

Executive summary

Transnational corporations (TNCs) are increasingly designing their production and distribution strategies with the global economy in view, thus expanding the scope of international production. But even as the configuration of their economic activities changes, production still takes place in specific locations, with employees closely attached to their place of work. The impact of corporate strategies and international production on the workplace -- in terms of the quantity and quality of employment, human resource development and industrial relations -- is the particular theme of the *World Investment Report 1994*.

This theme needs to be seen in the context of the return of large-scale unemployment to developed countries and its persistence in developing countries. Fifty years ago, when the international community met at Bretton Woods to lay out an international agenda for a new world order, unemployment was discussed against the backdrop of the Great Depression and the economic disintegration of the inter-war period. Today, the response to unemployment must take place against the background of a more integrated world economy, and one in which TNCs are, inevitably, among the more important vehicles through which any chosen agenda for economic stability and prosperity takes effect. Although the immediate impact of TNC activity on current levels of unemployment is small, the longer-term consequences through stimulating economic growth and improving international competitiveness cannot be underestimated. Policy makers and trade union leaders must find innovative ways to respond to the ongoing changes in the international economy. This is not an easy task. Not only must they address the many new issues raised by integration at the level of production; but, in a more open and integrