.6	46.2	..
Total	65.8	98.0	121.1	..

Source: UNCTAD, Division on Transnational Corporations and Investment, based on The World Bank, 1993a.

a Excludes short-term flows.

b Projection by the World Bank.

c Due to the different coverage of countries, the figures are slightly different from those in table II.10.

d Portfolio equity investments and bonds. Gross figures for the former flows.

e Includes both publicly guaranteed and non-guaranteed loans.

f Excludes technical cooperation grants.

g Includes Malta and the former Yugoslavia.

developing countries has remained not only very small, but has declined from 2.1 per cent during 1986-1990 to 0.9 per cent in 1991 and 0.6 per cent in 1992. Their share of worldwide FDI inflows was even smaller: a minuscule 0.2 per cent in 1992 (table II.10). In absolute terms, the roughly 300 million of total inflows to all least developed countries in 1992 was smaller than inflows to Pakistan during that year.

Factors that have discouraged investment inflows to least developed countries have included the falling global demand for most of their primary exports, often coupled with high levels of external indebtedness; their persistently small domestic investment and slow economic growth (table II.12); their small domestic markets; their poorly developed physical infrastructure, often including difficult and expensive transport and communication links with the outside world (UNCTAD, 1993b, 1994a); and a poorly skilled labour force. In a number of least developed countries, political instability and, in some instances, violence and civil strife have become prohibitive deterrents to FDI. While a number of least developed countries have embarked upon significant structural reforms and liberalized their FDI regulations (chapter VII), such measures — though necessary and helpful — have not yet proven sufficient inducements for TNCs to increase their investment in the group of least developed countries as a whole.

The largest concentration of the least developed countries (31 out of 47) is found in *Africa*. These account for 80 to 90 per cent of the total FDI flows to the least developed countries. African least developed countries did not participate in the investment boom to developing countries that began in the late 1980s. Furthermore, the early 1990s brought a contraction of flows to $268 million in 1991 and $240 million in 1992, from $321 million in 1990.[39] Besides, flows during the period 1981-1992 never returned to their highest level of $444 million, reached in 1980. Within the group of African least developed countries, inflows are also highly concentrated: five countries absorb between 60 per cent and almost all of the annual inflows (table II.13). The table illustrates also the rapidly changing fortunes as regards investment inflows: only Botswana and Zambia appear consistently on the list of the largest host African least developed countries in all years.

Despite its small absolute size, the amount of FDI received by a number of least developed countries in Africa is large in relation to the size of their domestic economies (see section 3(c) in this chapter). On the other hand, several least developed countries in Africa (e.g., Burkina Faso, Cape Verde and Chad) receive minuscule amounts of FDI flows even in relation to their own small GDPs. A number of least developed countries in Africa typically attract very moderate amounts of investment, and inflows tend to fluctuate widely between disinvestments and positive flows from year to year (table II.14). But the ability of these countries to attract some FDI, despite wide fluctuations, suggests that they are, in principle, within the purview of foreign investors.

It appears that least developed countries in *Asia* are faring better than least developed countries in Africa: in general, inflows in these countries increased during the early 1990s, compared to the second half of the 1980s. As a number of Asian developing countries are graduating to higher value-added FDI, some least developed countries in Asia are inheriting labour-intensive FDI mostly at the low end of the value-added chain. Bangladesh and Cambodia fall into this category. Among those countries that have adopted market-oriented economic policies recently, Lao People's Democratic Republic and Myanmar have attracted some investments (table II.15). Approved inflows of FDI to Lao People's Democratic Republic between 1989 (when FDI was allowed for the first time) and 1992 totalled $27 million. In that country, 102 permits were granted to foreign investors (mostly from Thailand) in 1992 and 79 in the first half of 1993, mainly in services (including banking).[40] Foreign-direct-investment flows to Myanmar began only recently as distinct from the 1980s when there were virtually none. Major investors are Thailand, the United States, Singapore and Hong Kong. Myanmar has the potential to play an important role as a source of raw materials important to developed countries and nearby newly

Table II.12. Macroeconomic indicators and foreign-direct-investment inflows in developing countries, 1986-1993

(Percentage)

Item	Least developed countries	Developing countries: Total	Africa [a]	Latin America and the Caribbean	Western Asia [b]	South, East and South-East Asia	World
Growth rate of FDI inflows							
1986-1990 (average)	.. [c]	21.0	7.4	15.7	21.4	35.9	32.6
1991	- 52.7	24.3	18.3	73.6	- 1.9	4.9	- 21.3
1992	- 15.3	18.7	12.5	-2.6	- 50.0	36.5	- 6.0
1993	..	57.0	..	..	..	..	23.0
Growth rate of gross domestic product [d]							
1986-1990 (average)	2.1	4.7	2.5	2.0	3.4	7.1	3.6
1991	0.6	4.5	1.6	3.3	2.4	6.1	0.6
1992	0.4	5.8	0.4	2.5	7.8	7.8	1.7
1993 [e]	..	6.1	1.6	3.4	3.4	8.7	2.2
Export growth rate [f]							
1986-1990 (average)	2.7	11.4	3.7	5.0	7.6	13.1	6.1
1991	0.4	8.1	1.9	4.7	3.1	11.9	2.4
1992	0.1	9.5	2.1	8.5	8.4	11.2	4.6
1993 [e]	3.6	9.4	0.1	4.1	6.9	12.7	3.0
Ratio of external debt to gross domestic product							
1986-1990 (average)	68.7	35.3	59.7	48.9	29.8	24.2	..
1991	55.2	32.3	58.9	43.6	24.0	24.9	..
1992	50.5	28.6	56.1	37.3	19.9	23.8	..
1993 [e]	48.1	27.2	56.0	37.5	16.8	24.2	..
Gross fixed capital formation as percentage of gross domestic product							
1986-1990 (average)	16.1	24.2	20.9	19.7	21.8	29.3	..
1991	15.1	24.8	20.8	20.8	23.9	29.0	2.0
1992 [e]	15.4	25.0	20.9	21.2	23.8	29.3	3.0
1993	..	..	..	..	..	..	..

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; International Monetary Fund, 1992, 1993b and 1993c; and UNCTAD, 1993b.

a Egypt and the Libyan Arab Jamahiriya are included in Western Asia except for the item on FDI.

b Includes Cyprus, Malta and Turkey except for the item on FDI.

c Due to negative inflows in 1986, growth rates cannot be calculated. Excluding the 1986 and 1987 data, the average growth rate was 24 per cent.

d Unlike table I.10, data in this table are not weighted averages. Therefore, there are some differences between these tables.

e Projection by the International Monetary Fund.

f Volume of merchandise exports. Data for least developed countries are estimates.

Table II.13. The largest five host countries among African least developed countries, based on foreign-direct-investment inflows, 1980, 1985 and 1990-1992

(Millions of dollars and percentage)

1980		*1985*		*1990*		*1991*		*1992*	
Botswana	112	Zaire	69	Zambia	203	Equatorial Guinea	42	Botswana	61
Zaire	110	Botswana	54	Botswana	38	Botswana	40	Zambia	50
Zambia	62	Zambia	52	Sierra Leona	32	Zambia	34	Sierra Leone	37
Niger	49	Togo	17	Malawi	23	Sierra Leone	30	Mozambique	25
Togo	42	Rwanda	15	Madagascar	22	Mozambique	23	Madagascar	21
Share in Africa's least developed-country total [a] (Per cent)	84		78		99		63		81

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994 and annex table 1.

a Excludes Liberia.

Table II.14. Highest and lowest amounts of foreign direct investment attracted by African least developed countries (excluding the largest recipients) during the period 1980-1992

(Millions of dollars)

Country	*Highest amount*	*Year*	*Lowest amount*	*Year*
Somalia	64	1987	- 15	1984
Mauritania	27	1980	- 0.2	1992
Malawi	25	1987	- 3	1986
Lesotho	21	1988	2	1986
Rwanda	21	1988	2	1992
Tanzania	19	1981	- 8	1984
Gambia	15	1989	- 2	1984
Benin	13	1991	- 0.1	1983 and 1985
Burundi	11	1981	0.5	1985

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994 and annex table 1.

industrializing economies. For some least developed countries in the Pacific, FDI flows are large relative to the size of their economies (table II.15).

Manufacturing has become an increasingly important sector of FDI in a number of Asian least developed countries. Bangladesh, with about three-quarters of its exports being manufactured goods, has been receiving most FDI in manufacturing (textiles and apparel) (box II.2). Nepal has also received FDI in textiles and apparel, which together with other manufacturing investments (e.g., carpets) account for nearly two-thirds of that country's exports (UNCTAD, 1992, p. 13). Foreign direct investment in Nepal, however, is concentrated in hotels and tourism, with significant multiplier effects for the economy in terms of the sale of locally manufactured products and the provision of services. Maldives is another country that has received considerable FDI in industry (which accounts for one-third of its exports), as well as in the development of hotels and tourist resorts (UNCTAD, 1992, p. 13).

For many least developed countries, FDI is often the only source of private external finance other than trade credits. Difficulties related mostly to their low level of development hinder their success in attracting these investments. A number of these countries offer locational advantages, which, if coupled with political and economic stability and friendly policies towards domestic and foreign companies, can make them attractive to foreign investors. These advantages include the availability of natural resources, touristic attractions and a low-cost labour force. In addition to overall FDI liberalization measures that are a necessary, although insufficient, ingredient of a good investment climate, targeting specific industries or even firms (including TNCs from developing countries) interested in matching their interests with the locational advantages of the least developed countries might be a possibility that can be explored, apart from general promotional efforts. However, even in the countries with some potential for attracting FDI, not to say, in the countries without such potential, official development assistance will remain essential for a good

Table II.15. Foreign direct investment and some economic indicators in selected least developed countries in Asia and Latin America and the Caribbean

(Millions of dollars and percentage)

Least developed countries	*Foreign direct investment* 1981-1985	1986-1990	1991-1992	*Per capita foreign direct investment 1991-1992a (Dollars)*	*Foreign direct investment as a share of gross domestic product, 1991-1992b (Per cent)*	*Per capita gross domestic product, 1991 (Dollars)*	*Per capita gross domestic product, growth rate 1990-1991 (Per cent)*
	(Annual average, million dollars)						
Afghanistan	0.06	0.08	0.04	0.03	-	485	- 10.1
Bangladesh	- 0.04	2.16	2.55	0.02	0.01	201	0.9
Haiti	6.64	7.44	10.80	1.64	0.41	399	- 4.9
Lao People's Democractic Republic	- 0.32	2.40	8.50	1.98	0.83	237	0.8
Maldives	- 0.32	4.34	6.55	32.75	4.91	667	4.1
Myanmar c	0.07	0.69	8.85	0.21	0.03	655	- 0.8
Nepal	0.15	1.92	1.80	0.09	0.05	168	2.9
Samoa	0.06	1.41	2.59	12.95	1.43	908	- 0.5
Solomon Islands	0.90	5.86	15.35	51.17	9.62	668	0.1
Vanuatu	5.77	9.60	15.20	76.00	6.62	1 148	1.4
Yemen	17.52	9.08	11.81	0.98	0.15	668	- 7.2
All least developed countries	187	524	324	0.62	0.18	349	- 2.3
All developing countries	13 105	24 892	45 272	15.68	1.40	1 035	0.8

Sources: Same as for table II.10; UNCTAD, 1994a, tables 1 and 2, pp. A-3 - A-5; and annex table 1.

a Average FDI flows during 1991-1992 divided by population in 1991.

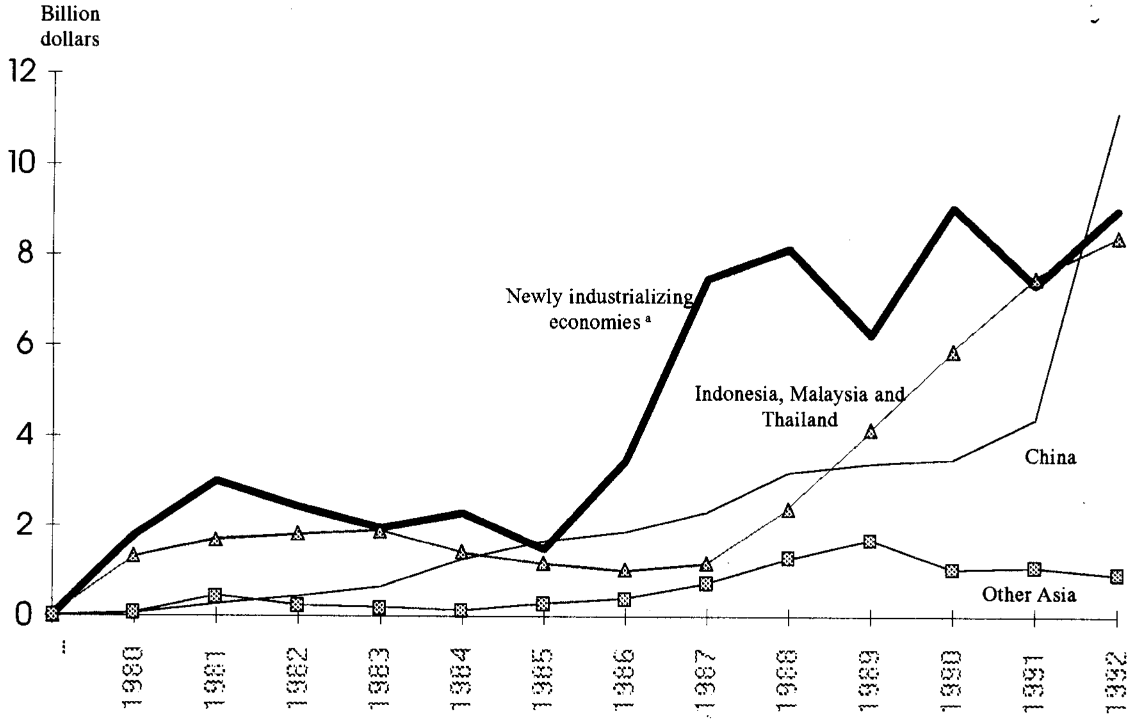
b Average FDI flows during 1991-1992 divided by gross domestic product in 1991.

c On an approval basis, cumulative inflows of FDI reported by the Government were $1,008 million between the end of 1988 (when the FDI law was promulgated) and 1993; see *Nihon Keizai Shimbun*, 1 February 1994.

As regards the newly industrializing economies of the region, investment inflows into the Republic of Korea and Taiwan Province of China fell by 51 per cent and 31 per cent, respectively, in 1992 (table II.16). Investments into Hong Kong and Singapore declined substantially in 1991, then increased by 257 per cent and 28 per cent, respectively, in 1992. As a result, these economies together attracted almost the same level of FDI in 1992 as during the late 1980s (figure II.4). Despite the slow-down of inflows, this level is high enough to permit these economies to continue to rank among the top 10 recipients of FDI among developing countries. The slow-down may be related to the restructuring of FDI owing to a loss of certain locational advantages and the acquisition of new ones. (The role of FDI in economic development and restructuring of these economies in Asia is discussed in box II.4.) Advantages that made these economies attractive to foreign investors in the 1980s — a stable macroeconomic climate, high growth rates of per capita income, expanding consumer markets, export-oriented trade policies, a well-developed (though, in some cases, deteriorating) infrastructure, a highly productive and educated workforce with entrepreneurial capabilities and an indigenous suppliers' network — remain unchanged. Furthermore, Hong Kong and Singapore have the most liberal investment regimes among developing countries, granting unrestricted national treatment to foreign investors in all areas.

Despite these attractions, rising costs in excess of productivity gains and an overburdened infrastructure (predominantly urban and road transportation) have discouraged efficiency seeking, labour-intensive FDI in these economies in recent years. Real wages increased by 30 per cent in Hong Kong, by 68 per cent in the Republic of Korea and by 36 per cent in Singapore between 1985 and 1990, while productivity gains during the same period were, for example, only 18 per cent in Singapore and 46 per cent in the Republic of Korea.[42] The loss of cost advantages of these economies has induced not only foreign, but also domestic companies to shift labour-intensive

Figure II.4. Foreign-direct-investment inflows to South, East and South-East Asia, 1980-1992



Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; and national official sources.

a Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

Box II.2. Foreign direct investment in Bangladesh

Bangladesh presents an interesting case of a least developed country that has been successful in obtaining a growing share of FDI flows. Rising labour costs and skills have led to the graduation of a number of other Asian countries to higher value-added activities. As a result, some labour-intensive activities are migrating from these countries to, *inter alia* Bangladesh. The stock of FDI was estimated to be 2.3 billion taka ($60 million) as of June 1992, not including export processing zones.[a] Investment flows to Bangladesh amounted to $3.7 million in 1992, up from $1.4 million in 1991.

Foreign investors have been attracted to the manufacturing sector of Bangladesh by its low wages and, in particular, its unused quota for exporting textiles and apparel to the markets of the European Union and the United States. (Ready-made garment exports rose from virtually nil in the 1970s to over one-half of its export earnings by the early 1990s.) Foreign direct investment in that industry accounted for nearly one-fifth of approved investment inflows in 1992, excluding export processing zones. The foundations of that industry were laid initially in 1979 through a collaborative agreement between Desh Garment Company, a local Bangladesh firm, and Daewoo Corporation, a TNC based in the Republic of Korea which provided labour training, start-up assistance and overall supervision of production and marketing.[b]

Aside from the textile and apparel industry, FDI in Bangladesh has been important in the food processing (20 per cent of cumulative approved investment by mid-1992), electric machinery (14 per cent) and chemical (13 per cent) industries. These investments, as with investments in textiles and apparel, tend to be concentrated at the low end of the value-added chain. Investors, mainly from other Asian developing countries, accounted for more than three-quarters of approved investments between mid-1990 and mid-1992. Firms from the Republic of Korea have dominated investment in the export processing zones, employing three times as many workers as Japanese firms (6,000 workers versus 2,000 workers) and exporting $4.3 million a month in 1992, compared to $2.3 million of exports by Japanese affiliates.[c]

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a Stock data are not available for FDI including export processing zones.

b For details, see UN-TCMD, 1992a, pp. 214-215.

c JETRO, 1993b, pp. 234-237.

part of the necessary financing for their investments, especially investments in the improvement of infrastructure needed to provide adequate services to TNCs. The public support from developed country governments and, of course, international organizations, is also essential to the success of structural adjustment programmes carried out by least developed countries. Without such support, it is not likely that those countries could generate development and create conditions on a scale sufficient to attract meaningful amounts of FDI.

3. Regional trends

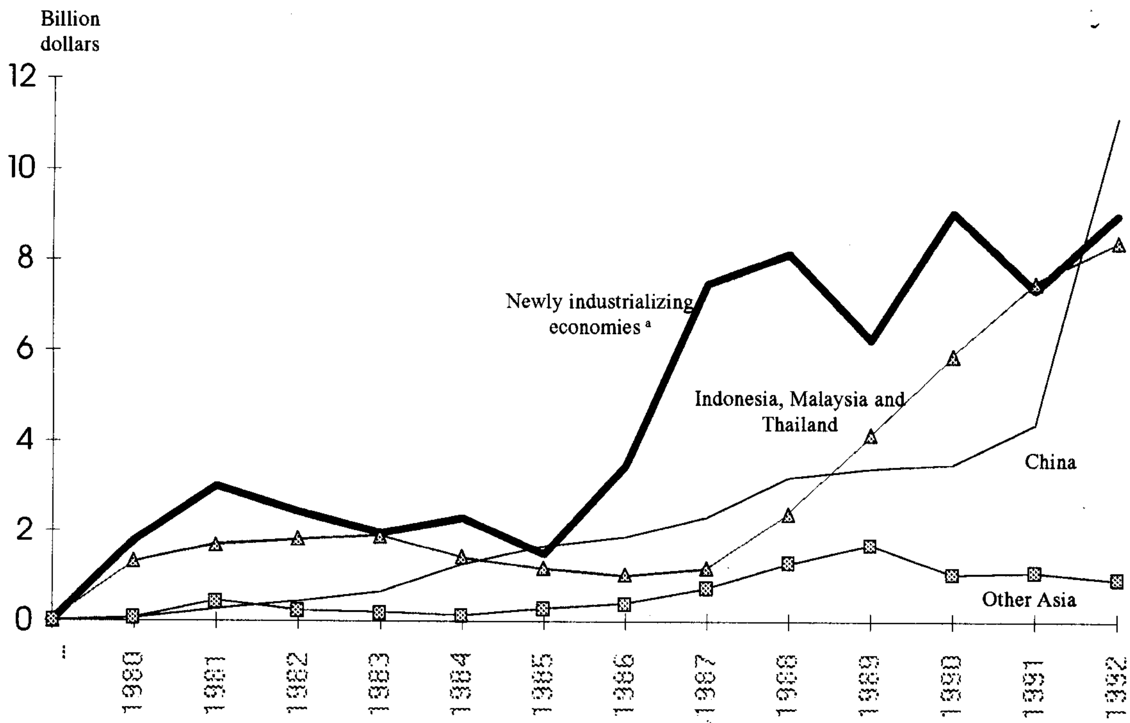
(a) Asia and the Pacific

Fuelled by high growth rates, large and increasingly affluent domestic markets, low production costs in a number of countries and a further liberalization of FDI policies, investment inflows to East, South and South-East Asia and the Pacific reached $30 billion in 1992, an increase of 45 per cent over the previous year. With inflows exceeding $11 billion, China emerged as the largest recipient of FDI among all developing countries in 1992, and dominated flows into Asia. Investments in China increased further to about $26 billion in 1993 (box II.3). Excluding China, the increase in investment inflows to East, South and South-East Asia and the Pacific was considerably less in 1992: 15 per cent, for a total of $19 billion.[41]

As regards the newly industrializing economies of the region, investment inflows into the Republic of Korea and Taiwan Province of China fell by 51 per cent and 31 per cent, respectively, in 1992 (table II.16). Investments into Hong Kong and Singapore declined substantially in 1991, then increased by 257 per cent and 28 per cent, respectively, in 1992. As a result, these economies together attracted almost the same level of FDI in 1992 as during the late 1980s (figure II.4). Despite the slow-down of inflows, this level is high enough to permit these economies to continue to rank among the top 10 recipients of FDI among developing countries. The slow-down may be related to the restructuring of FDI owing to a loss of certain locational advantages and the acquisition of new ones. (The role of FDI in economic development and restructuring of these economies in Asia is discussed in box II.4.) Advantages that made these economies attractive to foreign investors in the 1980s — a stable macroeconomic climate, high growth rates of per capita income, expanding consumer markets, export-oriented trade policies, a well-developed (though, in some cases, deteriorating) infrastructure, a highly productive and educated workforce with entrepreneurial capabilities and an indigenous suppliers' network — remain unchanged. Furthermore, Hong Kong and Singapore have the most liberal investment regimes among developing countries, granting unrestricted national treatment to foreign investors in all areas.

Despite these attractions, rising costs in excess of productivity gains and an overburdened infrastructure (predominantly urban and road transportation) have discouraged efficiency seeking, labour-intensive FDI in these economies in recent years. Real wages increased by 30 per cent in Hong Kong, by 68 per cent in the Republic of Korea and by 36 per cent in Singapore between 1985 and 1990, while productivity gains during the same period were, for example, only 18 per cent in Singapore and 46 per cent in the Republic of Korea.[42] The loss of cost advantages of these economies has induced not only foreign, but also domestic companies to shift labour-intensive

Figure II.4. Foreign-direct-investment inflows to South, East and South-East Asia, 1980-1992



Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; and national official sources.

a Hong Kong, Republic of Korea, Singapore and Taiwan Province of China.

Box. II.3. China's great leap forward

The recent FDI boom in China has been heralded as a miracle. In 1991, China ranked only thirteenth in the world and third among the developing countries in terms of FDI inflows. In 1993, it became the second largest FDI recipient in the world (following United States) and the single largest host country among the developing countries (figure 1).

During 1992 and 1993, 132,000 new projects were approved, with commitments more than triple the total of the previous 13 years. Actual inflows during these two years amounted to $37 billion ($11.1 billion in 1992 and $25.8 billion in 1993),[a] equivalent to one-and-a-half times the total inflow accumulated during 1979-1991. While FDI inflows grew, on average, by 30 per cent annually during 1985-1990, they leaped by 156 per cent in 1992 and 134 per cent in 1993. In the late 1980s, the average size of FDI projects was less than one million dollars; in contrast, projects above $50 million are now fairly common.

The past two years have also seen a significant expansion in terms of both sectoral and geographical patterns of FDI flows to China. While labour-intensive manufacturing continues to absorb a large share of FDI, inflows are increasingly directed towards capital- and technology-intensive industries, as well as towards infrastructure-building and services (particularly in the East and South-East provinces). At the same time, labour-intensive and resource-seeking investments are now gradually moving to the Northern and inland provinces. This sequential pattern of development — which had earlier been observed particularly in the Asia and Pacific region (described as "a flying-geese formation") — appears to be taking place within China.

The growing FDI inflows into China have been also evidenced by the large number of commitments by large TNCs in what might be termed the "third wave" of FDI inflows,[b] dwarfing earlier investments by overseas Chinese. A number of the world's largest TNCs have now a presence in China;[c] many of them have sizeable direct investments. Large TNCs, such as Mitsui, Marubeni, Siemens, Coca Cola Co., Motorola, IBM, Philips, Volkswagen, TPL and AT&T have recently revised upwards their investment plans in China. There is a wide perception in the business community that no one can afford to ignore the enormous investment opportunities in China.

With over 50,000 foreign affiliates in operation and a total stock of over $61 billion, the impact of FDI on China's economic development is becoming more and more tangible. Foreign affiliates have contributed significantly to the growth of China's exports (figure 2). The export share of foreign affiliates in total national exports increased from 13 per cent in 1990 to 28 per cent in 1993, amounting to $25.2 billion. China now ranks as the eleventh largest exporter in the world and second largest exporter among the developing countries; its exports accounted for 17 per cent of its GNP in 1992. There is no doubt that FDI has fuelled China's export boom and contributed to sharpening its international competitiveness.

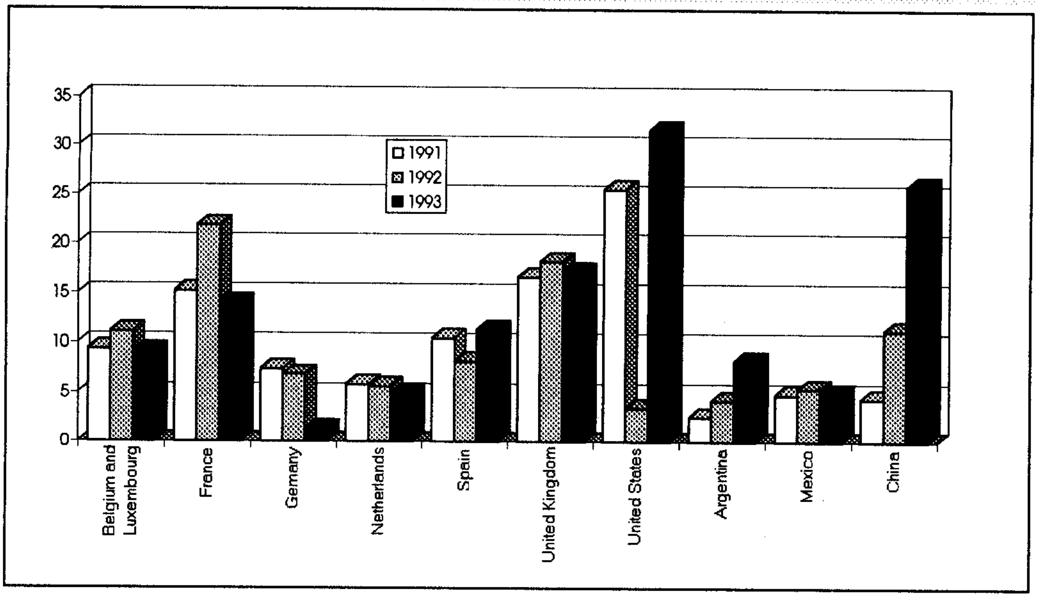
In 1993, the total annual outputs of foreign affiliates reached 300 billion yuan ($52 billion), with tax contributions of 10.7 billion yuan ($1.9 billion) in 1992 and 8.8 billion yuan ($1.5 billion) in the first half of 1993. In some large industrial cities, the tax contribution of foreign affiliates accounted for over 10 per cent of tax revenues in 1993. As of the end of 1992, there were nearly 6 million employees in foreign affiliates. Although they accounted for only about 4 per cent of the total employment in urban areas, foreign affiliates have played a positive role in the implementation of China's full employment policy (the unemployment rate in urban areas was 2.3 per cent). Foreign direct investment now accounts for around 10 per cent of gross national investment (which itself has also been growing rapidly). It should be noted that the importance of FDI is much greater in the coastal regions which have been an engine of growth for the Chinese economy.

A number of factors, acting in combination with one another, contributed to the current boom in FDI:

- The rapid expansion of the domestic market, driven by a strong economic performance;[d]
- The gradual opening of the domestic market to FDI, inducing a large number of market-seeking investments. In 1992, some service industries, such as transportation, banking, real estate and retail trade, and 52 cities and areas became open to foreign investors;
- Low-cost production and rich natural resources, attracting a large number of TNCs;

Figure 1. The world's ten largest recipients of foreign-direct-investment inflows in the 1990s

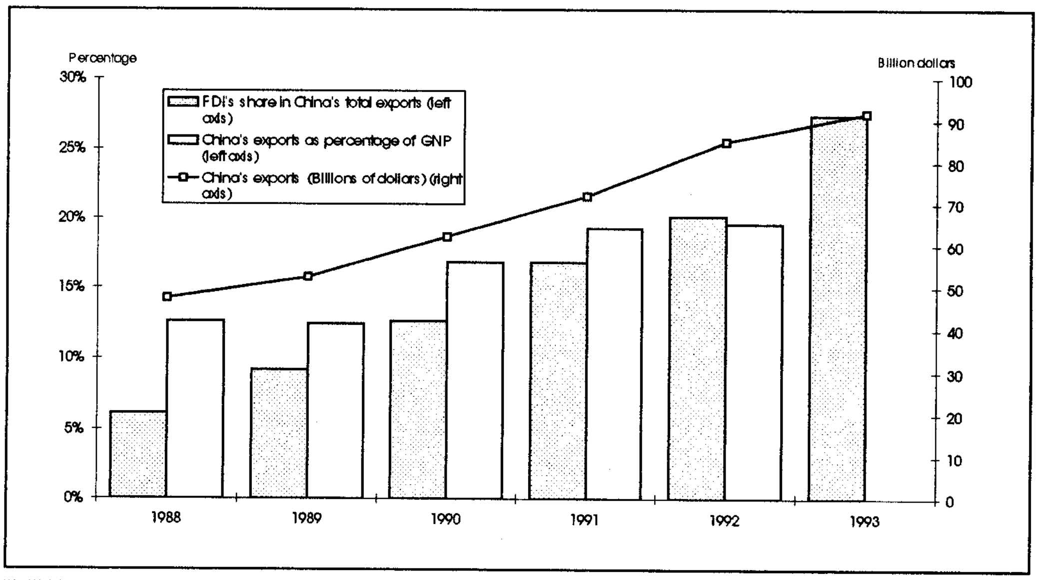
(Billions of dollars)



Source: annex table 1 and estimates of UNCTAD, Division on Transnational Corporations and Investment.

Figure 2. The contribution of foreign direct investment to China's exports

(Billions of dollars and percentage)



Source: Zhan, 1993.

- The restructuring of the economy towards market-based mechanisms and other economic reforms, significantly improving the overall enabling framework for foreign (and domestic) investors;
- High economic growth in neighbouring countries and the improvement of relations with the Republic of Korea and Taiwan Province of China. These economies used to have negligible investment outflows to China in the 1980s; they have now become major sources of investment in China, ranking third and sixth, respectively.

Looking ahead, some of these factors can be maintained: it is likely that China's economy would still be growing at a high rate until the end of the century (perhaps between 7 and 10 per cent per annum); the liberalization of the FDI regime is expected to proceed further, especially through the opening of more industries and geographical areas to foreign investors,[e] and allowing more flexible modes of investment, while providing incentives to preferred high-technology and infrastructure projects. The current round of market-oriented reforms, if carried out successfully, would contribute further to a more favourable environment for FDI. For example, the eventual full convertibility of the domestic currency is expected by the end of the century. The sheer size of the domestic market, still expanding rapidly, and the diversity of the Chinese economy in many respects — e.g., labour costs, endowment in natural resources — have a potential to sustain not only large quantities of FDI, but also different types of these investments, namely, market-seeking, resource-seeking and efficiency-seeking.

China will probably remain a major FDI recipient in the years to come, at least in the short-run. However, the rate of FDI growth will depend largely on China's future political stability, the consistency of its economic policies and its macro-economic management capabilities, as well as the extent to which China will succeed in its transformation into a market economy and its integration into the world economy, depending on developments in these and other respects, it is possible that inflows of FDI will experience short-term fluctuations, as had been the case in past years.[f]

Sources: Zhan (1993) and various national data.

a It should be noted that investment inflows are likely to be overestimated in two ways. About 70 per cent of FDI inflows are "in kind", that is, equipment and technology; translating the amount of these investments into cash tends to overvalue the amount of FDI (Zhan, 1993). The other overvaluation is caused by the disguise of some domestic investment that is re-routed through foreign affiliates in Hong Kong back into China as FDI in order to take advantage of fiscal entitlements awarded to foreign investors (Harrold and Lall, 1993).

b The first wave occurred in late 1970s and early 1980s, when there was great interest, but not much actual investment. The second wave took place in the mid- and late 1980s and was predominated by Asian companies.

c Shanghai alone has attracted about 120 of the world's 500 largest TNCs.

d During the period 1978-1991, real GNP grew at an average annual rate of 9.7 per cent; growth rates were 13 per cent in 1992 and 1993.

e Some of the newly opened sectors, such as banking, aviation, telecommunication, retail etc., are only partially liberalized.

f In November 1993, it was decided to introduce national treatment for foreign affiliates, in order to establish a level-playing field for both domestic and foreign firms. While this may improve the regulatory framework in the longer term, it reduces also existing preferential treatment of foreign investors; the latter may not only discourage the round-tripping of investment originating from domestic firms but probably also some "real" FDI.

Table II.16. Foreign-direct-investment inflows to selected South, East and South-East Asian countries, 1981-1992

(Millions of dollars)

Economy	*1981-1985* (*Annual average*)	*1986-1990* (*Annual average*)	*1991*	*1992*
China	850	2 853	4 366	11 156
Hong Kong	576	1 945	538	1 918
India [a]	59	182	145	140
Indonesia	236	599	1 482	1 774
Korea, Republic of	117	676	1 116	550
Malaysia	1 083	1 126	3 998	4 469
Pakistan	77	175	257	349
Philippines	63	493	544	228
Singapore	1 349	3 247	4 395	5 635
Sri Lanka	42	40	48	123
Taiwan Province of China	189	987	1 271	879
Thailand	279	1 188	2 014	2 116
Viet Nam	6	6	32	-

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; estimates of Organisation for Economic Co-operation and Development; and annex table 1.

a Based on outward FDI flows to India from the members of the Development Assistance Committee of OECD. These data underestimate the magnitude of FDI inflows to India.

production abroad and thus expedite the process of industrial upgrading at home. In addition, these economies (as well as other Asian countries, such as Malaysia) are increasingly pursuing policies that encourage quality FDI through attracting high value-adding activities of TNCs.[43] This means, however, that establishing research-and-development facilities or regional headquarters fosters an upgrading in the activities of TNCs that is not necessarily accompanied by large investment flows.

The fact that the share of the newly industrializing economies in investment flows into Asia has diminished in recent years also reflects the emergence of a "second-tier" group of industrializing countries (Indonesia, Malaysia and Thailand) and China, where FDI grew rapidly in the late 1980s and 1990s from low initial levels. Those countries became preferred locations for labour-intensive FDI seeking to reduce costs and, more recently, market-seeking FDI (including such action by TNCs from the newly industrializing economies). In Thailand, for example, there was only a 3 per cent (total) increase in real wage rates between 1985 and 1991; and in 1991 the wage level was only 19 per cent of that of the Republic of Korea.

Japan in particular, still the principal source country for this region, has increased its investments in the new destinations of FDI at the expense of the newly industrializing economies: the share of the latter in the investment outflows from Japan to South, East and South-East Asia has declined steadily from 60 per cent in 1989 to 24 per cent in 1992.[44] As indicated earlier, recently, Japanese TNCs facing financial difficulties and low profits at home and abroad, as well as an appreciating exchange rate, have been seeking to reduce costs further by shifting production to

Box II.4. The role of foreign direct investment in East and South-East Asia

The experience with FDI of the Asian newly industrializing economies (the Republic of Korea, Taiwan Province of China, Hong Kong and Singapore) and the second-tier newly industrializing economies (Indonesia, Malaysia and Thailand) is of great interest to the developing world. In part, this is because of their outstanding economic performance — any factor that may be significant in explaining that performance has important lessons for other developing countries — in part, it is because they adopted very *different* strategies within the common context of export orientation. They all relied heavily on foreign technology to fuel their entry into world markets and were generally open to international technology flows. In contrast to a number of import-substituting countries, they made no attempt at self-reliance in technology.

However, the mode in which they imported technology, the efforts they made to complement and build upon imported knowledge and the interventions they undertook to encourage domestic enterprises to enter complex activities, all differed significantly. Some depended heavily on FDI by TNCs, others on licensing and the import of capital goods (also, often, from TNCs). Although all of these countries were successful in expanding industrial production and exports, they developed very different industrial structures, export specialization and technological capabilities. To a significant extent, this can be explained by their strategies regarding foreign technology and industrial promotion.

The recent, much publicized study by the World Bank of the East Asian "miracle" (World Bank, 1993d) attempts to explain the economic success of several countries in that region. It points to the role of factors like good macroeconomic management, human capital formation, general openness to foreign technology and export orientation. These are valid, but not original: no one disputes any longer the role of such factors in fostering long-term development. The study also notes the large *differences* between these countries in their policies on FDI, import protection and industrial targeting. However, the study does not attempt to analyze what impact these differences had on industrial structures, specialization and upgrading, and reaches generally negative conclusions on the role of industrial policy (selective interventions to promote industrial development and deepening). The subject of industrial policy remains controversial, and the World Bank's conclusions are strongly debated (Lall, 1994a).

Openness was essential to the Asian success, and technology imported from TNCs was an essential ingredient. However, an active strategy to maximize indigenous capabilities was essential for the industrial prowess of the larger "tigers". There remain many deficiencies in free markets as far as industrial and technological development are concerned, and a positive role exists for careful and selective government interventions in using FDI.

The high growth economies of East and South-East Asia may be divided into four broad categories as far as FDI strategies are concerned:

- Economies that followed passive open-door policies on TNCs and did not intervene to promote industrial development in other ways (e.g., Hong Kong).

- Countries that pursued active industrial policies for certain industries and promoted local enterprises in certain activities, but adopted effectively open-door, non-interventionist policies in some export-oriented industries (e.g., Thailand, Malaysia).

- Countries that actively sought heavy TNC participation in manufacturing, but intervened selectively to guide investors in directions and technological activity thought to be desirable for industrial upgrading (e.g., Singapore).

- Economies that selectively restricted FDI and sought to maximize reliance on externalized forms of technology transfer in the context of a comprehensive set of industrial policies to deepen the manufacturing sector, promote local linkages and increase local innovative capabilities (e.g., the

Republic of Korea and Taiwan Province of China and, earlier, Japan). These industrial policies encompassed interventions in trade, finance, skills, technology and institution building, with strongly selective aspects to practically all interventions.

Table 1 shows the share of FDI in gross domestic capital formation in these economies. It also provides data on research and development by productive enterprises as a share of GDP in a recent year. It shows, in very broad terms, that the economies that developed the most diverse, complex and technologically dynamic industrial sectors (the Republic of Korea, Taiwan Province of China and, earlier, Japan) had the least reliance on FDI. There was, apparently, a causal connection between industrial policy, selective restrictions on FDI, the pursuit of technological deepening and export-orientation that allowed these countries to achieve historically unprecedented rates of industrial growth. Certainly, their industrial strategies were aimed at the development of indigenous capabilities, and selectivity on FDI was one important aspect of their strategies. These are issues on which the World Bank's interpretation of the East-Asian "miracle" has little to say.

Table 1: Foreign direct investment as share of gross domestic investment, and research and development as share of gross domestic product in selected East and South-East Asian countries, 1981-1985 and 1986-1991

(Percentage)

Economy	*FDI/GDI, 1981-1985*	*FDI/GDI, 1986-1991*	*Research and development by productive enterprises as a share of GDP*
Hong Kong	10.7	11.4	0.3 [a]
Republic of Korea	0.5	1.1	1.3
Singapore	17.4	29.4	0.2
Taiwan Province of China	1.5	3.5	0.6
Malaysia	1.5	9.7	0.1
Thailand	0.1	6.3	0.03
Memorandum:			
Japan	0.1	0.1	1.9

Source: UNCTAD-DTCI, 1993a; Lall, 1992.

a Estimate.

To amplify on the experience of some economies of East and South-East Asia:

- First, *Hong Kong*, with the most liberal FDI regime, was able to attract substantial amounts of FDI and, at the same time, develop a dynamic indigenous industrial class that was very successful on export markets. Hong Kong is, however, a very special case, by virtue of its location, long entrepôt tradition, presence of large and highly developed trading and financial companies of the United Kingdom, and the influx of trained engineers/technicians from China. This allowed it to launch into export-oriented light manufacturing. In the case of garments, the relatively brief learning period, had been undergone already in China; other activities (toys, watches etc.) could be financed locally.

However, because of the essentially *laissez faire* policies pursued, Hong Kong's industrialization shows special features. The colony started *and stayed with* light labour-intensive manufacturing, though considerable upgrading has taken place. Hong Kong's success was based on an impressive development of operational and marketing capabilities, but there was little industrial deepening and diversification because of the lack of promotion of more demanding complex technological learning. There was some "natural" progression up the ladder of industrial complexity, but it was relatively limited in relation to other newly industrializing economies. As wages and land costs rose, Hong Kong had to relocate its manufacturing to other countries, mainly China, and suffered a significant loss of industrial activity at home (over the period 1986-1992, it lost about 35 per cent of its manufacturing employment, and that process is continuing).[a] The growth of its manufactured exports has slowed down considerably, and may even have declined during 1993-1994. Its impressive outward FDI performance, especially in China, is a reflection of its advanced entrepreneurial, but limited, technological capabilities rather than of broad industrial strengths (Lall, 1993a). At the same time, the lack of a strong technological base is of concern to the Government that is now launching initiatives, such as the Hong Kong Industrial Technology Centre, to promote selectively local high-tech companies.[b]

- Second, *Malaysia* has been able to develop an impressive array of high-technology exports driven almost entirely by FDI, because it was successful in targeting and attracting electronics assembly when the burst of labour-intensive activity started in developing countries. Its excellent infrastructure, stable and open economy, low wages and use of English has made it an ideal investment site, an advantage that seemed to grow over time, despite the fact that it imposed various equity sharing and other conditions on investors that were not wholly export-oriented. Malaysia benefited greatly from its location in a hub of dynamic growth, much of it driven by strategic industrial policy in the larger countries like the Republic of Korea and Taiwan Province of China. As technologies progressed and wages rose, TNCs responded by automating their facilities in Malaysia and diversifying; in turn other assembly operations were attracted, and today the country has annually some $34 billion of manufacturing exports. At the same time, Malaysia pursued active industrial policies in other activities, such as setting up public enterprises, promoting *bumiputra* ownership, helping small- and medium-sized firms and upgrading resource-based activities. To a large extent, however, these activities remained detached from the TNC sphere of manufacturing for export.

Has this dependence on FDI hampered growth in Malaysia? The evidence suggests not. However, Malaysia's technological base is small and underdeveloped, TNCs have low local content and their ability to upgrade constantly in the face of rising wages remains a source of concern. The pattern of industrial development has been skewed towards electronics and electrical industries — still assembly operations (though now fairly capital rather than labour-intensive) with low levels of linkages with local firms, little local design-and-development activity and no independent marketing capabilities. The scarcity of local technical skills is a constraint to further upgrading. The paucity of indigenous suppliers and technological support makes local research and development difficult for TNCs. Approvals of FDI in 1993 dropped by 60 per cent; over a longer period, FDI in high-technology activities has not been growing rapidly. The Government has ambitious technology-development plans, drawing on the model of the Republic of Korea. It is also launching selective policies towards TNCs to induce technological deepening and greater local content. Clearly, FDI in a late comer can do wonders for export performance and manufacturing output if certain conditions are met, but its impact on local technological capabilities remains weak. The conditions offered by Malaysia are unusual, and practically no other country (including its neighbours) has been able to reproduce them. The export drive by Thailand, for instance, is far more concentrated in low-technology assembly activity, and even is more so in Indonesia.

* Third, *Singapore* has the highest reliance of almost any country on TNCs, and has done extremely well from it. The Government has been very interventionist, but the form of interventionism has been very different from that in the Republic of Korea. The economy started with a base of capabilities in *entrepôt* trading, ship servicing and petroleum refining. After a brief period of import substitution, it moved into export-oriented industrialization, based overwhelmingly on FDI. Unlike Hong Kong, there was a weak tradition of local entrepreneurship, and there was no influx of technical know-how from China. For a decade or so, there was light industrial activity (garment and semiconductor assembly), after which the Government of Singapore acted firmly to upgrade its industrial sector, by intervening to guide TNCs to higher value-added activities and to create the specific high-level technical skills that would be needed.[c] The Government also set up a number of public enterprises to undertake those activities that were considered to enhance the country's future competitive advantage (including, most recently, an investment push into China); the public sector in Singapore accounts for a substantial proportion of GDP.

  Specific areas of both manufacturing and services (e.g., banking, freight and aircraft servicing) were selected for promotion by the Government of Singapore, but the policy instruments used did not include trade protection. Instead, they comprised a range of incentives and pressures that guided the allocation of foreign and local resources and lowered the cost of entry into difficult activities by providing the requisite skills and infrastructure. Manufacturing activity was guided into highly specialized processes and products, but there was no attempt to increase local content deliberately. Such specialization, along with the heavy reliance on FDI for technology and skill transfer, greatly reduced the need for indigenous technological investments (as compared, say, with the Republic of Korea). Thus, while selective interventions led Singapore's industry into sophisticated electronic products, precision instruments, optics and so on, the technological depth of the enterprises located there remained comparatively low. Some design-and-development activity did develop over time, but this was again with considerable urging and support from the Government.

  The lessons of Singapore are twofold. First, FDI can take a small economy a long way if it is carefully selected and guided, supplied with very good infrastructure and a disciplined and trained workforce, and given a competitive and stable investment environment. Second, it is not necessary to offer import protection to technologically complex activities if the main sources of operational and other technologies remain foreign and production is integrated with that in foreign countries (rather than with local suppliers) and is concentrated on selected stages of production. This strategy required both functional and selective interventions by the Government: the contrasting experiences of Singapore and Hong Kong with respect to the deepening of industrial activity illustrate this clearly.

* Finally, the cases of the *Republic of Korea* and *Taiwan Province of China* are by now well examined.[d] It only needs to be reiterated that the role of FDI was secondary to that of technology import in other forms and that the export drive was led by local firms to develop impressive technological capabilities. The Republic of Korea went much further in developing advanced innovative capabilities than did Taiwan Province of China, though perhaps at the cost of a more concentrated industrial structure and a worsening of income distribution. Unlike Taiwan Province of China, the Republic of Korea had to promote the growth of giant conglomerates (to internalize poorly functioning markets and bear the risk of going into demanding activities at world levels of efficiency), though the former also tried to enter heavy industry with public sector enterprises. Both economies invested heavily in higher education and technical training, and both created a range of technology-support institutions. Strong incentives (including subsidies and cheap credit) were given to promote local research and development and to use local research institutes. The Governments took a strong lead in targeting industries for technology development, and both countries have selected around ten to twelve activities for investment to promote their future competitiveness.

The most important point about the experiences of the Republic of Korea and Taiwan Province of China (and that of early Japan) is that while TNCs made important inputs into their industrialization, they were used by the Governments primarily in furthering the acquisition of technology and the development of local innovative capabilities. The externalities generated by these capabilities were captured by local firms and were used to dynamize the countries' competitive advantage. The internalized markets of TNCs were not, in other words, allowed to weaken the deficient factor markets of the host economies, but were tapped in such a way that local capabilities were strengthened. As their capabilities grew, FDI was allowed to play a larger role, but it never became the "custodian of development".

The best conditions for domestic "learning" are still to be determined, but the growing empirical evidence on developing countries' technological development suggests that simple "openness" and passive reliance on market forces may not be the best strategy for development. Transnational corporations remain the main source of innovation and technology, and in many instances investment by them is the best and most effective way to develop manufacturing and export capabilities. However, there are other cases in which a more independent approach can yield greater benefits to indigenous learning, for countries that have the capacity to undertake it. One of the lessons of East and South-East Asia is that the effort is feasible and worthwhile.

Source: Sanjaya Lall, "The role of foreign direct investment in East Asia: a note", prepared for UNCTAD, Division on Transnational Corporations and Investment, June 1994.

a "Survey of Hong Kong", *Financial Times*, 4 May 1993. A recent article in the *Far Eastern Economic Review* (29 May 1994, p. 68) shows that manufacturing employment declined from 45 per cent to 23 per cent of the total in 1980-1992.

b *Far Eastern Economic Review*, 26 May 1994, p. 69.

c When the local skill base was unable to cope, the Government allowed a controlled import of skilled manpower.

d For a summary description, see Lall, 1994b.

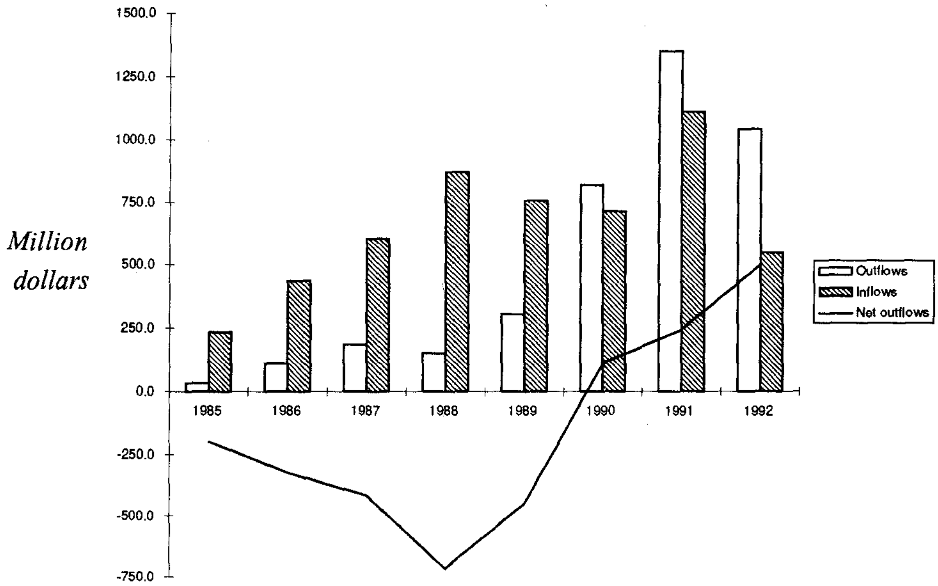
the second-tier industrializing countries and China. In their cost-cutting efforts, wage increases that outstrip productivity gains appear to be an important consideration in the decision of Japanese firms as to where to locate production in Asia, which places the newly industrializing economies at a disadvantage.

As regards outward investment, as already mentioned, firms from the newly industrializing economies continue to invest abroad: annual FDI outflows from the Republic of Korea, Singapore and Taiwan Province of China were $5.7 billion during 1988-1992, compared to $0.4 billion during 1983-1987. The Republic of Korea and Taiwan Province of China have become net outward investors since 1990 and 1988, respectively (figure II.5). Firms from Singapore, which have been lagging as outward investors compared with those from the other two economies, have recently undertaken a number of investments in China, as well as in Malaysia and Indonesia, in an effort to boost their regional presence.[45] Although most FDI from the newly industrializing economies is located in developing countries of Asia, recently such investment in North America and Western Europe has increased.[46] The 1990s have also witnessed the ascendancy of China as a new sizeable outward investor. In addition to being the largest host developing country, China is now the largest source of FDI from developing countries,[47] with investments in both developing and developed countries. All in all, FDI by developing countries from Asia into other developing countries of the region has become a considerable factor behind the increasing flows of these investments to developing countries, an outstanding feature of the recent trends in worldwide FDI .

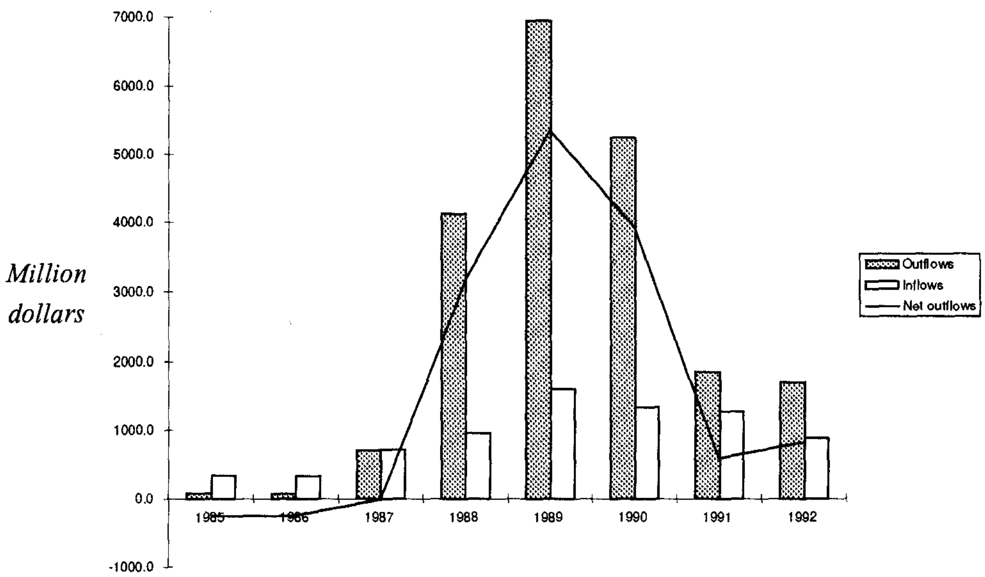
Figure II.5. Foreign-direct-investment inflows and outflows for the Republic of Korea and Taiwan Province of China, 1986-1992

(Millions of dollars)

Republic of Korea



Taiwan Province of China



Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994 and national official sources.

Investments in Asia from the newly industrializing economies are often motivated by rising production costs at home. Traditionally, preferred locations for these investments have been members of the Association of South East Asian Nations (ASEAN), such as Thailand and Indonesia. In 1993, however, the level of outflows from the newly industrializing economies into ASEAN (excluding Singapore) was considerably less than in 1992: \$2.2 billion in 1993 (January-September), compared with \$4.5 billion in 1992.[48] Increasingly, China and Viet Nam are becoming attractive to cost-reducing, efficiency-promoting FDI from Hong Kong, Taiwan Province of China and, more recently, Singapore and the Republic of Korea. In turn, former recipients of these investments (e.g., Thailand) are themselves investing in neighbouring countries (Lao People's Democratic Republic). Investments by the newly industrializing economies in developed countries have different objectives, namely, to secure market shares and access to technology (UN-TCMD, 1993d).

Additional extra- and intraregional FDI flows in the region may be induced in the near future by the ASEAN Free Trade Area established formally in 1993 with a view to eliminating intraregional tariffs and non-tariff barriers provided, however, that the Area succeeds in creating a large regional market (box II.5). The present low level of trade interdependence among ASEAN members — intraregional trade accounted for only 17 per cent of the members' total trade in 1992 — indicates great potential for the expansion of intraregional market and trade.[49] If this potential is tapped by the ASEAN member countries, this is also likely to encourage the regional rationalization of the existing investments (Braga and Bannister, 1994).

South Asia is another part of the region, next to China, and in contrast to the newly industrializing economies, where investment inflows increased significantly in 1992 (by 39 per cent). Inflows into that subregion increased further in 1993 owing, primarily, to the renewed interest of foreign investors in India's sizeable domestic market as a consequence of the ongoing liberalization of its investment regime (box II.6). Between August 1991 (when the new industrial policy liberalizing India's investment regime was introduced) and February 1993, more than 2,300 foreign collaborations had been approved, with FDI amounting to 67 billion rupees (\$2.6 billion), more than five times the total FDI approved between 1981 and 1990 (UNCTAD, Ad Hoc Working Group on Investment and Financial Flows, 1993, p. 28). Inflows into other countries in South Asia remain relatively small, hindered in part by the small size of their domestic markets, an underdeveloped infrastructure and administrative bottlenecks in implementing the typically liberal investment regimes.

Viet Nam, which opened to FDI only in 1988, has experienced rapid increases in FDI. Since then, investment in Viet Nam increased to about \$2 billion by 1993, out of the \$7.5 billion of investments that were approved.[50] The rapid growth of FDI in Viet Nam is attributed primarily to the availability of natural resources (petroleum) and low production costs. Firms from Taiwan Province of China are the largest investors in Viet Nam, accounting for about one-fifth of total approved FDI. These firms invest primarily in labour-intensive activities facing high production costs at home; by taking advantage of low wages in Viet Nam, they seek to retain their international competitiveness. Firms from Australia, France, Hong Kong, Japan and Singapore are also sizeable investors in oil exploration, manufacturing and services. A few automobile companies from Japan have set up joint ventures with other foreign manufacturers and domestic companies to produce cars for the domestic market. While FDI is viewed as a positive force in the modernization of the domestic economy, its poor infrastructure acts as a disincentive and a bottleneck as regards the amount of investment that Viet Nam can attract and absorb.

The lifting of economic sanctions against Viet Nam by the United States in February 1994 allows United States companies to invest in Viet Nam. Before, United States TNCs were only permitted to sign, but not execute contractual agreements. Coca Cola, for example, was allowed to sign an agreement to produce soft drinks in Viet Nam that was to become operative after the trade embargo was lifted. Immediately following the lifting of the trade embargo, Du Pont and

Box II.5. The ASEAN Free Trade Area and foreign direct investment

The ASEAN Free Trade Area (AFTA), launched in January 1993, was formed with a view to strengthening regional cooperation by way of further enhancing liberalization of regional markets and, at the same time, establishing a level playing field for FDI to avoid mutual competition among member countries. Market liberalization policies, as well as policies emphasizing macroeconomic stabilization and the development of human resources, have enabled ASEAN countries — which constitute the core of AFTA — to grow at rates of 6 to 12 per cent in recent years (with the exception of the Philippines). Flows of FDI, by enhancing the industrialization process, have contributed to the rapid economic growth. Accordingly, intra-ASEAN trade has expanded, giving rise to mutually complementary and dependent relationships in manufacturing.

The principal provisions of AFTA are:

- An agreement on a Common Effective Preferential Tariffs (CEPT) scheme (normal track), which aims at reducing intra-regional industrial tariffs to below 5 per cent within 15 years, between 1 January 1993 and 1 January 2008. The ASEAN Free Trade Area does not adopt common tariffs for extraregional countries. This agreement covers all industrial goods, including capital goods and processed agricultural products. Over 40 per cent of the value-added must be produced in the region. Exemptions are admitted for sensitive commodities, and restrictions on volume and non-tariff barriers for CEPT commodities are to be abolished.
- An agreement on CEPT (fast track): a "fast track" tariff reduction programme, which enables accelerated reductions, if agreed upon by more than two members. It applies to fifteen categories of goods; tariffs must be reduced to below 5 per cent within 10 years. The implementation schedules are shown in the accompanying table.

The *raison d'être* for the formation of AFTA springs from the recent closer economic tie-ups among the member countries and, in particular, the trade-FDI link within the region. The trade-FDI link in East Asia — induced in the 1980s through the initiative of Japanese TNCs through expanded FDI — is reaching a stage in which it is being further strengthened by FDI from the newly industrializing economies, thereby stimulating further economic integration in the region. Moreover, the recent burst in intraregional FDI can be expected to deepen further existing intraregional networks in the 1990s (Braga and Bannister, 1994).

Thus, the impact of AFTA on the strategies of TNCs can be significant. Transnational corporations can become more competitive by purchasing and producing within the region, taking advantage of low tariffs, rather than importing finished products from outside the region. As a result, they are likely to rationalize production in various countries in the region, establishing intraregional networks of specialization to procure parts and raw materials. Some corporate groups have already such networks, others are planning to establish them. For example, Japanese automotive manufacturers, such as Toyota, Nissan, Mitsubishi and Mazda (which were compelled to establish production bases in ASEAN countries), have begun to seek ways to foster a complimentary network of parts based on the Brand-to-

other major United States TNCs opened offices in Viet Nam. This removal of restrictions to trade and investment will, almost certainly, induce a further spurt of investment in Viet Nam from the United States.

Except for China and Viet Nam and, to a much lesser extent, Lao People's Democratic Republic, other economies in Asia that have liberalized their FDI policies have not yet attracted significant amounts of FDI. Despite the adoption of a joint venture law in 1984 and the development of the Rajin-Sonbong free economic zone targeting foreign investors, the Democratic People's Republic of Korea has attracted meagre amounts of FDI ($43 million in 1992).[51] Mongolia introduced its foreign investment law only in 1990, extending permission of investments to firms from developed countries (JETRO, 1993b, p. 250). In 1992, full foreign ownership was permitted in mineral resources. Despite that, mineral-rich Mongolia has been able to attract few investments in natural resources (oil, gas and gold mining), with the Russian Federation and China being the

Brand Complementation scheme launched in ASEAN countries in 1988, whereby firms can increase regional purchasing of parts and materials. Toyota introduced this scheme already in 1989, giving its Singapore subsidiary the role to coordinate procurement among the four supplying bases in, respectively, Thailand, Malaysia, the Philippines and Indonesia (UNCTAD-DTCI, 1993a, p. 138). The formation of similar intraregional networks by other firms can be expected to further reinforce the trade-FDI link.

Table 1. Implementation dates for common effective preferential tariffs
(Year and percentage)

Country	*"Fast-track"products*		*"Normal-track" products*	
	Current tariffs			
	Above 20 per cent	20 per cent and below	Above 20 per cent	20 per cent and below
Indonesia	1995	1993	1998	1993
Malaysia [a]	1993	1993	1993	1993
Philippines	1996	1993	1996	1996
Singapore [a]	1993	1993	..	1993
Thailand	1993	1993	1993	1996

Source: based on Japan, Ministry of International Trade and Industry.
a Singapore and Malaysia were the only countries that implemented CEPT on schedule; later in 1993 it was agreed that the first tariff reduction would be implemented simultaneously among all member countries from January 1994.

The total GNP of East Asia, including Japan, was about $4 trillion at the beginning of the 1990s, and it is projected to reach $6 trillion by 2015, surpassing the current GNP of the United States and the European Union. The integration scheme is likely to stimulate further growth in East Asia; as a result, FDI targeting such a market will increase. In particular, it is very likely that additional Japanese FDI will be attracted, especially if the yen appreciates further. Moreover, a probable increase in outward FDI by countries such as the Republic of Korea and Taiwan Province of China, losing their comparative advantages in labour-intensive goods due to an appreciation of their currencies and rising labour costs, may contribute to increasing FDI in East Asia.

Source: based on an input by the Japan Institute for Overseas Investment.

largest source countries. By 1992, FDI in Mongolia amounted to a total of $17 million. While all of these countries are eager to receive greater inflows of FDI, low per capita incomes, inadequate physical infrastructure, an underdeveloped financial system (including inconvertible domestic currencies) and inexperience in doing business with TNCs have contributed to the slow growth of investment.

Foreign-direct-investment flows into Western Asia started recovering from the adverse impact of the Gulf war. They increased by 48 per cent in 1992, reaching a record level of nearly $750 million. The flows are unevenly distributed between the countries of the region. Three quarters of the inflows were in oil-exporting countries. Saudi Arabia accounted for 70 per cent of flows into the oil-exporting countries and Cyprus accounted for 54 per cent of flows into the non-oil exporters. Many of the countries of this region receive insignificant amounts of FDI flows given their absorption potential determined by the size of their domestic market and their relatively high

Box II.6. Liberalization and foreign direct investment in India

The liberalization of the macroeconomic environment in India aiming at restructuring its domestic economy, reducing the fiscal deficit and increasing industrial competitiveness was accompanied by the liberalization of regulations on FDI. The first liberalization introduced in July 1991 provided automatic approval of FDI project proposals with up to 51 per cent foreign equity ownership in 34 priority industries. At the same time, local-content regulations were withdrawn. In 1992, and again in 1993, a series of proposals were made to dismantle more barriers to FDI, such as restrictions on the use of foreign brand names and trade marks and on participation in mining of thirteen minerals. In January 1993, the Foreign Exchange Regulation Act was amended to remove restrictions on foreign-owned enterprises and accord them national treatment. Full ownership was allowed for foreign firms on a case-by-case basis. Foreign participation was allowed in building, maintaining and operating certain highways and bridges on a toll-collection basis, as well as in operating telephone service networks in the country.[a] Foreign investors have freedom of repatriation of earnings, as well as repatriation of divested capital.

The policy on foreign technology agreements was also liberalized. Agreements involving less than 5 per cent royalty on domestic sales, 8 per cent royalty on exports and lump-sum payments up to 10 million rupees are now automatically approved by the Reserve Bank of India. To complement the relaxation of investment rules, import duties were lowered to 85 per cent for general goods and to 35 per cent for capital goods, and the rupee on the trade account became convertible in 1994. An array of tax holidays and capital-gains concessions was also implemented to attract FDI, especially in the energy sector that was opened to foreign firms in 1992. Taking advantage of the liberalized policies, several TNCs (e.g., Pepsi Cola, Nestlé, Suzuki and Colgate Palmolive) are increasing their stakes in their existing affiliates in India to 51 per cent from 40 per cent or less. Exxon, IBM and Coca Cola are examples of TNCs that disinvested from India following the Foreign Exchange Regulation Act of 1977, but have returned to take advantage of the sizeable domestic market.[b]

Table 1. Approved and actual foreign-direct-investment flows into India
(Millions of dollars)

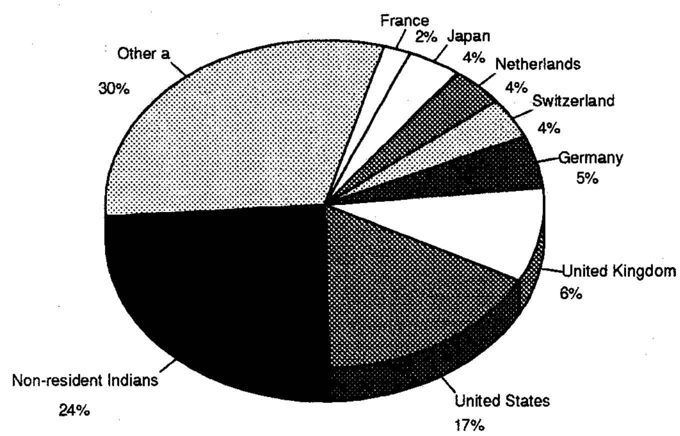
Year	*Approved*	*Actual*
1990	73	..
1991	171	113
1992	1255	220
1993	2858	577
1994 a	265	..

Sources: Consulate General of India, Frankfurt, Germany and The Secretariat of Industrial Approvals, The Government of India; India, Ministry of industry, *SIA Newsletter*, March 1994.
a First two months.

Approved and actual flows of investment reported by the Government of India indicate substantial increases during the period 1992-1993 (table 1). Actual flows are expected to rise to $2 billion by 1995, if the current rate of growth of these investments is to continue. The extent of realization of approved FDI in India in recent years reflects in part the sectoral composition of these investments; it is heavily skewed towards the power (electricity generation) and hydrocarbon (essentially petroleum refining) industries that accounted for 40-45 per cent of the approved investments: FDI in these industries is yet to materialize because of the length of the gestation period involved. The United States was the largest investor, accounting for 17 per cent of all actual investments during the period from 1991 until January 1994, followed by the United Kingdom and Germany with substantially smaller shares (figure 1). Non-resident Indians from different countries accounted for 11 per cent of these investments.[c]

Figure 1. Geographical composition of cumulative foreign-direct-investment inflows, 1991-January 1994

(Percentage)

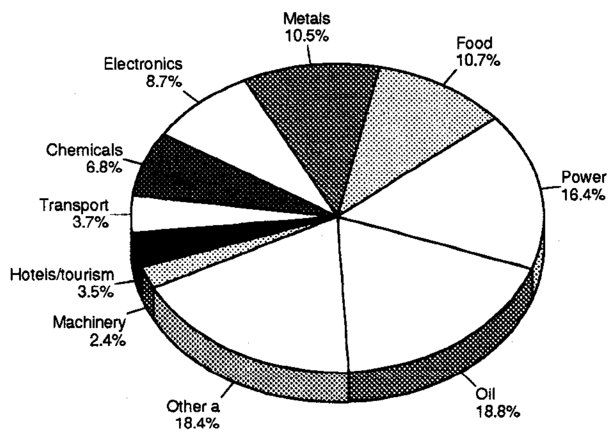


Source: Consulate General of India, Frankfurt, Germany.

a Including Hong Kong (1 per cent), Singapore (1 per cent) and Sweden (1 per cent)

Figure 2. Industrial composition of foreign-direct-investment approvals, August 1991-November 1993

(Percentage)



Source: Consulate General of India, Frankfurt, Germany.

a Includes glass and ceramics, paper and pulp, telecommunications, and services and trade.

Infrastructure industries — power and telecommunications — and hydrocarbon are likely to continue to receive major investments for some years, not just because of their sheer size and because they represent newly opened areas to foreign firms, but also because the Government strongly welcomes such investments.[d] In the manufacturing sector, food processing, electronic parts, chemicals, industrial machinery, transport and machinery are the major industries that attract FDI (figure 2). In the services sector, FDI is concentrated in the development of computer software and financial industries. In early 1993, there were 25 software centres located just outside Bangalore.[e] These centres principally act as offshore maintenance facilities to service computer software for companies throughout the world. The main factors drawing FDI into Bangalore are relatively low salaries, the availability of qualified software engineers and the increasing ease of communications. Between 1985 and 1990, FDI in that industry has come from both large computer firms (e.g., Texas Instruments), as well as small joint ventures (e.g., Verifone).

The introduction of financial deregulation renewed foreign interest in Indian financial services. Since the beginning of 1993, banks have been allowed to set their own interest rates on loans of more than about $6,400. In addition, the private sector has also been permitted to provide more banking services and to operate mutual funds. These changes have resulted in a great deal of activity to establish joint financial ventures. For example, GE Capital, a unit of United States-based General Electric Company, signed a joint venture agreement with the Housing Development Finance Corporation to establish a consumer finance unit; and Asian Capital Partners (Hong Kong) has arrangements with the Industrial Development Bank of India for investment banking. Other joint financial ventures have been concluded for diversified financial services, fund management and for currency management.[f]

The process of economic liberalization in India has made great strides since 1991. Yet, there are still further adjustments required to provide support to the macroeconomic restructuring efforts and to make conditions for investment, both domestic and foreign, more attractive. A survey of the investment perceptions of 16 leading TNCs cited an array of difficulties in operating in India.[g] The complex web of regulatory controls and bureaucratic interventions is of particular concern. The lack of adequate infrastructure, particularly power, telecommunications and transportation, is also regarded as a major constraint. There is, however, strong support in the international investor community for the current direction of India's macroeconomic policy.

In terms of future policies affecting FDI, the Government has indicated that it would consider lowering corporate taxes and import duties, introduce a value-added tax, further deregulate banks and capital markets and open the nationalized insurance industry to foreign investors. The establishment and implementation of policies aimed at greater market efficiency is critical for encouraging both domestic and foreign investment in India. Complementary policies for the development of agriculture, the provision of social welfare nets for displaced labour and other similar measures are also important.[h]

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a Kumar (forthcoming); "India opens phone business to private firms", *International Herald Tribune*, 14-15 April 1994.

b IBM has a joint venture with the Tata group and Coca Cola has taken over Parle, a domestic beverages producer.

c India, Ministry of Industry, *SIA Newsletter*, March 1994.

d As was stated in the budget speech by the Finance Minister on 29 February 1992: "A policy to encourage private investment, including foreign investment, in the power sector has already been announced.... The Government will welcome proposals for private investment, including foreign investment, in production, refining and marketing of oil and gas...." (paragraph 21).

e In February 1994, the establishment of the Information Technology Park in Bangalore was announced aimed at providing facilities to companies, including TNCs wishing to set up operations there.

f *The Asian Wall Street Journal*, 7 September 1993.

g The Economist Intelligence Unit, *India Supplement* (London, 1993).

h "The money juggernaut", *Far Eastern Economic Review*, 11 March 1993.

per capita income. Developing countries with markets of similar size or at a similar level of development typically attract larger FDI flows.

(b) Latin America and the Caribbean

Latin America and the Caribbean continued to attract increasing flows of FDI in the 1990s, after a period during the mid-1980s when investment inflows had virtually dried up and, what little arrived, was generally obtained only at the cost of substantial incentives.[52] The revival of external financial inflows, including FDI, to the region reflects not only economic recovery and the perception that the debt crisis is resolved, but also the abandonment of the import-substitution development model (Ramos, 1993) that had been central to Latin America's pattern of industrialization and had helped attract considerable FDI flows during the previous decades. The structural adjustment programmes carried out by most countries of the region promoting market-oriented reforms and an outward trade orientation contributed to the recovery of economic activity in general and FDI inflows in particular. Investment inflows to the region grew rapidly in the early 1990s, doubling their annual average level of 1986-1990 (tables II.10 and II.17).

The recovery of FDI flows to the region as a whole, until 1990, was to a significant extent due to FDI related to debt-equity swaps and after that year to privatization (table II.17) — both forms of FDI sometimes referred to as "subsidized" FDI.[53] Despite the fact that the role of FDI related to privatization in the total FDI inflows was much smaller in 1990-1992 than the rate of FDI related to debt-equity conversion in 1988-1990, the total inflows to the region continued to grow, thus making the shift from subsidized forms of FDI to its conventional forms. This process is most notably advanced in Chile (box II.7) and Mexico .

Some countries of the region are still in a process of transition from receiving FDI through debt-equity swaps and privatization to receiving more conventional investments. In Argentina subsidized FDI accounted for a large share of all investments in 1992 (49 per cent) and in 1993 (78 per cent). The increasing flows into Venezuela were initially largely fuelled by debt-equity conversions and, in 1991, when they augmented sharply, by privatizations. In that year, subsidized FDI accounted for 78 per cent of total inflows. In 1992, they plummeted, pulling down the total inflows to less than one-third of the 1991 level (table II.17). Other countries — Brazil, Colombia and Peru — have not yet benefited substantially from FDI flows related to privatization and debt-equity conversions. As regards the latter, Brazil has been an exception, especially during 1988-1989, when these conversions fuelled the inflows, accounting for almost three-quarters of the total. Recent flows to Brazil, based almost entirely on conventional FDI, have been small in comparison to the size of the economy and the past historical levels of FDI flows into that country.

The countries that succeeded in attracting considerable FDI flows did so especially in the services and natural-resources sectors in which privatization programmes were concentrated (UNCTAD-DTCI, 1994a). About $7 billion (or two-thirds) of the investments in Mexico during 1991-1992 went into services industries (telecommunications, tourism, financial and professional services).[54] Similarly, $1.1 billion of FDI flows into Argentina and $1.5 billion into Venezuela in the same period were in services, primarily in power-generation, telecommunication and transportation. In the primary sector, petroleum has been the largest recipient of FDI through privatization. The privatization of the State-owned petroleum company, YPF, and gas companies in Argentina and the auctioning of petroleum concessions to foreign investors produced the single largest FDI inflow (about $2-3 billion) during 1991-1992 in that country. In Colombia in 1992 alone, $440 million (or 56 per cent) of FDI flows went into petroleum, according to the National Planning Department. Investments in the Cusiana fields not only contributed to the recent increase in FDI flows, but will continue to do so in the future, as they are expected to reach $1.6 billion.[55] Copper and gold mining projects, often in joint ventures with the State-owned copper company,

Table II.17. Latin America and the Caribbean: foreign-direct-investment inflows by mode of investment, 1988-1993
(Millions of dollars)

Country/mode	1988	1989	1990	1991	1992	1993 [a]	Total 1988-1992
Argentina (total)	1 147	1 028	1 836	2 439	4 179	3 300	10 629
Conventional FDI	807	869	- 80	1 586	2 112	732	5 294
Debt-equity conversion	340	159	815	-	-	-	1 314
Privatization	-	-	1 101	853 [b]	2 067 [b]	2 568	4 021
Brazil (total)	2 969	1 267	901	972	1 454	2000	7 563
Conventional FDI	882	321	618	850	1 359	..	4 030
Debt-equity conversion	2 087	946	283	68	95	..	3 479
Privatization	-	-	-	54	-	.	54
Chile (total)	937	1 291	604	523	705	841	4 060
Conventional FDI [c]	2	69	249	563	737	891	1 620
Debt-equity conversion	796	1 107	355	-40	- 32	- 50	2 186
Privatization [d]	139	115	-	-	-	-	254
Colombia (total)	203	576	500	457	790	850	2 526
Conventional FDI	203	576	500	405	790	..	2 474
Debt-equity conversion	-	-	-	-	-	-	-
Privatization	-	-	-	52	-	..	52
Mexico (total)	2 594	3 037	2 632	4 762	5 366	6 900	18 391
Conventional FDI	1 671	2 648	2 432	3 956	5 275	..	15 982
Debt-equity conversion	868	389	85	19	-	-	1 361
Privatization	55	-	115	787	91	..	1 048
Peru (total)	26	59	41	-7	127	200	246
Conventional FDI	26	59	41	-7	-13	..	106
Debt-equity conversion	-	-	-	-	-	-	-
Privatization	-	-	-	-	140	..	140
Venezuela (total)	89	213	451	1 916	629	256	3 298
Conventional FDI	39	30	148	161	545 [a]	256	923
Debt-equity conversion	50	183	303	256	70 [a]	-	862
Privatization	-	-	-	1 499	14 [a]	-	1 513
Total above (total)	8 055	7 685	7 052	11 102	13 282	14 356	47 176
Conventional FDI	3 630	4 572	3 908	7 514	10 805	..	30 429
Debt-equity conversion	4 231	2 998	1 928	343	165	..	9 665
Privatization	194	115	1 216	3 245	2 312	..	7 082
Latin America and the Caribbean [e]	9 040	6 248	8 647	15 032	17 711	..	53 335

Source: UNCTAD, Division on Transnational Corporations and Investment, based on Calderon, 1993b and data provided by ECLAC/UNCTAD Joint Unit on Transnational Corporations.

a Estimates by ECLAC/UNCTAD Joint Unit on Transnational Corporations.

b All debt-equity conversion activities in 1991-1992 were directly related to privatization.

c Corresponds to net inflows of FDI based on Decree Law No. 600 and Chapter XIV of the Central Bank foreign-exchange regulations.

d Mainly Chapter XIX operations. The IMF does not include those flows as FDI in its statistics as it considers them portfolio operations due to the nature of the exchange mechanism.

e The differences in total inflows between this table and table II.11 are mainly due to the inclusion of Bermuda here.

CODELCO accounted for the single largest portion of new FDI to Chile (about $1 billion); there has also been significant FDI involvement in cellulose projects (box II.7).

Investments in the manufacturing sector, which used to be the core of FDI activity in Latin America during the import-substitution period, were less dynamic with two major exceptions. The first concerns the adaptation of foreign affiliates already present in that region to the newly liberalized and more competitive domestic markets. Although the overall dimension of this phenomenon is still not clear, restructuring foreign affiliates that used to supply solely local markets, with the aim of making them internationally competitive, is becoming increasingly apparent, as TNCs alter their strategies to take into account the trade and investment liberalization in Latin America and the Caribbean. The clearest and most important example of that phenomenon is the automobile industry in Mexico (Mortimore, forthcoming; de María y Campos, 1992; UNCTC, 1992c) in which new investments in the order of $4 billion have been announced for the 1993-1995 period. Announcements of major investments by automobile manufacturers in Brazil and Argentina in the context of Protocol 21 of Mercosur suggest that the restructuring of that industry is taking a region-wide dimension.[56] The second major exception to the generally sluggish picture for FDI in the manufacturing sector concerns the *maquiladora* industry. The surge in FDI taking advantage of United States legislation that offers tax incentives for the use of export processing zones for materials originating in the United States has continued. These investments go not only to border industries in Mexico, but also to a number of small economies (Costa Rica, Dominican Republic (box II.8) and Jamaica). The principal investments in the *maquiladora* are in export-oriented activities in electric and electronic equipment, automobiles and clothing industries.

In sum, FDI flows to Latin America and the Caribbean have strongly increased, with investments — especially through debt-equity swaps — declining in importance. Except for Mexico and, to a lesser extent, perhaps Chile, privatization programmes remain an important tool for attracting investments. Flows, however, remain concentrated in a few countries and exhibit an industrial pattern stemming from the economic developments in the principal recipients; yet they all have in common an increased export orientation. Overall, with the exception of Mexico and, to a certain degree, Argentina, manufacturing has attracted less FDI. Inflows in the primary and tertiary sectors benefited greatly from privatization programmes. Within the framework of liberal FDI and trade policies, there may be greater scope to attract investments into the manufacturing sector. However, the specific experiences of Mexico, and perhaps Argentina, with privatization have left a significant imprint on the FDI profile of the region during the 1990s.

* * *

The new economic policies in Latin America and the Caribbean clearly rest on the conviction that the region's future depends on an improvement of its international competitiveness and its further integration into the world economy. The means of that integration include not only trade, but also external finance and, in particular, FDI. The liberalization of legislation relating to foreign capital flows has been a prominent aspect of the region's landscape for several years now. While this perspective is generally shared by virtually all governments of the region, strategies to integrate into the world economy vary appreciably, especially in respect to the geographical scope of such integration (global, inter-regional or intraregional), its sequence and speed.

Free trade agreements within the region exemplify intraregional efforts. Agreements with regional partners so far focus primarily on Mexico's participation in the North American Free Trade Agreement (NAFTA). With regard to the multilateral trade negotiations, virtually all countries of the region have arrived at the conclusion that an open and unencumbered internation-

Box II.7. The revival of conventional foreign capital flows into Chile

As of 1993, Chile had enjoyed a decade of solid economic growth, averaging 6 per cent per year. The successful economic performance stemmed not only from market-based economic reforms but also, in large part, from a sharp change in Chile's growth strategy towards export-oriented industrialization based on the country's abundant supply of natural resources. Exports as a percentage of gross domestic product rose from 29 per cent in 1985 to 37 per cent in 1993. Growth was concentrated in three new groups of export products: fish products, fruits and forestry products (notably, paper and cellulose). As regards fresh fruits, for example, their share in total exports rose to ten per cent by the late 1980s (from 1 per cent in the mid-1970s), with annual export revenues exceeding $500 million. Foreign direct investment, attracted in considerable amounts to traditional and new export industries by the effective debt-equity conversion scheme known as Chapter XIX (table 1), became one of the pillars of this export-based strategy. In case of fruits exports, of the five largest fruit companies accounting for about half of Chile's fruit exports, four are TNCs. Their knowledge of export markets and ability to penetrate them have been important ingredients in Chile's successful export drive.[a]

Table 1. Chile: long-term capital inflows, by type, 1980-1993

(Millions of dollars)

Type of flow	1980-1982[a]	1983-1985[a]	1986	1987	1988	1989	1990	1991	1992	1993
Foreign direct investment	332	136	372	1 127	937	1 291	604	523	705	841
Conventional FDI[b]	332	109	116	230	2	69	249	563	737	891
FDI from debt-equity conversion	-	27	256	786	796	1 107	355	- 40	- 32	- 50
FDI from privatization[c]	-	-	-	-	139	115	-	-	-	-
Portfolio investment	41	-	-	-	-	87	359	225	452	1 157
Bonds	41	-	-	-	-	-	-	200	120	324
Equity	-	-	-	-	-	87	359	25	332	833
Loans (net)	2 200	984	19	- 790	- 938	- 1 316	645	- 258	133	223
Credits linked to DL 600 projects	115	- 1	67	185	388	311	749	336	51	615
Total[d]	2 527	1 572	398	345	339	73	1 676	466	1 329	2 193

Source: UNCTAD/ECLAC Joint Unit on Transnational Corporations, based on data provided by the Banco Central de Chile.

a Annual average.

b Corresponds to net inflows of FDI based on Decree Law No. 600 and Chapter XIV of the Central Bank foreign exchange regulations.

c Mainly Chapter XIX operations. The IMF does not include these flows as FDI in its statistics as it considers them portfolio operations due to the nature of the exchange mechanism.

d Includes other mid- and long-term capital.

The prime examples of FDI in traditional export activities are the La Escondida and La Disputada de Las Condes copper-mining projects which accounted for a major proportion of FDI through the Decree Law No. 600, that is, the law for normal FDI, during the 1987-1990 period. Most FDI projects in the forestry, fruit and fishing sectors took place by way of the debt-equity conversions (Chapter XIX) which provided a varying degree of subsidy in respect of the secondary market price of Chilean external debt instruments. Debt-equity conversions financed important industrial projects, including cellulose, paper and derivative products. Forestry as a whole (including both investments in the acquisition of existing companies and the implementation of new projects in that sector) received more than 30 per cent of the total investment channelled by that mechanism. These conversions were decisive in increasing FDI inflows: over the period 1985-1990, they were responsible for more than 75 per cent of FDI in Chile, or around 55 per cent, if loans associated with the Decree Law No. 600 are included in the FDI total.[b]

Chapter XIX gained widespread acceptance because it provided an implicit subsidy, through discounts, estimated at 46 per cent of the investment (Ffrench-Davis, 1990; Mortimore, 1991; UNCTC, 1993, pp. 43-81), which was not available to the users of Decree Law No. 600. The broad international publicity that this mechanism achieved and a favourable climate for investors created in Chile stimulated renewed interest in this country. In 1991, after the sharp increase in the price of Chilean foreign debt in the secondary market the mechanism lost its attractiveness to foreign investors; since then, no debt-equity conversions have occurred.

Despite this, inflows of foreign capital did not decrease, because in the meantime Chile's access to foreign capital became more stable due to a diversification of instruments (to include especially portfolio equity investment) and the growth of normal FDI flows. This was, in turn, possible owing to a revival of economic growth and of the confidence of investors in the Chilean economy: it increased so much that the country has recently attained investment-grade status in international capital markets.[c] As to the near future, several large new mining projects, as well as the expansion of existing ones, are planned with TNCs.[d] They include: La Candelaria ($1.5 billion), El Abra ($1.2 billion), Zaldivar ($600 million) and Cerro Colorado ($500 million). Important cellulose projects — such as Celulosa Arauco y Constitución ($600 million) and Celulosa del Pacifico ($587 million) — will also play a role in stabilizing or even increasing FDI inflows.

Source: based on an input by UNCTAD/ECLAC Joint Unit on Transnational Corporations.

a See Rozas, 1992; Behrens, 1992.

b DL 600 loans were mainly used in large mining projects. The Chilean Foreign Investment Committee includes these associated loans in their FDI statistics.

c The Standard and Poor's risk classification, for example, places Chile in the BBB+ category — below some OECD member countries and the Asian newly industrializing economies, but above the rest of the countries in Latin America.

d See *AméricaEconomía*, Special Numbers, December 1992 and December 1993.

al trade, investment and financial system is of fundamental importance to their development objectives. The region has therefore supported strongly not only the Uruguay Round, but also greater trade liberalization in all its forms, especially that leading to increased access to the markets of developed countries. The best evidence of this new liberal policy is that the region has embarked on the liberalization of FDI and trade policies, often in a unilateral fashion, coupled with a strong export orientation. In particular, the trade-liberalization programmes of nine principal countries of the region between the mid- and late 1980s led to a reduction of average tariffs by half, from 20-40 per cent to 10-20 per cent; similarly, maximum tariffs and the number of tariff ranges declined steeply (Agosin and Ffrench-Davis, 1993, p. 44; Alam and Rajapatirana, 1993, p. 45).

Box II.8. Foreign direct investment in small economies: the export processing zones in the Dominican Republic

Export processing zones have emerged as an important tool for small countries to attract foreign investors and integrate themselves into the world economy. The Dominican Republic established its first export processing zone in 1969, but only since 1983 have those zones achieved significant growth, stimulated by a number of domestic and external factors. On the domestic scene, these factors included political and social stability, incentives to reactivate export processing zones and the depreciation of the national currency. External factors included mechanisms facilitating access to the United States market, such as the Caribbean Basin Initiative, the Generalized System of Preferences (GSP) and certain United States tariff and tax provisions:

- The Caribbean Basin Economic Recovery Act, in effect since 1 January 1984, provides for nonreciprocal duty-free (or reduced duty) entry into the United States for a wide range of Caribbean Basin products (excluding clothing) (USITC, 1992). The Act draws the attention of foreign investors to the Caribbean Basin countries as a location for export-oriented FDI. Textiles and apparel are covered by a "Special Access Program" within which the United States has negotiated bilateral agreements, since 1986, with several Caribbean Basin countries including the Dominican Republic. These articles qualify for preferential treatment provided, however, that the fabric originates from the United States.
- The Generalized System of Preferences provides non-reciprocal duty-free entry for eligible articles shipped directly from beneficiary countries, as long as at least 35 per cent of the value of the product is added in the beneficiary country. All Caribbean Basin Economic Recovery Act countries are also GSP beneficiaries. Despite several key differences between the Caribbean Basin Economic Recovery Act and the GSP, many products of the Caribbean Basin countries are eligible for duty-free entry under either of the two mechanisms.
- The Harmonized Tariff Schedule subheadings 9802.00.60 and 9802.00.80 are tariff provisions that provide reduced duties for certain United States products processed or assembled outside the United States (mostly textiles and apparel) and subsequently re-exported to that country (so-called "production sharing").
- The United States Internal Revenue Code grants certain incentives to increase United States investment in the Caribbean Basin. Section 936 of that code applies to the profits of affiliates of United States TNCs operating in Puerto Rico. Under that section, profits are exempt from Federal taxes as long as they are invested directly in eligible projects or retained in local financial institutions. Investors are allowed to borrow funds from financial institutions of Puerto Rico to finance projects in certain Caribbean countries.

Financing under Section 936 is done by one arm of Puerto Rico's Caribbean Development Program. The other major part of that Program is the promotion of production-sharing operations (twin plants). The administration of Puerto Rico encourages firms with operations in Puerto Rico to seek opportunities for sharing production between Puerto Rico and a twin-plant operation in a Caribbean Basin site. Because Puerto Rican wage rates are considerably higher than those in most Caribbean Basin countries, it is usually the labour-intensive portion of the operation that is relocated.

By June 1989, 18 export processing zones had been established in the Dominican Republic, 9 in Barbados, 9 in Costa Rica, 7 in Jamaica, 5 in the Honduras and 2 in Haiti. By the end of 1992, the number of export processing zones (public and private) that had been established in the Dominican Republic had increased to 27, involving a total of 404 enterprises (Consejo Nacional de Zonas Francas de Exportacion, 1993). Firms can also operate with a Special Free Zone Status that makes it possible for them to operate outside the zones (for example, agricultural enterprises).

Most FDI in the export processing zones in the Dominican Republic is in manufacturing. The growth of gross exports (rising from \$0.2 billion in 1983 to \$0.5 billion in 1988 and \$1.2 billion in 1992) demonstrates that those zones can be very dynamic,[a] especially when considering that exports from non-export processing zones declined in the Dominican Republic during the period 1988-1992 from \$0.9 billion to \$0.6 billion (Banco Central de la Republica Dominicana, 1993).

Export processing zones have also contributed to the creation of a more diversified export base. In 1988, clothing represented 36 per cent of gross exports of these zones; switches and commutators, 16 per cent; tobacco, 10 per cent: footwear, 9 per cent; and pharmaceuticals, 7 per cent (Willmore, 1993). According to the Central Bank of the Dominican Republic, export processing zones generated $0.3 billion net foreign exchange earnings, representing 11 per cent of total foreign-exchange earnings ($2.6 billion). Traditional exports represented 9 per cent; mining, 8 per cent; and tourism, 42 per cent of total foreign-exchange earnings.

Firms operating in export processing zones are obliged to meet local expenses in foreign currency. Salaries account for more than 60 per cent of these expenditures, while the remainder covers local inputs, such as rent, electricity, water and raw materials (2-3 per cent) (Dauhajre-Hijo, Riley, Mena and Guerrero, 1989). Operating in export processing zones involves a number of advantages: low wage rates, duty-free imports of raw materials, 8-20 years tax holidays, a streamlined bureaucracy and an adequate transportation network. From the point of view of the Dominican Republic, apart from foreign-exchange earnings, the advantages include employment for 142,000 people, that is, about 6 per cent of all the jobs in a country with a workforce of 3 million where unemployment is in the order of 25 per cent (EIU, 1993).

The clothing industry alone accounts for more than two-thirds of the jobs and enterprises in the zones. Most of those enterprises were created with capital from the United States (54 per cent), followed by the Dominican Republic itself (22 per cent), the Republic of Korea (11 per cent) and Taiwan Province of China (3 per cent). The strong presence of United States firms is explained not only by the proximity of that country's market, but also by the abundance of cheap labour, which makes it possible to compete with East Asian countries. Transnational corporations from the Republic of Korea and Taiwan Province of China invest in these zones in order to take advantage of the quotas under the GSP. More than 90 per cent of export processing zone exports are destined for the United States (including Puerto Rico and the Virgin Islands), a process made possible by the various aforementioned trade and tax arrangements that the United States has established for the countries in the Caribbean Basin.

Export processing zones in the Dominican Republic have not enjoyed the same success as zones in countries, such as the Republic of Korea, Mauritius and Santa Lucia, when measured in terms of their contributions to the process of industrialization. There is little vertical integration between the activities in the zones and the local economy (Rhee, Katterbach and White, 1990), a phenomenon that has been observed in other export processing zones around the world. In the more successful cases, in this regard, the authorities allow indirect exporters to import material inputs duty-free and encourage domestic producers to supply the export processing factories (Willmore, 1993), as well as to sell a proportion of their output locally. In the Dominican Republic, drawback mechanisms do not exist and local sales are discouraged (subject to taxation and other restrictions), thereby limiting the impact of the export processing zones on the local economy.

The low value-added nature of production in export processing zones is also directly related to the use of the advantages provided by United States tariff-schedule provision HTS 9802.00.80. Under that provision, duties are applied on the full value of the imported product (assembled in foreign locations and containing United States-made components) minus the value of the United States made-components. As a result, enterprises operating in export processing zones have an incentive to minimize locally purchased inputs in labour-intensive industries. This constitutes a major impediment to increasing local value added and may limit the usefulness of export processing zones as stepping stones to higher stages of industrialization via the transfer of technology.

Source: based on an input by UNCTAD/ECLAC Joint Unit on Transnational Corporations.

a Gross export figures also include imported raw material and intermediate inputs that are required for assembly.

The strengthening of intraregional links (without restricting integration into the international market) has been based so far mainly on a grid of bilateral agreements (CEPAL, 1994a, p. 10). Thirty three agreements were concluded during 1985-1993; of these, twenty seven were approved and six are to be implemented in the period 1994-1998. While Colombia and Venezuela have concentrated more on agreements with their partners in the Andean Pact integration scheme, Mexico and Chile have agreements with a wide array of partners, including regional ones (in the case of NAFTA). As a result of multilateral tariff cuts and bilateral agreements, intraregional exports grew from 10 to 17 per cent of total exports between 1988 and 1992. Furthermore, intraregional FDI grew appreciably, admittedly from a narrow base (box II.9). Chilean investments in privatized power companies in Argentina were prominent elements of this new regional FDI.

The North American Free Trade Agreement is so far the only free trade agreement involving regional developed (United States and Canada) partners.[57] It has also the strongest provisions for the liberalization of FDI. Its negotiation provided a strong boost to FDI flows to Mexico during 1986-1992. As a result, that country emerged as the most important recipient of such inflows (after Bermuda) in Latin America and the Caribbean. Many TNCs have now incorporated Mexico into their international production systems. In fact, Mexican companies themselves have invested in the United States, most notably in the cement and glass industries.

Other Latin American countries, fearing that NAFTA could develop into a closed regional grouping, have manifested their interest in becoming party to that agreement. The prominent exception has been Brazil.[58] High in the priorities of those wishing to join is the desire to gain better access to the North American market and to obtain considerable FDI and especially export-oriented FDI. As an example of Mexico shows (UN-TCMD, 1992a, pp. 40-42) FDI can become the principal means to translate formal access into increased exports, if TNCs choose, within their new strategies in the large market, to locate their specialized affiliates supplying the whole market in the low-cost member of the integration scheme. By comparison, other Latin American integration schemes have not generated much in the way of new FDI. That has been evident in the case of the Andean Pact and also seems to be the case for Mercosur (Argentina, Brazil, Paraguay and Uruguay) scheduled to begin as a customs union in 1995. With the exception of automotive firms interested in taking advantage of the trade provisions of Protocol 21, little in the way of increased and sustained FDI has resulted from the Mercosur scheme itself.

In summary, the desire to attract FDI is the key factor behind the interest of Latin American and Caribbean countries in integrating with the North American market. While international liberalization measures, as well as intraregional trade agreements, are creating a more competitive environment, they have led so far only to small increases of investment inflows meant to serve international or intraregional markets. As regards the latter, however, trade liberalization has laid the foundation for a restructuring of previously domestic-market-oriented FDI in the direction of regionally-oriented corporate networks (e.g., the automobile industry in Brazil). Progress towards greater economic regional integration could, therefore, generate and attract greater amounts of FDI for the regional market and, in this manner, contribute to the economic growth and restructuring in Latin America and the Caribbean.

(c) *Africa*[59]

During the 1980s, most African countries have adopted, typically as part of structural adjustment programmes, national regulatory frameworks conducive to FDI. These permit profit repatriation and provide tax and other incentives to attract such investment. In addition, efforts to increase FDI inflows have included efforts to simplify the investment-approval process (e.g., by setting up "one-stop" investment centres), the establishment of investment-promotion institutions and the increased use of representative offices abroad to publicize investment opportuni-

Box II.9. Intra-regional foreign direct investment in Latin America

One of the new developments in worldwide FDI and TNC activities has been the growth of TNCs from developing countries (UN-TCMD, 1993c) that undertake investment in developed countries and, increasingly, in developing countries of the same region. So far, this development — to the extent that it was significant — was almost entirely centred on the newly industrializing economies of Asia and quite recently on China as both host and home country. These FDI in other developing countries of the region reached such dimensions that it started to break the FDI monopoly of TNCs from developed countries. It also fuelled the increase of the investment flows to developing countries in general.

Latin America hardly participated in this development until not long ago. Cases of FDI by Latin American firms were rare. Whatever existed was concentrated in few countries and industries. The flows originated mostly from Brazil, Mexico and Venezuela and went primarily to the United States. Venezuelan FDI went mainly to petroleum refining and associated activities. Mexican investment was concentrated in the glass (Vitro) and cement (CEMEX) industries. Brazilian investment was found mainly in the autoparts and clothing industries and in trading companies. *Intraregional* FDI flows have traditionally been even scarcer. Examples include Mexican investments in Central America,[a] Argentine companies, such as Bunge y Borg or Alpargatas, that have established affiliates in neighbouring countries, and Brazilian engineering and construction firms that have carried out important projects in other countries of the region (Peres, 1993 and CEPAL, 1994b).

As of the beginning of the 1990s, the economic recovery of several countries of the region has revived the propensity to invest abroad (Calderon, 1993b). A significant part of those investments is undertaken in other Latin American and Caribbean countries.

One of the developments that has encouraged an important surge in intraregional investment is the privatization of state companies. Some leading Latin American companies are taking advantage of privatization opportunities in other countries of the region. Outstanding among these was the purchase of 80 per cent of the Argentine company SOMISA by a consortium made up of the Argentine group TECHNIT, the Chilean company Compaña de Acero (CAP) and the Brazilian companies USIMINAS and VALE DO RIO DOCE. Another striking instance was the sale of the QUELLAVECO copper deposits in Peru, in December 1992, for $12 million, to the Chilean company MANTOS BLANCOS, which has promised to invest more than $500 million. Also noteworthy is the sale of Peru's national airline AEROPERU to the Mexican company AEROMEXICO for $54 million and of the Peruvian gas distribution company SOLGAS to the Chilean company LIPIGAS for $9 million.

Chile has become the most active Latin American country undertaking FDI in the region (Calderon, 1994). The very low and selective presence of Chilean companies in other countries until not long ago is evolving rapidly due to the liberalization of the relevant legislation in that country: by the end of 1993, the stock of the Chilean FDI in the region amounted to more than $1 billion.[b] Over half of this stock is concentrated in Argentina, where there are more than 50 companies owned by or linked to Chilean corporations. A large part of this stock was acquired in 1992 through the participation in the Argentine privatization programme. According to the Argentine Ministry of Economy, 60 per cent of the income from sales of public companies during 1992 came from foreign investors. Chilean investors played an important role in this process; accounting for 6 per cent of the total sales, they were surpassed only by Spain (15 per cent), the United States (12 per cent), Italy (9 per cent) and France (7 per cent).

Important purchases by Chilean firms include a majority participation in Servicios Electricos de Gran Buenos Aires (SEGBA), and Gas del Estado ($72 million) as well as the already mentioned minority participation in SOMISA ($150 million). The Chilean presence in Argentina also extends to the services sector, including control of supermarkets (Jumbo, Unicentro and Ekono-Almac). In 1993, Peru attracted the interest of Chilean investors. As in Argentina, the most interesting opportunities have been those linked to the privatization of public companies and the substantial changes brought about by the adoption of liberal policies, such as the recent implementation of a new scheme of private pension funds. Chilean pension-fund administration companies have been well placed to take advantage of the liberalization of pension funds abroad and outward FDI at home because, over the years, they required know-how, putting them in an advantageous position *vis-à-vis* Peruvian and Argentine administrators of such funds.

Although intraregional FDI in Latin America is still incipient, it is growing and involves new countries and extends to new industries. Chile, which emerged as a major new home country for regional investment, has also been a host country to $12 million of inflows in 1992 and $126 million of inflows in 1993 (until September) from Argentina (JETRO, 1994, p. 164). The flows of FDI between Colombia and Venezuela have reached impressive amounts: from Venezuela to Colombia $32 million in 1992 and from Colombia to Venezuela $39 million in the same year, increasing from a level of $0.4 million in 1991 and $26 million in 1990, respectively (JETRO, 1994, pp. 145-146). If the macroeconomic stability and economic growth of the region continue, it may well be that intraregional FDI will expand, approaching proportions that are similar to Asian intraregional FDI flows.

Source: Based on an input by UNCTAD/ECLAC Joint Unit on Transnational Corporations.

a "Las empresas globales de México", *Revista Expansión*, 589, 24 (México, D.F., 29 April 1992).

b In the early 1990s, the legislation concerning outward investment was liberalized permitting Chileans to invest abroad. As rapidly increasing supply of foreign currencies caused by the inflows of foreign capital including FDI exerted the upward pressure on the exchange rate of the national currency, an outward investment was seen as a mechanism softening this pressure.

ties. The reformist mood has been widespread and, at times, exhibited itself in quite rapid policy and legislative changes. For instance, between 1982 and 1987, about one half of all African countries either introduced or made adjustments to their investment codes or guidelines in order to attract more FDI. The end of the 1980s and the start of the 1990s also saw many other countries among the other half introduce new investment laws or amend the old ones. In addition, countries with a previous reputation of hostility to FDI, such as Ethiopia, Guinea and Mozambique, introduced new legislation offering a wide range of guarantees and opportunities for foreign investors. But even countries that have traditionally been regarded as being more open to FDI, such as Kenya and Zimbabwe, went out of their way to revise their regulatory frameworks to be more attractive.

Despite this widespread liberalization of FDI policies , FDI flows did not respond impressively. Although the total value of FDI flows into Africa nearly doubled from an annual average of $1.7 billion during 1981-1985, to an average of almost $3 billion during 1986-1990, that increase did not give rise to much optimism concerning prospects for FDI in that region, not only because these investments were concentrated in few countries, but also because they were quite modest when compared to FDI flows to other regions of the developing world: average annual FDI flows into Africa as a proportion of all inflows in developing countries declined between these two periods from 13 per cent to 11 per cent (table II.18). In addition, during the early 1990s, flows into many African countries stagnated, while those to other developing countries continued to increase. As a result, Africa's share declined further to 6 per cent by 1992, thus underlining the marginalization of that continent in relation to FDI, apart from its marginalization in relation to international trade (Shafaeddin, 1993).

Investment flows into Africa have been concentrated in — and therefore largely determined by — flows to the oil-exporting countries. These alone accounted for over four-fifths of flows into Africa during the first half of the 1980s. At the beginning of the 1990s, their share declined, but remained around 70 per cent of flows into that region (table II.18). Within the group of oil-exporting countries, inflows are concentrated in Egypt and Nigeria, which together absorbed between 36 per cent (in 1991) and 84 per cent (in 1981) of all flows into Africa, or between 52 per cent (in 1991) to 89 per cent, respectively, (in 1989) of those to the oil-exporting countries. The underlining trend is a decline in the importance of these two countries (based on annual average flows), from 65 per cent in the first half of the 1980s to 40 per cent during 1991-1992. That decline reflected a reduction of flows into Egypt in the aftermath of the Gulf War by more than a half between the above-mentioned periods, and a recovery of flows to Angola, Libyan Arab Jamahiriya and Tunisia during the early 1990s. However, not all — and in some cases not even the majority — of FDI in these countries is undertaken in the petroleum industry. While investment flows to Angola in 1991 exceeded $600 million and went mostly to petroleum exploration and mining (Economic Commission for Africa, 1993a, p. 22) the majority of those to Nigeria went to manufacturing (annually between 52 and 63 per cent of the number of approved projects during 1989-1991) (UNCTAD, Ad Hoc Working Group on Investment and Financial Flows, 1994, p. 39).

Investment flows into Africa as a whole are still so small in size that they are easily subject to year-to-year fluctuations in response to changes in flows to few countries. The peak that FDI flows to Africa reached in 1989 — nearly $5 billion, or 18 per cent of total flows to developing countries — would wrongly suggest that Africa took part in the worldwide FDI boom during the second half of the 1980s. Around 90 per cent of the $2.1 billion increase in Africa's FDI inflows in 1989 were concentrated in two countries, Nigeria and Liberia; flows to them registered historic highs in 1989, not repeated after that year.

Investment flows into Africa have been weak compared to other developing countries because Africa as a whole does not compare favourably as regards the location-specific advantag-

Table II.18. Foreign-direct-investment flows into Africa, 1981-1992
(Billions of dollars and percentage)

Region/country	*1981-1985* *Annual average*	*1986-1990*	*1991*	*1992*
Africa	1.7	2.8	2.7	3.0
Africa's share in: (Per cent)				
All countries	3.4	1.8	1.7	1.9
Developing countries	12.9	11.4	7.0	5.9
Oil-exporting countries [a]	1.4	2.1	1.8	2.2
Egypt	0.7	1.1	0.3	0.5
Nigeria	0.4	0.7	0.7	0.9
Other countries	0.3	0.8 [b]	0.9	0.9
Share in Africa's total [c]: (Per cent)				
Oil-exporting countries	82.3	72.7	67.8	71.0
Egypt	40.6	37.7	9.3	15.1
Nigeria	23.6	25.5	26.3	29.5
Other countries	17.7	27.3 [b]	32.2	29.0

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994, and annex table 1.

a Algeria, Angola, Cameroon, Congo, Egypt, Gabon, Libyan Arab Jamahiriya, Nigeria and Tunisia.

b Figure is inflated by unusually high investment in Liberia in 1988-1990 ($290 million, $656 million, and $225 million, respectively), most likely in flags-of-convenience facilities. Inflows to "other Africa" net of Liberia were as follows: 1988, $407 million; 1989, $714 million; 1990, $695 million.

c Figures may not add to total because of rounding.

es that it offers. In addition, a number of factors that favoured an increase of FDI to other developing countries, such as privatization programmes and debt-equity swaps, play only a limited role in Africa (table I.13).

A number of basic factors influence the investment climate in Africa for foreign as well as domestic investors:

- Continuing civil conflicts, political crises and natural disasters (especially drought) are obviously not conducive to investment. The group of countries affected by these circumstances is quite large. At least five countries remain mired in conflicts: Angola, Liberia, Rwanda, Somalia and Sudan. Another group of countries is emerging from prolonged periods of conflict: Chad, Eritrea, Ethiopia, Mozambique and Uganda. Countries recently affected by drought include Algeria, Libyan Arab Jamahiriya, Morocco, Tunisia and Zimbabwe. Last but not least, strikes and protests against unpaid wages and stipends or against economic policies were organized in 1992 in about a dozen countries (Economic Commission for Africa, 1993b; United Nations, 1993, pp. 41-45). Most of the countries afflicted by wars as well as social or political conflict have received virtually no new FDI or have experienced prolonged periods of disinvestment. Notable exceptions include Angola which was able to attract quite considerable FDI inflows during 1991-1992.
- Domestic markets are typically relatively small. Most economies in sub-Saharan Africa have an average GDP of $3.5 billion (or $340 per capita) while North African economies have an average GDP of $25 billion (or $1,120 per capita) (Economic Commission for Africa, 1993b; United Nations, 1993, pp. 41-45). Attempts to address this problem through regional integration schemes have either collapsed or proved ineffective in terms of affecting intraregional trade and creating larger economic areas.
- Growth rates are substantially lower compared to other developing countries and even declining (e.g., in 1991, 1.9 per cent; in 1992, 2.1 per cent; and in 1993, 0.1 per cent) (table II.12). The lack of dynamism prolongs the problem of the small size of domestic markets.
- Poor, and in many cases deteriorating, physical infrastructure, especially in telecommunication and transportation, and the lack of capital to improve it, act as a disincentive to FDI. Added to that are often inadequate institutional and financial infrastructures, such as banking and financial institutions.
- The high level of indebtedness continues to make the debt of many African countries difficult to manage. The debt problem is aggravated by balance-of-payments difficulties caused in particular by the sharp decline of commodity prices. Therefore, a number of African countries suffer chronically from foreign exchange shortages. This makes it very difficult to guarantee that FDI income and profits can be repatriated — a key aspect of a favourable investment climate.
- Slow progress in a number of countries in introducing market- and private sector-oriented economic reforms undertaken within the framework of structural adjustment programmes hinder FDI.
- Lack of or low level of skills and general technological capabilities, combined with relatively high production costs inhibit FDI. By the mid-1980s, costs of production in sub-Saharan Africa were frequently as much as twice as high as those in low-income countries in Asia. For example, the cost of rail transport was 2.8 times higher, and wages of unskilled workers in the construction industry 1.4 times higher in sub-Saharan Africa than those of low-income countries in Asia (World Bank, 1989, table I.1, p. 27). Since productivity levels in Africa were generally lower than in low-income Asian countries, high production costs further weakened the attractiveness of Africa as an investment location. In the early 1990s,

however, many African countries regained their attractiveness in this respect after a series of devaluations of their currencies.

In clear distinction from Africa as a whole, and a sizeable group of countries afflicted by a few or several of these adverse factors, stands a small group of countries that has done well in terms of attracting FDI flows. Table II.19 shows, in addition to the ranking of the largest host countries in Africa by the *absolute* size of FDI inflows, rankings by the *relative* size of inflows (per capita and per unit of GDP) and by increases of inflows (between the second half of the 1980s and the early 1990s and during the 1980s). The ranking of countries by the absolute size of inflows produces an expected outcome: during the early 1990s, five out of the six largest host countries were oil-exporting, led by Nigeria. The only exception in this group is Morocco, one of a handful of African countries experiencing a continuous increase of flows during the three periods under consideration. Other measures produce a group of smaller non-oil exporting countries that have been able to attract FDI inflows in quantities that are large relative to the size of their populations or their economies, or which have distinguished themselves by very rapid growth rates for a number of years. Some of these countries are the least developed countries. For example, $21 million of annual flows does not bring the Seychelles even close to the list of the largest host countries in *absolute* terms; but these flows represent $302 of flows per capita and $84 per $1,000 of GDP, which gives this country the lead (together with Equatorial Guinea), among the host countries ranked by the *relative* importance of FDI.

In terms of attracting relatively significant and/or growing amounts of FDI, Botswana, Côte d'Ivoire, Morocco, Namibia, Swaziland and Zambia fared particularly well during the 1980s and early 1990s (table II.19). A number of countries on the list of countries with increasing flows (Ghana, Senegal, Swaziland and Tunisia) experienced a serious decline during the mid-1980s (leading to negative flows for Senegal and Swaziland). For them, the fast growth of inflows at the end of the 1980s and the beginning of 1990s is merely a revival of the lost dynamism of flows from the beginning of the 1980s. A case in point is Ghana where FDI was strongly curtailed from $16 million annually during 1980-1982 to $2-5 million in the mid-1980s, likely in response to an investment climate that was perceived as negative, but subsequently revived as the country undertook efforts to improve it.

While oil and other natural resources have been a major factor in attracting FDI to a few of these countries (e.g., Angola, Namibia and recently Equatorial Guinea), many others — in addition to having the fundamental factors right — have been able to use specific locational and other advantages to boost their attractiveness. For example, Lesotho and Swaziland benefited particularly from their special status as members of a common monetary area, with potential as a base for exporting both to the region (as members of the Preferential Trade Area) and the European Union (as signatories to the Lomé Convention). Mauritius has particularly benefited from FDI by firms based in Hong Kong seeking to export to Europe and elsewhere. Capitalizing on its success, the island is seeking foreign investors in banking and finance, with a view to becoming an offshore financial centre and to diversify the sources of its FDI inflows. Morocco and the Seychelles benefited from very large investments in the tourism industry. Morocco has been trying to make the most of its economic achievements, cheap labour and closeness to Europe by establishing a low-cost manufacturing base for exports to the European Union.[60] Kenya — among the top ten in the growth list during the 1980s — derived significant benefit from a high level of re-investment of corporate earnings at a time when foreign exchange controls were a constraint on the transfer of dividends and management fees. Botswana is an example — not frequent among African countries with similar characteristics — of a country that, over the years, has been successful in using FDI for the development of its natural resources and its transformation from a low-income country into a middle-income one (UNCTAD-DTCI, 1993a, pp. 66-67). These country-specific factors most likely have been more important in attracting FDI — especially

Table II.19. The largest host countries to foreign-direct-investment inflows into Africa, various measures

Size of inflows[a] *(Millions of dollars)*		*Inflows per capita*[b] *(Dollars)*		*Inflows per $1000 of GDP*[c] *(Dollars)*		*Increase in inflows, early 1990s*[d f] *(Per cent)*		*Increase in inflows during the 1980s*[e f] *(Per cent)*	
Nigeria	805	Seychelles	302	Equatorial Guinea	206	Benin	1 335	Comoros	9 913
Angola	476	Equatorial Guinea	88	Seychelles	84	Namibia	1 055	Guinea	2 270
Morocco	372	Swaziland	60	Swaziland	64	Libyan Arab Jamahiriya	866	Liberia	1 049
Egypt	356	Namibia	56	Angola	61	Angola	582	Mozambique	1 038
Tunisia	252	Angola	52	Namibia	39	Mozambique	382	Gambia	661
Libyan Arab Jamahiriya	170	Botswana	41	Sierra Leone	37	Morocco	289	Mauritius	636
Namibia	81	Libyan Arab Jamahiriya	37	Gambia	33	Tunisia	241	Swaziland	604
Botswana	51	Tunisia	31	Nigeria	25	Ghana	143	Sierra Leone	518
Swaziland	45	Mauritius	16	Tunisia	20	Gambia	134	Zambia	486
Côte d'Ivoire	21	Morocco	15	Botswana	19	Algeria	60	Madagascar	394

Source: UNCTAD, Division on Transnational Corporations and Investment, based on annex table 1 and UNCTAD, 1993c, table 6.1, pp. 432-433.

a 1991-1992 annual average.
b 1991-1992 annual average by 1990 population.
c 1991-1992 annual average by 1990 GDP.
d Increase in annual average between 1986-1990 and 1991-1992.
e Increase in annual average between 1981-1985 and 1986-1990.
f Excluding countries with negative flows (disinvestment) in 1981-1985 or 1986-1990, i.e., that have a "minus" denominator.

during the 1980s — than fiscal and legislative reforms, since, of these countries, only two (Lesotho and Mauritius) had introduced specific incentive regimes by 1989.

The success of these countries demonstrates that it is wrong to assume that Africa as a whole is an inhospitable FDI location. Rather, differentiating analyses are required to determine the specific locational advantages that individual countries have and that can become the basis for a mutually beneficial relationship between TNCs willing to explore investment opportunities and governments prepared to do whatever is in their power to create a favourable investment climate. At the same time, external assistance, particularily offered development assistance, will remain crucial to help create the basis for self-sustained growth and an FDI-friendly environment (UNCTAD, 1993a).

Conclusions

Foreign-direct-investment flows into developing countries grew rapidly in the 1990s, but these flows remain unevenly distributed among developing regions and countries. The fastest growth in these flows in the 1990s occurred in China. Other Asian countries with rapidly growing economies and a well-trained, relatively low-paid labour force have been the main recipients of investment flows. Countries with improved macroeconomic performances and privatization schemes under way, allowing foreign investors' participation, accounted for much of the growth of FDI into Latin America. Most African countries, in particular the least developed countries in that region, with low growth rates, small markets, unstable economic or political conditions, unresolved debt overhangs, few economically viable public enterprises to privatize and lacking a skilled, even if low-paid, workforce, have seen their FDI flows, already at low levels, decline or stagnate.

C. Central and Eastern Europe

Introduction

Since 1989, the countries in Central and Eastern Europe — which, by convention, also includes the Republics that comprised the former Soviet Union in Asia[61] — have embarked, one after another, on a process aimed at transforming their centrally planned economies into market economies. As part of this process, all countries have opened up their economies to FDI, albeit in varying degrees. Their policies towards FDI were triggered by their capital needs (a number of them lacked easy access to international capital markets due to their sizeable foreign debts), and, in particular, the expectations they had concerning the role that FDI — and the technology, trade, management practices and training associated with it — can play in economic development (Csaki, 1992). These expectations were reinforced by international organizations which even considered FDI "crucial in the transition" (International Monetary Fund, World Bank, OECD and EBRD, 1991, p. 75) and further fuelled by the economic crisis which has been aggravated by the "transformational depression" (Szamuely, 1993). This section addresses the question of how far these expectations have been met.

1. Foreign-direct-investment trends

(a) Inflows

Investment inflows did, indeed, increase rapidly, but from an almost zero base. In 1991, total FDI inflows amounted to $2.6 billion, to reach $4.6 billion in 1992 and an estimated $5 billion in 1993 (comparable with $5 billion inflows to Mexico alone in the same year, table II.20). (By comparison, FDI flows into developing countries increased from $39 billion in 1991 to $80 billion in 1993.) As of 1 January 1994, cumulated FDI stock amounted to an estimated $13 billion. This stock was invested in an estimated 50,000 foreign affiliates. Based on committed (but not actually implemented) FDI projects, the total inward stock would amount to some $19 billion in some 100,000 foreign affiliates (tables II.21).[62] The difference between registered and operational foreign affiliates is partially due to the fact that many registered foreign projects are implemented very cautiously due to uncertainties regarding the domestic economic and political environment. Not surprisingly so, the ratio of operational to registered FDI projects was the highest in Hungary (80 per cent) and the lowest in Belarus (30 per cent) (OECD, 1992a, p. 77).[63] During the period between 1 October 1991 and 31 March 1993, greenfield investments accounted for less than 10 per cent of the total FDI funds announced or actually invested, or both (table II.22).[64] The average size of foreign affiliates in the region is small. While affiliates in developed countries average $18 million in invested foreign equity capital and developing country affiliates average $4 million, foreign affiliates established in Central and Eastern Europe have an average investment of $260,000. In Hungary, only 4 per cent of the projects involving foreign investors had investments exceeding $1 million. In Romania, 95 per cent of FDI projects had foreign capital of less than $50,000 (OECD,

Table II.20. Foreign-direct-investment inflows in Central and Eastern Europe, 1990-1993

(Millions of dollars)

Country	*1990*	*1991*	*1992*	*1992*		*1993*
				Total stock [a]	*Per cent*	
Albania	..	-1	1	-	-	..
Belarus	..	..	7	7	0.1	..
Bulgaria	4	56	42	102	1.2	..
Former Czechoslovakia	207	600	1 103	2 167 [b]	26.4	..
Estonia	..	..	58	58	0.7	..
Hungary	..	1 462	1 479	2 944 [b]	35.9	832 [c]
Kazakhstan	..	..	100	100	1.2	..
Latvia	..	..	14	14	0.2	..
Lithuania	..	..	10	10	0.1	..
Moldova, Republic of	..	..	17	17	0.2	..
Poland	89	291	678	1 289 [b]	15.7	29 [d]
Romania	..	40	77	117	1.4	..
Russian Federation	..	..	700	700	8.5	..
Ukraine	..	..	200	200	2.4	..
Uzbekistan	..	..	40	40	0.5	..
Former Yugoslavia [e]	67	119	64	439 [b]	5.4	..
Total	367	2 567	4 590	8 204 [b]	100.0	5 000 [f]

Source: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994 and annex tables 1 and 3.

a Estimated as cumulative inflows.

b Includes FDI prior to 1990 (in the former Czechoslovakia, $257 million, in Poland, $231 million, in the former Yugoslavia, $189 million; and in Hungary, $3 million).

c Until third quarter of 1993.

d Until first quarter of 1993.

e Also included in developing countries.

f Based on preliminary estimates.

1992a). Thus, the total amounts of investment capital that have actually flowed to the region are quite limited.

This distribution of flows within the region has been highly uneven. Inward FDI stock is heavily concentrated in the former Czechoslovakia (mostly in the Czech Republic), Hungary and Poland. As of 1 January 1993, these countries alone accounted for more than three-fourths of the FDI stock in that region; the Russian Federation accounted for less than one-tenth (table II.20). The implication is that large parts of the region have not (or barely) been touched by FDI and, hence, cannot count on it for the transition process. In part, this reflects the divergence in economic performance and progress in reform, with the Czech Republic, Hungary and Poland having made the most progress in transforming their economies.

Table II.21. Cumulative foreign-direct-investment registrations in Central and Eastern Europe, 1991-1993

(Number of cases, millions of dollars and percentage)

Country	1991		1992		1993		
	Number	*Millions of dollars*	*Number*	*Millions of dollars*	*Number*	*Millions of dollars*	*Per cent*
Bulgaria	900	130.0	1 200	170.0	2 300	200.0	1.0
Former Czechoslovakia	4 000	1 076.0	-	-	-	-	-
Czech Republic	-	-	3 120	1 573.5	5 000	2 053.0	10.6
Slovakia	-	-	2 875	231.2	4 350	380.0	2.0
Hungary	9 117	3 137.0	17 182	3 680.0	21 468	6 005.7	30.8
Poland	5 583	479.5	5 740	1 545.6	6 800	2 100.0	10.8
Romania	8 022	268.7	20 684	539.8	29 115	755.0	3.9
Former Soviet Union	4 206	4 462.2	15 300	5 566.5	27 200	6 800.0	34.9
Commonwealth of Independent States	2 593	4300.0	8 007	5 250.0	17 200	6 300.0	32.3
Russian Federation	2 022	2 827.4	3 252	2 850.0	7 989	3 153.2	16.2
Ukraine	400	440.0	2 000	480.0	2 800	600.0	3.1
Belarus	283	..	714	265.5	1 250	340.0	1.7
Estonia	1 100	84.2	2 662	142.0	4 150	220.0	1.1
Latvia	295	45.0	2 621	84.5	2 850	150.0	0.8
Lithuania	220	33.0	2 000	90.0	3 000	140.0	0.7
Former Yugoslavia [a]	..	..	..	..	..	..	..
Slovenia	1 000	650.0	2 815	962.2	3 300	1 200.0	6.2
Total	32 828	10 203.4	68 916	14 268.8	99 533	19 493.7	100.0

Sources: Economic Commission for Europe, 1993a and 1994.

a Also included in developing countries.

To the extent that the countries of the region have benefited from FDI, it is primarily through linkages with Western European firms, with Japanese firms — among the leading investors worldwide — playing a conspicuously low role. According to data of the Economic Commission for Europe (that include also committed FDI), the countries of Western Europe were responsible for 92 per cent of FDI in Slovenia, 78 per cent in Hungary and Estonia, 45 per cent in Lithuania and 35 per cent in Belarus. The members of the European Union as a group (in particular, Germany, Italy and the United Kingdom) were the dominant investors in Hungary, Poland, Romania and Slovenia (table II.23). The countries of the European Free Trade Association dominate investments in Estonia and the Slovak Republic. Investors from India, Iran, Pakistan, the Republic of Korea and Turkey play a major role in the central Asian republics of the former USSR. Intraregional FDI figures prominently in some of the central Asian Republics of the former Soviet Union, where foreign affiliates originating in other economies in transition play a major role in Belarus, Lithuania, the Russian Federation and Estonia. Czech investors account for 11 per cent of foreign capital in the Slovak Republic (ECE, 1993a).

As regards the sectoral distribution, manufacturing has attracted half or more of foreign capital (with the exception of Estonia). In some countries in the region the stock in manufacturing is concentrated in a single undertaking. For example, both the Czech Republic and Poland have each more than half of their industrial FDI in a single project in the automobile industry (Volkswagen/Skoda and Fiat/FSM, respectively). The share of FDI in services is also quite

Table II.22. Number of foreign-direct-investment projects in selected Central and Eastern European countries, by type of transaction, 1 October 1991 to 31 March 1993 [a]

(Number of projects, millions of dollars and percentage)

Country	*Acquisitions*		*Joint ventures*		*Greenfield investments*		*Total investments*	
	Number of projects and percentage							
	Number	*Per cent*	*Number*	*Per cent*	*Number*	*Per cent*	*Number*	*Per cent*
Azerbaijan	-	-	7	100	-	-	7	100
Czech Republic	62	34	60	33	59	33	181	100
Hungary	121	36	121	36	92	28	334	100
Kazakhstan	-	-	43	74	15	26	58	100
Poland	48	30	46	28	68	42	162	100
Russian Federation	11	3	285	71	106	26	402	100
Total	242	21	562	49	340	30	1 144	100
Excluding Kazakhstan and Azerbaijan	242	22	519	48	325	30	1 079	100
	Millions of dollars and percentage							
	Millions of dollars	*Per cent*	*Millions of dollars*	*Per cent*	*Millions of dollars*	*Per cent*	*Millions of dollars*	*Per cent*
Azerbaijan	-	-	2 565	100	-	-	2 565	100
Czech Republic	880	63	444	32	66	5	1 390	100
Hungary	1 093	35	1141	36	929	29	3 163	100
Kazakhstan	-	-	9 118	100	-	-	9 118	100
Poland	3 135	56	1 706	31	722	13	5 560	100
Russian Federation	1 167	11	9 239	88	152	1	10 559	100
Total	6 275	19	24 213	75	1875	6	32 361	100
Excluding Kazakhstan and Azerbaijan	6 275	30	12 530	61	1 869	9	20 672	100

Source: Anthony Robinson, "Ex-Soviet bloc attracts $42bn", *Financial Times*, 28 September 1993.

a Includes tentative, announced and concluded transactions.

considerable. In Estonia, trading activities account for 47 per cent of all investments. Trading activities also figure high in the Slovak Republic (23 per cent) and in Poland (16 per cent). Financial services figure prominently in the inward FDI stock in Hungary (ECE, 1994).

Overall, the ability of Central and Eastern Europe to attract sizeable investment flows and to utilize FDI in the transition process has been hindered by several factors. First, the overall domestic environment in most of these countries, with declining domestic output, high inflation rates, inconvertible currencies and underdeveloped infrastructure and financial services, is not conducive to attracting sizeable investments. The economic and political situation is not always

Table II.23. Composition of cumulative foreign-direct-investment registrations in Central and Eastern Europe, by country of origin, 1993[a]

(Percentage)

Country	*United States*	*European Union*	*European Free Trade Area*	*Central and Eastern Europe*	*Canada*	*Developing countries*	*Other countries*	*Total*
Belarus [b]	8	27	6	50	..	5	5	100
Czech Republic [c]	28	55	11	..	..	..	7	100
Estonia [c]	5	9	68	14	1	1	3	100
Hungary	5	54	24	5	1	-	12	100
Lithuania	13	26	18	39	3	-	1	100
Poland	39	51	8	1		-	11	100
Romania	10	63	4	3	7	7	7	100
Russian Federation[b]	14	31	18	15	2	7	14	100
Slovakia	15	37	31	12	2	4	-	100
Slovenia [c]	1	68	24	2	-	-	5	100

Source: same as for table II.21.

a As of second quarter 1993. Based on registration statistics in millions of dollars.
b Number of foreign affiliates.
c As of third quarter 1993.

stable and the regulatory framework pertaining to land and property ownership by foreign firms is often unclear. Second, the recession in the European Union and investment competition from the developing countries could have also contributed to the slow growth of FDI in Central and Eastern Europe. Third, in a number of countries, the actual process of building a market economy, privatization and creating the necessary institutional framework has not advanced significantly.

(b) Relative importance and impact

Given the low level of FDI and its uneven distribution, the relative importance of FDI in the host countries of the region is small, albeit with a few exceptions. The average contribution of foreign affiliates to the gross domestic product in Central and Eastern Europe was 3 per cent in 1992.[65] Similarly, foreign affiliates are estimated to have contributed only 0.9 per cent to the 1992 gross social product of the Russian Federation and only 0.3 per cent to the gross social product of Ukraine (OECD, 1992a). Only in Estonia, Hungary and Poland did enterprises with foreign participation play a more significant role, with 11, 17 and 7 per cent of enterprise sales, respectively (ECE, 1994, p. 15). In relation to population, FDI stock is the highest in Hungary ($407 per capita), the former Czechoslovakia ($199), Estonia ($80) and Poland ($51). On the basis of committed foreign capital, this ratio is $572 per capita in Hungary and a remarkable $600 in Slovenia.

Estonia, Hungary and Poland are also notable exceptions as regards the share of foreign affiliates in employment which, for the region as a whole, is low, averaging less than 0.5 per cent: foreign affiliates in the three countries accounted for 3.0, 4.5 and 2.3 per cent of total employment, respectively (ECE, 1994, p. 15). In general, the employment-creation effects of FDI, apart from those stemming from greenfield investments, have often been overshadowed by employment-reduction effects associated with the modernization of privatized state enterprises. General Electric, for example, cut the work force in its Tungsram affiliate in Hungary by almost half since its acquisition, resulting in lay-offs of more than 8,000 employees. Likewise, the restructuring of the Hungarian company Lehel, which was acquired by Electrolux in 1991, resulted in the loss of 1,600 employees or 34 per cent of total employment.[66] Lay-offs of this kind were, however, often the first step in increasing productivity and re-establishing profitability, both conditions indispensable to survive in a market economy.

In spite of the relatively low average role of TNCs in Central and Eastern Europe, the impact of FDI on the economies in transition may have been larger than the actual size and relative importance of these investments suggest. In particular, FDI in key industries seems to have contributed to economic recovery. In Poland, for example, economic recovery is fostered by the increase in domestic automobile production fuelled by foreign investment in the automobile industry (by Fiat and General Motors).[67] In Hungary, only two out of 19 engineering-product groups (household refrigerators and fluorescent tubes) reported an increase in physical output over the 1989-1992 period; in both cases, the principal domestic producers had been acquired by TNCs (Electrolux and General Electric) (Török, 1994, p. 9). Likewise, in brewing — the best performing subsector of the Hungarian industry — five out of seven main breweries are owned by foreign companies (Török, 1994, p. 11).

Furthermore, TNCs from Western Europe especially have helped establish new trade linkages between Central and Eastern Europe on the one hand, and the European Union and the European Free Trade Association on the other, sometimes in the framework of regional core network strategies (UNCTC, 1991). For example, Ford's electrical components now come from its Hungarian affiliate, which became an integral part of the company's manufacturing operations in Europe (helped by the introduction of higher quality standards and control systems in Hungary). A similar export-oriented strategy focusing on the Western European market has been pursued by Skoda (Volkswagen's affiliate in the Czech Republic); Japan's Daikan affiliate in Hungary is expected to follow suit.[68] Similarly, Asea Brown Boveri's affiliate in Poland now provides electrical engines on a globally integrated basis.[69] As a result, the share of foreign affiliates in foreign trade appears to be quite high in a number of countries. In exports, it is the highest in Poland (10 per cent), followed by Ukraine (7 per cent), the Russian Federation (5 per cent) and Belarus (3 per cent). Foreign affiliates accounted for 15 per cent of total imports of Ukraine, 7 per cent of Belarus and 6 per cent of the Russian Federation (ECE, 1994). To the extent that trade plays an important role in promoting growth and facilitating the adjustment process, it appears that the role of TNCs has been somewhat larger than what other indicators suggest regarding the importance of FDI in Central and Eastern Europe.

Another important contribution of TNCs is the transfer of modern technology and management practices to foreign affiliates and supplier firms (UNCTAD, Ad Hoc Working Group on Interrelationship between Investment and Technology Transfer, 1994, p. 20). Examples include Ford and Suzuki in Hungary, Volkswagen/Skoda in the Czech Republic and Renault in Slovenia. The Volkswagen investment in Skoda, for example, involved not only technology transfer to improve production quality generally, introduce more standard features and new luxury items, but also provided blueprints and design for a new range of models.[70] In the case of Renault, a series of technology transfer contracts were signed between Renault's major European component suppliers and domestic companies to help them upgrade the quality of their products to Western European standards.[71] Technology can also be transferred through franchising by TNCs, which is gradually emerging in the countries of the region, particularly in hotels and fast-food. An important element of franchising agreements are typically strong quality control programmes and support in quality improvements to local franchisees (Tomzack, 1994, pp. 32-34). Human resource development and local labour-force training to help in the acceptance of Western quality standards in both manufacturing and services industries is, in fact, a common impact of FDI in the region. In order to increase the quality of output, Fiat in Poland undertakes training of all employees in specifically designed schools.[72] Also in Poland, Citibank spends $400,000 on training each year.[73]

The transfer of such soft technologies has been complemented by the provision of "unique" services that used to be unavailable (or unknown) in the formerly centrally planned economies.[74] With the opening up of their economies, management consulting, advertising, real estate services, insurance brokerage and re-insurance services, as well as financial intermediation and credit card services (Coleman, 1994, p. 17) began mushrooming in most countries of the region.[75] After foreign firms were licensed, local companies too began offering these services.[76]

* * *

Overall, the direct role of TNCs in Central and Eastern Europe has been fairly small and uneven. But part of this unevenness has been that FDI has also been relatively important in a number of industries and areas that are central to the resumption of growth and the transition process.

2. Foreign direct investment and the transition

Beyond these direct impacts, FDI and TNCs also play an indirect — though difficult-to-measure — role in the establishment of a market economy, be it in Central and Eastern Europe or elsewhere (see box II.10 for a discussion of the role of TNCs in this respect in China). In the case of Central and Eastern Europe, their impact on institution-building, privatization and competition illustrates this role (McMillan, 1993).

(a) Institution-building

In a number of the economies in transition, the legal framework for a market economy did either not exist, especially in the Republics that comprised the former Soviet Union, or what existed was largely outdated or inadequate. With the desire to introduce market-economy principles, the establishment of such a framework became, therefore, of paramount importance. At the same time, this is a slow and painful process, further complicated by the absence of relevant experience. The desire to attract FDI exerts additional pressures in this regard because TNCs are used — and prefer — to operate within a legal framework conducive to FDI. This, and the actual presence of TNCs therefore provides an impetus to create new or updated laws in such areas as company laws, bankruptcy, taxation, accounting (see box II.11) and the repatriation of earnings. At the same time, the broader infrastructure of a market-oriented environment needs to be created, including a well-functioning financial system.

Indeed, FDI laws often constituted the first step in a series of market-oriented legislation and can be the core of that legislation around which other basic laws evolve. This especially has been the case in the Baltic Republics, Bulgaria, Romania and the Russian Federation, where laws relating to FDI and foreign business presence constituted one of the first legal steps towards market-oriented legislation (OECD, 1992a). For example, in Romania, one of the first market-economy related legislations was the "Decree Concerning Measures for Attracting Foreign Capital Investment to Romania" of 14 March 1990. Only subsequently, laws concerning business organizations, profit tax, unfair competition and the reorganization of state enterprises were adopted (UN-TCMD and ECE, 1993). The evolution of the legislative framework is less advanced in Albania, Belarus, Kazakhstan and Ukraine, where FDI legislation still provides the legal base for business and investment (OECD, 1992a). By contrast, the Czech Republic, Hungary and Poland adopted separate commercial legislation dealing with monopolies, bankruptcies, securities, stock exchanges etc., which form the legislative base in these areas not only for domestic but also for foreign firms.

In general, the legislative framework for FDI has expanded quickly and has prompted, to varying degrees, additional legislation to support market-oriented reform. However, in some economies in transition, the newly established legal frameworks did not always result in a favourable legal environment for foreign business: new laws were enacted very quickly and often without considering their full implications; occasionally they had conflicting objectives; and their implementation suffered from inadequate transparency and conflicts of competence between local and central government institutions.[77]

(b) Privatization

The process of privatization is an inherent part of the establishment of a market economy. Transnational corporations can have direct and indirect effects on the creation of a private ownership structure. Directly, TNCs can provide the necessary financial resources for the purchase of state enterprises; as such they contribute to bridging the gap between savings and investment that is particularly acute in Central and Eastern Europe due to low savings rates, the savings erosion due to inflation and the underdevelopment of local financial institutions and capital markets (Odle, 1993). Indirectly, TNCs can encourage private entrepreneurship, especially through demonstration effects and forward and backward linkages. Successful privatizations, furthermore, can have a signalling effect, indicating to foreign investors the willingness of governments to accept and support private economic activity, which may further encourage inflows of FDI.

Foreign direct investment in Central and Eastern Europe has played an important role in privatization, albeit varying from country to country due to (among other things) differences in the legislative environment (e.g., restrictions on access by foreign investors) and the mode of privatization.[78] Between 1988 and 1992, an average of 67 per cent of FDI inflows into the region were related to privatizations (table I.13). In general, FDI plays a marginal role in small-scale privatization processes (i.e., of small shops and restaurants), where most countries emphasize domestic ownership and preferential treatment of enterprise employees (OECD, 1992a). The role of FDI in medium and large-scale privatization processes is, for the time being, limited in some countries, either because countries apply preferential conditions for enterprise employees andor citizens in their privatization schemes (such as the Czech Republic, the Russian Federation and Ukraine) or because uncertainties regarding their privatization approaches and the vagueness of their privatization legislation tend to discourage foreign investors (as is the case in Albania, Belarus and Bulgaria). In some countries, the privatization process has virtually come to a standstill due to political uncertainties and differing policies pursued by different institutions.

Only in those countries that actively encourage foreign participation in their privatization programmes of medium and large-sized firms (Hungary and Poland) does FDI figure prominently as a source of finance (OECD, 1992a; Sader, 1993). In Poland, revenues from privatization involving foreign investors from 1988 to 1992 amounted to $490 million, which accounted for approximately 45 per cent of total FDI in Poland (Sader, 1993, p. 37; and annex table 1). In Hungary, from 1988 to 1992, FDI from privatization amounted to $2.3 billion; FDI through privatization thus accounted for approximately 78 per cent of all investment in that country (Sader, 1993, p. 36; and annex table 1). In the former Czechoslovakia, while giving preferential status to citizens in the privatization process, FDI-related proceeds from medium- and large-scale privatizations in 1988-1992 accounted for approximately $1.9 billion or 87 per cent of all FDI inflows during that period (Sader, 1993, p. 36; and annex table 1).

In some countries, foreign participation in privatization is particularly prominent in infrastructure industries that require massive capital and technology inflows, e.g., telecommunications. Basic telecommunication services and related services are now attracting foreign involvement in Estonia, Hungary and Latvia (ECE, 1993b). In contrast, Belarus, Bulgaria, the Czech Republic and the Russian Federation do not yet allow foreign capital in the privatization of their basic telecommunications services — only long distance services and upscale services, such as mobile phones, are open to FDI.[79]

Not all aspects of the privatization process are considered positive in the countries in Central and Eastern Europe. Some privatization schemes have been criticized for selling off state assets to foreigners too cheaply or corruptly.[80] Furthermore, as TNCs adjust the profile of the acquired firms to their own strategies and needs, they sometimes limit the production of the acquired firms. Privatization may therefore result in the termination of production lines that were previously considered profitable. General Electric, for example, closed the production of vacuum equipment, electronic components, floppy disk and magnetic tape at its Hungarian affiliate, Tungsram, some of which were considered profitable operations by that affiliate (Smart and Kasriel, 1994, p. 25). Similarly, the privatization of the Hungarian cement industry resulted in foreign ownership that prevented affiliates from exporting (Rojec, 1994, p. 26). The resulting conflicts can lead to policy reversals. In this context, the Czech Republic, Hungary and Poland, as well as others, have revoked their initial tax incentives for foreign investors and are now pursuing a more cautious policy towards foreign involvement in privatizations (Svetlicic and Rojec, 1993).

While there is certainly scope for FDI through privatization in those countries of the region that have not yet embarked on full-scale privatization or have, for the time being, barred foreign participation from that process, it should be recognized that the scope for foreign involvement in those countries that have already actively encouraged FDI involvement in privatization is limited by the availability of attractive assets. In Hungary, for example, the pace of FDI through privatization is already slowing down. While, in 1992, almost 80 per cent of privatization revenues in that country came from abroad, in 1993 that share dropped to 50 per cent. This has been attributed to the fact that most of the Hungarian consumer-goods companies have been sold by now and only a few of the remaining companies are attractive to foreign investors.[81]

The demonstration effects of FDI and the encouragement of private entrepreneurship through foreign business presence arise from both the demand for, and the supply of, market inputs by TNCs, in particular as regards banking, accounting and other intermediate business services. The demand of TNCs for advertising services has, for example, led to the establishment of domestic advertising agencies in Poland which are now competing with the affiliates of Western advertising TNCs. In the automobile industry, competition by domestic automobile manufactures led to an ever increasing network of dealerships,[82] while, at the same time, the demand for improved quality provided an impetus in the restructuring (and privatization) of supplier firms in that industry.[83]

(c) Competition

An important role that TNCs can play in the establishment of a market economy is through the introduction of competition into local markets. Exposing domestic monopolies to a more competitive environment is a means to improve allocative efficiency and to facilitate the free determination of prices. The potential role of FDI in this respect is significant, as barriers to market entry are high and state monopolies are strong in Central and Eastern Europe.

Box II.10. Foreign direct investment and the transition to a market-based economy: the experience of China

While the role of FDI in the transition process to a market-based economy has not yet fully manifested itself in Central and Eastern Europe, there is, indeed, some evidence from China that offers some useful insights in this respect. Market-oriented reforms have been carried out in China since 1979. The principal aspects of these reforms include: establishing a market-oriented institutional framework; diversifying the ownership structure by promoting non-public enterprises; deregulating the economy according to the principles of a market system and, encouraging competition to break up the State monopolies; reforming public enterprises; restructuring the financial sector and the fiscal system; and integrating China into the world economy through the gradual liberalization of its trade and investment regimes. Within the broader context of economic reforms currently under way, the following specific examples indicate the contribution that FDI can make to the transition process:

- **Establishing a market-oriented institutional framework**

  Foreign direct investment generates constant pressure for institution building. In China, it has stimulated and, in some occasions, led the move towards establishing a market-oriented institutional framework. This has been apparent in the liberalization of foreign-exchange controls and the reform of China's accounting system and, to a lesser extent, in the establishment of the regulatory framework for the protection of intellectual property rights (laws on patents, trademarks and copyrights).

  Foreign direct investment has played a catalytic role in the process of liberalizing foreign exchange controls. Transnational corporations consistently considered controls on the repatriation of earnings and capital a serious — if not the most serious — limitation on their operations in China. Accordingly, on numerous occasions and in numerous ways, they expressed their strong desire for a liberalized foreign-exchange regime. There was even a crisis in the mid-1980s, when a number of foreign affiliates were finding it difficult to continue their operations due to a lack of foreign exchange. The Government dealt with it on an ad hoc basis by providing these enterprises with large amounts of foreign exchange as an immediate remedy. Subsequently, the Government established foreign exchange adjustment centres, or "swap markets", to make foreign exchange available to foreign affiliates. As the Government became increasingly aware of the importance of avoiding an overvalued exchange rate and abandoning the preferential treatment awarded to foreign firms, it gradually opened these swap markets to domestic firms. This was an important step forward in relaxing foreign exchange controls. At the beginning of 1994, another important step was taken to change from a "dual exchange rate system" (the official fixed rate and the swap market rate) to a "single managed floating rate", based mainly on market supply and demand. It is now the intention of the Government to move towards full convertibility of the currency.

  The reform in the accounting system is another example. China had its own accounting system, one that was incompatible with that required for a market economy. That system caused some confusion for the operations of foreign affiliates, particularly joint ventures, in the early 1980s. In March 1985, China promulgated an accounting system for joint ventures which was close to international standards. The successful experiments with international accounting standards in joint ventures prompted China to abandon its traditional accounting system completely and adopt a new accounting system consistent with international standards. Similarly, a system for verifying certified public accountants was established in the mid-1980s, specifically aimed at facilitating the accounting system for joint ventures. As the traditional supervisory function of accountants in domestic enterprises was giving way, certified public accountants with experience gained through work with joint ventures were requested to extend their work to domestic enterprises. While the accounting reform was mainly generated by the country's overall efforts to change over to a market economy, FDI did play a catalytic and demonstrational role in accelerating the process of reform in this area.

- **Diversifying the ownership structure**

China has not embarked on a comprehensive privatization programme to the same extent as other countries in transition. Instead, it has promoted private sector development, aimed at changing the ownership structure of the economy from predominantly State-based ownership towards a mix of ownership, characterized by the coexistence of public, collective and private ownership. Foreign affiliates, including joint ventures with domestic firms, have contributed to achieving that objective by initiating the process of ownership diversification. There are now over 50,000 foreign affiliates in operation in China. Although the impact of FDI on changing the ownership structure of the economy has not been significant overall, it has been remarkable in a number of important manufacturing and services industries. In tourism, for example, there are about 500 foreign-invested luxury hotels accounting for 29 per cent of China's total capacity and 49 per cent of the total foreign exchange revenues generated by hotels.[a] The automobile industry is another example: the majority of the top automobile manufacturers in China are now joint ventures with foreign investors.

The diversification of the structure of ownership has had important implications for economic growth. The average annual rate of growth of output during the period 1986-1990 was 7 per cent for State enterprises, 18 per cent for collective enterprises and 74 per cent for foreign affiliates. Of the total industrial output in 1992, public enterprises accounted for 48 per cent and collective enterprises for 38 per cent. Private enterprises accounted for 13 per cent, of which 65 per cent was attributed to FDI. In retail trade, these shares were even higher: 41 per cent was accounted for by public enterprises, 28 per cent by collective enterprises and 31 per cent by private enterprises.[b]

- **Stimulating competition**

To enable markets to function efficiently, the organizational structure of the economy needs to be reformed fundamentally. The entry of foreign enterprises with competitive advantages is one of the most effective means of breaking up monopolies and stimulating competition. The entry of TNCs into China has reduced industrial concentration and the monopoly of the large State enterprises and has stimulated competition in a number of key industries. As a result, State enterprises now face active product-market competition and have to respond to the presence of the new market entrants by improving their own efficiency. Competition has been stimulated not only in industries that typically attract substantial domestic market-oriented FDI, but also in export-oriented industries, such as textiles and clothing, electric appliances, food processing, footwear and travel goods. The development in toy manufacturing is an example for both cases. There are now over 300 toy producers funded by foreign investment, accounting for over 10 per cent of the industry. These foreign affiliates are competing with about 2,600 domestic toy manufacturers. As a result, quality of output and productivity increased rapidly, making China one of the efficient toy producers in the world. China is now one of the largest toy exporters in the world, with a market share of 25 to 35 per cent in the major importing countries (33 per cent in the United States, 29 per cent in Germany, 30 per cent in Italy and 32 per cent in France) (China Economic News, 1993). Competition is also taking place among foreign affiliates in China. In the automobile industry, affiliates of Volkswagen (Germany), Chrysler (United States), Peugeot (France), Toyota (Japan), General Motors (United States), Isuzu (Japan), Ford (United States), Fiat (Italy), Renault (France) and Citroen (France) etc. are competing with each other, as well as with over 100 major domestic manufacturers, producing automobiles and spare parts.

While recognizing the positive effect of FDI in stimulating competition in China, tax incentives and other preferential treatment given to the FDI have caused distortions against domestic manufacturers which are already lagging behind in many respects. Although these effects are caused by FDI promotion rather than by FDI itself, they do result in market distortions.

- **Reforming enterprises**

  In the context of a socialist market economy, FDI has played a unique role in rejuvenating and reforming public enterprises in China. This has been accomplished either by contributing directly to these enterprises through joint ventures, or by providing lessons and experiences through operational demonstration and backward and forward linkages.

  One of the Government's policies concerning enterprise reform is to encourage foreign investors to establish joint ventures with Chinese public enterprises. What is important is that, in addition to capital and technology, foreign investors contribute new management practices (including incentive schemes, production organization, accounting, risk management etc.) to their partners that are in line with the business culture of a market economy. As a rule, joint ventures do, indeed, adopt, either partly or entirely, the management systems used by their foreign partners. As an overwhelming majority of the 50,000 foreign affiliates are joint ventures between foreign investors and Chinese State enterprises, the impact of FDI in rejuvenating these public enterprises is considerable. For example, Liaoning Province, China's major industrial base, is home to one-tenth of the country's large and medium-sized enterprises. As of June 1993, one-fourth of these enterprises were joint ventures with foreign partners.[c]

- **Integrating China into the world economic system**

  Foreign direct investment has contributed to the integration of China into the world economy through joint ventures with domestic firms. These ventures have played a central role in establishing organized linkages. Foreign investors have brought in the necessary technology to produce products of export quality, the skills and attitudes to ensure the delivery and the dependability necessary for export marketing and knowledge of export markets. At the same time, they have helped to promote exports, as they are normally more conversant with their home and other foreign markets and have their own well-established marketing networks. In 1993, foreign affiliates generated $25.2 billion of foreign exchange, accounting for 27.5 per cent of total national exports. China's outstanding performance in international trade over the past 15 years (with an annual growth of 12 per cent during 1980s and 17 per cent in the past 3 years) has been, to a considerable extent, facilitated and prompted by FDI.

The effects of FDI extend beyond the immediate sphere of the activities of TNCs, spreading indirectly to other areas of the economy. In the early stages of reform, FDI was viewed by the Government of China as an experimental ground for trying out market-oriented mechanisms, with the rationale that some of the successful ideas could be applied subsequently to the entire economy. The lessons learned from foreign affiliates with respect to ownership, management, organization, policies and procedures are reflected in ongoing domestic enterprise reform in China. Features of foreign affiliates that have demonstrated their usefulness are being adopted nation-wide in what are called "contract management systems" and "management responsibility systems". These features include, among others, the separation of ownership from management, greater freedom to hire and fire labour, profit centres in enterprises and incentive systems for managers and workers. Joint stock companies are being created, particularly as a mechanism to form large enterprise groups. Transnational corporations have been used as model for the internationalization of domestic firms. The presence of foreign firms has also helped to build a new business culture. New business standards introduced by FDI are, to some extent, disseminated through the forward and backward linkages of foreign affiliates.

Source: based on Zhan, 1993.

a "FDI in tourism industry in China", *International Business* (January 1994).

b Statement by Ma Kai, Deputy Director-General of the State System Reform Commission, at the International Conference on Transnational Corporations and China (Beijing, September 1993), mimeo.

c "Retooling large state enterprises in Liaoning", *China Economic News*, 40 (1993), p. 15.

Box II.11. Foreign direct investment and accounting reform in formerly centrally planned economies

In the course of the former Soviet Union's initial opening to FDI in the form of joint-venture legislation and the establishment of free economic zones, different accounting standards quickly became a major obstacle in attracting FDI (Menshikov, 1989). Incompatibilities in accounting systems regarding the recognition of revenues, expenses and certain liabilities, depreciation methods, valuation of assets and, most importantly, the determination of profits (especially in light of profit taxes) turned out to be major hurdles in the setting-up and implementation of foreign investment projects (Ruffing, 1989).

In order to overcome this problem, the authorities recognized that the introduction of an accounting law that was closer to Western accounting standards was necessary. Central to this task was to modernize the basic manual for bookkeepers (Chart of Accounts) in accordance with international standards, including the definition of relevant concepts and the provision of updated instructions. It became also apparent, however, that, as a complement, an independent accounting profession appropriately suited to prepare (sometimes for the first time) accounting records of business enterprises needed to be developed, since accountants were an integral part of the system of enterprise management, not professionals trained to provide financial and managerial expertise.

Both reforms were implemented with the help of the United Nations which, since 1990, provided technical assistance in several projects on accounting reform and the retraining of accountants (Sauvant, 1990). It became quickly apparent, however, that these efforts were not only important for foreign affiliates and the attractiveness of the country to FDI. Rather, in the light of the broader changes that were taking place at that time, the undertaking soon took on an experimental dimension for broader purposes, namely the introduction of a market-oriented economic system. The transition from a centrally planned to a market-oriented economic system required in fact a thorough modernization of accounting methods, since accounting is basic to business in any market economy. Without an appropriate accounting system, the State, firms, investors and the general public are in no position to evaluate business performance. Accounting reform therefore became a priority in the transitional process of the Soviet Union in particular and the countries of Central and Eastern Europe in general. Most of the countries in transition have enacted full-fledged laws for introducing Western accounting principles (UN-TCMD and ECE, 1993).

The benefits of competition introduced by FDI in the region in terms of price decreases, quality of output and productivity increases are profound in those services industries that were neglected under the centrally planned economic system. In advertising, for example, competition that was originally introduced by large Western advertising companies, such as Young & Rubicom, McCann-Erickson and others, is now becoming more intense through the entry of other foreign firms as well as the creation of new domestic companies. For example in Poland, this has induced advertising agencies to offer lower prices and better services (Rohwedder, 1994). The licensing of foreign companies also introduced competition in the Czech Republic's insurance market, where the former monopoly provider, Ceska Pojistovna, has lost 20 per cent of its market share.[84]

The impact of FDI is, however, by no means straightforward and depends on many factors, among others, the willingness of Governments to promote competition and the willingness of TNCs to compete:

- In the automobile sector, FDI was linked to demands by foreign investors for protected domestic markets over extended periods; thus, Japanese investment in the Hungarian automobile industry was conditioned on high tariff protection of domestic automobile production.[85] Similarly, in the Czech Republic, Volkswagen's engagement in Skoda (originally put at $6.1 billion, but scaled down to half that amount in the meantime)[86] was linked to protective tariff measures on imports.[87]

- In Hungary, the former State oligopolistic markets in paper and cardboard products, detergents, cosmetics and cement turned into *de facto* monopolies because foreign investors acquired most or all of the domestic companies in the respective industries. Foreign investors temporarily reduced or ceased production in response to their failure in achieving customs protection or the introduction of non-tariff barriers (especially in detergents and cement) (Török, 1994, p. 12).[88]

Transnational corporations have also been criticized in some countries as aggravating the economic crisis (Svetlicic and Rojec, 1993). The exposure of domestic industrial capacity to the process and cost levels of the world market resulting from foreign business presence rendered it sometimes idle and useless, incapable of competing in world markets as well as in domestic markets. As a result, demands for a "sensible protection" of domestic industry have recently surfaced in a number of countries of the region.[89] The resulting limitation of the activities of foreign affiliates is noticeable, for example, in the Russian Federation, aggravated by the political situation in that country.[90] Governments have to be vigilant, therefore, if they want to reap the advantages from competition that FDI can offer.

* * *

Thus, apart from direct effects, TNCs have a number of intangible and indirect effects on the transition to a market economy and especially on the establishment of a market-oriented infrastructure. While difficult to measure, it may well be that, for the time being, some of the most important effects of FDI are in this area.

Conclusions

Despite the growth of FDI in Central and Eastern Europe, inflows into that region remain small by world standards. The transformational depression of domestic economies and the inadequate regulatory framework are partly responsible for the lack of significant investor interest and the low levels of FDI inflows into the region. Although FDI has a tangible and intangible role to play in domestic economic recovery and the transformation to a market economy, neither needs nor expectations have been met. Consequently, these processes need to rely, first and foremost, on domestic resources and efforts.

But it may well be that the relative contribution of FDI may increase in the future. After all, the region is potentially very attractive to foreign investors: many countries of the region are industrialized, middle-income economies with markets ranging from a few million to 150 million consumers with pent-up demand for goods and services; some countries are rich in natural resources and have considerable human resource endowments and relatively low labour costs; and proximity to the European Union market is an advantage that could entice investments in the framework of regional core network strategies of TNCs. But for that potential to be realized, the factors identified earlier in this section as preventing an upsurge of FDI inflows need to be tackled. Even then, however, it is not likely that the result would be a large-scale transfer of production capacities from developed countries to Central and Eastern Europe. Rather, what is more likely is a longer-term process of an incremental increase in production located there, partly to satisfy local markets, partly as a part of integrated international production.

Finally, there is an aspect of the role of FDI in the transition process which, to date, has received little attention: for the countries of Central and Eastern Europe to become competitive in the world economy, it is not only important that they attract FDI and benefit from the assets associated with it; they also need to insert themselves actively — and competitively — in the world market and the emerging integrated international production system by undertaking their own FDI, building on the already existing (small) outward stock of about $1 billion (UN-TCMD and ECE, 1993 and UN-TCMD, 1992b). While this may appear far-fetched at the present time, the logic of a full integration of the region into the world economy requires that attention be paid to this aspect of the integration process at one time. And the level of development of a number of countries in that region suggests that this is a distinct possibility once the economic situation in Central and Eastern Europe shows noticeable improvements.[91]

Notes

1 The declining trend was also reported by the Ministry of Finance for FDI figures based on an approval or a notification requirement: -16 per cent decline in fiscal year 1990, -27 per cent in fiscal year 1991 and -18 per cent in fiscal year 1992. Prior to 1980, firms wishing to invest abroad had to obtain approval from the Government. Now they should only notify the Government of their intention to invest if investment value exceeds 10 million yen. Foreign-direct-investment data collected from approvals or notifications are normally higher than those on the balance-of-payments basis.

2 *Nihon Keizai Shimbun*, 31 March 1993, quoted these figures from the Ministry of International Trade and Industry; and Japan, Ministry of International Trade and Industry, 1990.

3 JETRO, 1993a; and JETRO, "Outline for the 10th survey of European operations of Japanese companies in the manufacturing sector", press release, 24 March 1994.

4 Data on share prices are from International Monetary Fund, 1994a.

5 Surveyed in mid-1992. About 60 per cent of the TNCs covered in the survey that do not plan to make FDI until 1995 give this reason. See Export-Import Bank of Japan, 1993.

6 *Weekly Toyo Keizai*, 10 April 1993, pp. 90-95 and Toyo Keizai Shimposha, 1989, pp. 169-174.

7 *Nihon Keizai Shimbun*, 9 May 1993, p. 1.

8 There is another region that received more FDI flows in fiscal year 1992 than in 1991 — Western Asia. However, the absolute amount of FDI is small, only one-ninth of the level of FDI outflows to South, East and South-East Asia in fiscal year 1992.

9 "Japanese firms in South-East Asia. The second wave", *The Economist*, 7 May 1994, pp. 71-72.

10 *Nihon Keizai Shimbun*, 14 April 1994.

11 In the 1990 survey looking into investment prospects in 1991-1993, the rate was 20 per cent for each of the destinations. See Export-Import Bank of Japan, 1993.

12 For example, the ratio of sales by Japanese affiliates abroad to sales by all Japanese companies in fiscal year 1992 was 6.7 per cent, compared to 24 per cent for the United States (1989) and 17 per cent for Germany (1987). Data from Japan, Ministry of International Trade and Industry, 1990, and "The 22nd survey on Japanese business activities abroad", *News from MITI* (Tokyo, June 1993).

13 Japan Institute for Overseas Investment, 1994. The share of Japanese TNCs that planned to invest in the following three years at the mid-1989 survey was 84 per cent. For this survey, see Export-Import Bank of Japan, 1990.

14 In 1990 only 7.8 per cent of sales by foreign affiliates in the United States were exported. This is a very small share. Even in Japan, which is known for its very small stock of inward FDI, this share is higher and amounted to 11.2 per cent in fiscal year 1990. Data from United States, Department of Commerce, 1993a, and Japan, Ministry of International Trade and Industry 1992.

15 The largest decline in inflows to the manufacturing sector was recorded in the chemicals and allied products industry ($11 billion) between 1989 and 1992 (see table II.5). The reasons for this decline are different from those in the machinery industry because this industry generated the largest income among

industries during this period. The decline in inflows to this industry is largely explained by the absence of large cross-border mergers and acquisitions that inflated inflows in the late 1980s.

16 "Beat of the heartlands", Financial Times Survey: Locating in North America, *Financial Times*, 28 October 1993, p. 1.

17 Total private investment in eastern states of Germany amounted to DM 72.4 billion in 1991, DM 93.8 billion in 1992 and DM 113.2 billion in 1993, a good part of which was largely financed by companies from the western states of Germany. JETRO, 1993b, p. 274 and JETRO, 1994, p. 268.

18 "Beat of the heartlands", *Financial Times*, op. cit.

19 Labour cost per hour in manufacturing in Germany was $26.4 in 1991, while it was $15.6 in the United States. Data from International Labour Office, 1993a, table 22, pp. 957-960.

20 Barbara Harrison, "The incentives that pass the test", Financial Times Survey: Locating in North America, *Financial Times*, op. cit., p. 15.

21 Based on a survey by JETRO, New York, 1988.

22 "Western ventures helping East's phones to ring," *New York Times*, 21 December 1993; "Hungarian telephone stake is won by Deutsche Telekom-Ameritech Group," *The Wall Street Journal*, 20 December 1993.

23 The data on FDI in this industry cannot be disaggregated into the data for developed and developing countries in these years.

24 Commission of the EC, *Panorama of the EC Industry*, various issues.

25 At the bottom of the recession, in 1991, output in the United Kingdom declined by 2.3 per cent while that in France continued to increase by 1.2 per cent (table I.10).

26 For example since 1988, foreign companies establishing an affiliate in France have no longer been required to obtain prior approval from the Government (see, "France extends a warmer welcome to foreign investors", *Business Europe*, 2 February 1990, pp. 1-2). In 1992 prior approval requirements related to cross-border mergers and acquisitions in France were reduced. Furthermore, in 1993, a 20 per cent ceiling on foreign ownership of privatized companies was abolished for TNCs from the European Union. France also started promoting itself as an attractive FDI location. Within this effort the Invest in France Mission was established as an arm of the Ministry of Economy in 1992.

27 See Emma Tucker, "France bucks trend as foreign investment rises", *Financial Times*, 1 March 1993, and "France's foreign affair", *The Economist*, 12 February 1994.

28 "Euro-skepticism slows down on inevitable process", Financial Times Survey: International Mergers and Acquisitions, *Financial Times*, 19 October 1992.

29 "Cross-border M&A", *Mergers & Acquisitions*, 27 (May/June 1993), pp. 57-60.

30 Tony Jackson, "Footloose across Europe's frontiers", *Financial Times*, 9 March 1993.

31 Ibid.

32 "Starting over", *Eurobusiness* (December 1993/January 1994), pp. 50-52.

33 For further explanation of new methods of production by firms, see Dunning, 1994; "New mood in mergers", *Eurobusiness* (December 1993/January 1994), pp. 62-63.

34 To a certain extent, the distinction between portfolio and direct investment is a definitional one.

35 For recent developments in the external financing of developing countries, see UNCTAD, 1993a, pp. 49-69.

36 "Asia's wealth", *Business Week*, 29 November 1993.

37 *Nihon Keizai Shimbun*, 19 January 1994.

38 There are 47 developing countries recognized by the United Nations as least developed countries. For a listing, see UNCTAD, 1994a.

39 Liberia, a flag-of-convenience country, accounted for 43 per cent of FDI flows into the least developed countries of Africa during 1988-1992.

40 See Paul Handley, "The old and the bold: far reaching economic reforms draw mixed reviews", *Far Eastern Economic Review*, 4 November 1993, pp. 30-31.

41 However, the growth of investment flows into the Pacific islands was more rapid, rising from an annual average of $210 million during 1986-1990 to $381 million in 1991 and to more than $500 million in 1992.

42 Real wage increases are nominal wage increases divided by consumer prices index. Data on wages are from the International Labour Office, 1993a and on productivity from World Bank, 1990, table 7, pp. 190-191 and World Bank, 1993b, table 7, pp. 250-251.

43 For example, the Statute for Industrial Upgrading that came into effect in 1991 in Taiwan Province of China provides incentives to TNCs engaging in research and development, the enhancement of productivity, training, the establishment of international brand names and the use of environmental protection systems.

44 The Bank of Japan, 1990 and 1993. This concurs with approval/notification data reported by the Ministry of Finance, according to which that share decreased from 59 per cent in fiscal year 1989 to 30 per cent in fiscal year 1992.

45 "Lee can do", *The Economist*, 21 August 1993.

46 For example, PGI (Singapore) announced its intention to set up a manufacturing plant (electric and electronic equipment) and its European research-and-development headquarters in Scotland. See, James Buxton, "First Singapore company comes to UK", *Financial Times*, 16 November 1993.

47 Reported outflows were $4 billion in 1992. It was probably inflated by the inclusion of local funds that are "roundtripped" through Chinese affiliates abroad or other entities in order to be reinvested in China. See box II.3.

48 *Nihon Keizai Shimbun*, 3 December 1993, p. 9.

49 *Nihon Keizai Shimbun*, 20 December 1993. The share of intraregional trade in total trade based on exports was 68 per cent for the European Union and 43 per cent for the North American Free Trade Area in 1992.

50 William Keeling. "The capitalist spirit is unleashed", *Financial Times*, 30 November 1993, and Victor Mallet, "Investment for Vietnam", *Financial Times*, 13 January 1994, p.4.

51 Mark Clifford, "Send money: North Korea appeals for investment in free-trade zone", *Far Eastern Economic Review*, 30 September 1993. It is reported that most FDI is attributed to Democratic People's Republic of Korea and Republic of Korea residents in Japan (JETRO, 1993b, p. 249).

52 Calderon, 1993a. See also UNCTAD-DTCI, 1993a, pp. 50-54.

53 These non-conventional types of FDI have given rise to concerns that the change in ownership of assets will not contribute to increasing capital formation upon which future growth depends (Kosacoff and Bezchinsky, 1993; Fanelli and Machinea, 1993). Although this may, indeed, be the case, neither does conventional FDI (with the exception of greenfield investments) necessarily add to the domestic capital stock. In fact, if proceeds from debt-equity swaps are being used to reduce debt, this can free up domestic savings for investment purposes.

54 SECOFI, "La inversión extranjera en Mexico", *Comercio Exterior*, 43 (March 1993), p. 213. See also Ortiz, 1993.

55 See "Colombia: opening the door to foreign investment", *Institutional Investor*, 18 (December 1993), p. 4. See also "Fin de siesta", *AméricaEconomia*, 79 (December 1993), p. 40.

56 The following investments were announced by automobile producers in Brazil and Argentina as of the end of 1993: Ford $1,600 million, General Motors $1,500 million, Fiat $755 million and Kia $500 million; see *AméricaEconomia*, Special Number, 1993-1994, pp. 23-24.

57 It should also be mentioned that a number of small economies in the region, mostly in the Caribbean, are linked to the European Union through the Lomé Convention. Although this Convention provides access to the European Union on a preferential basis and contains a number of provisions aimed at stimulating FDI, it is not a free trade agreement. Another extra-regional forum — the Asia and Pacific Economic Cooperation organization — admitted Mexico as a member in 1993, and Chile is expected to be admitted in 1994. While it obviously does not carry as much importance as a free trade agreement with extra-regional partners, it does underline the growing international orientation of Mexico and Chile.

58 It is worth mentioning that Brazil does not belong to the North American cluster in the context of the clustering of international trade and investment (chapter III).

59 For a detailed examination of FDI in Africa, see UNCTAD-DTCI, 1994d and UNCTAD-DTCI, forthcoming.

60 "Morocco courts foreign investors", *International Herald Tribune* , 12 November 1993.

61 By convention, Central and Eastern Europe includes Albania, Armenia, Azerbaijan, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, the Federal Republic of Yugoslavia, Georgia, Hungary, Kazakhstan, Kyrghyzstan, Latvia, Lithuania, the Former Yugoslav Republic of Macedonia, the Republic of Moldova, Poland, Romania, the Russian Federation, the Slovak Republic, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. The former Yugoslavia is also included in the developing countries.

62 The compilation of data on FDI differs from country to country and sometimes even within countries where they are compiled by several government agencies (statistical offices, national banks, foreign investment promotion agencies etc.). The differences in criteria used (including or excluding in-kind investments, reporting initial and/or committed investments and/or tentative investments) and the time-span applied (different reporting phases, different criteria for the disbursement of investments) in the compilation of data may result in a considerable divergence in aggregated FDI statistics. As a result, the data are often not comparable and should be used with caution; see UN-TCMD and ECE, 1993, and ECE, 1994.

63 In addition, many of the registered foreign affiliates were established purely for fiscal purposes, a result of the favourable treatment that was granted initially to joint ventures in several countries. Here, the disbursement of funds originally promised never materialized. See Deloitte, Touche Tohmatsu International, 1992.

64 According to a *Financial Times* survey covering 18 months from 1 October 1991 to 31 March 1993, that included tentative, announced and concluded transactions. See Anthony Robinson, "Ex-Soviet bloc attracts $42bn", *Financial Times*, 28 September 1993.

65 Data for Albania, Bulgaria, Czech Republic, Hungary, Poland, Romania and the Slovak Republic.

66 Nickolas Denton, "In from the cold", *Financial Times*, 19 November 1993.

67 "Automotive survey", *Business Central Europe*, 2, 8 (February 1994), pp. 31-42; and Anthony Robinson, "Survey of world car industry", *Financial Times*, 9 September 1993.

68 "Automotive survey", *Business Central Europe*, op. cit.

69 See Anthony Robinson, "Profitable vision", Financial Times Survey on Poland, *Financial Times*, 18 March 1994, p. II.

70 "Skoda — playing hard to get", 30 June 1990, *The Economist*, p. 69; and EIU, 1994a.

71 "Automotive survey", *Business Central Europe*, op. cit.

72 Ibid.

73 Christopher Bobinski, "Lame ducks are the target", Financial Times Survey on Poland, *Financial Times*, 18 March 1994, p. III.

74 For a discussion of unique services, see Lipsey and Zimny (1993).

75 For example, after insurance restrictions were lifted in the Czech market in February 1992, several Western insurance companies established a presence in that country (among others, Nationale Nederlanden (Netherlands), Sedgwick (United Kingdom), Marsh & McLennan (United States)), primarily to service TNCs. See "Insurance options increase", *Business Eastern Europe*, 22, 29 (19 July 1993), p. 8; see also "In need of a net: a survey of insurance", *Business Central Europe*, 1, 6 (November 1993), pp. 33-47.

76 In the case of advertising, see Rohwedder, 1994, pp. 24-25; for insurance, see "In need of a net: a survey of insurance", *Business Central Europe*, op. cit.

77 In the Russian Federation, apart from the central Government, some of the autonomous Republics and regions have also adopted foreign investment and privatization legislation, sometimes with conflicting requirements (OECD, 1992a).

78 For an overview of privatization schemes, see, for example, Rondinelli, 1994 and Kiss, 1993.

79 See "Telecommunications survey", *Business Central Europe*, 2, 11 (May 1994), pp. 33-48.

80 Nickolas Denton, "Hungary builds capitalism without capital", *Financial Times*, 1 November 1993.

81 Nick Clegg, "Hungary's privatization falters after flying start", *Financial Times*, 19 October 1993; and Nickolas Denton, "Hungary builds capitalism without capital", *Financial Times*, op. cit.

82 "Automotive survey", *Business Central Europe*, op. cit.

83 For the latter, see Jonathan Gafni's case study on Rychtar Tools s.p., a supplier of compact jacks for SkodaVolkswagen's automobile production (Gafni and Niles, 1994).

84 "In need of a net: a survey of insurance", *Business Central Europe*, op. cit.

85 "Automotive survey", *Business Central Europe*, op. cit.

86 Volkswagen's original commitment included an investment of $5.3 billion by the turn of the century; to double Skoda's annual production to 400,000 cars a year by 1997; to help Skoda develop a new range of models; to make available to Skoda its purchasing and parts network, while allowing the company to retain its own identity; and to clean up pollution of factory sites. "Skoda — playing the hard to get", *The Economist*, op. cit.

87 See "Automotive survey", *Business Central Europe*, op. cit. Import duties range from 15.2 per cent on European Community-made cars to 19 per cent on all other automobiles.

88 Production in paper and cardboard fell by 17 per cent, in detergents and cosmetics by 27 per cent and in cement by 33 per cent.

89 Leyla Boulton, "Gaidar urges more government protection for Russian industry", *Financial Times*, 24 November 1993, p. 16.

90 Leyla Boulton, "Inflation fall is boost for Yeltsin man", *Financial Times*, 8 December 1993, p. 3.

91 The region's gross domestic product in 1992 was approximately $900 billion, roughly equivalent to that of the United Kingdom ($1,100 billion). The United Kingdom had an outward stock of $287 billion in 1991.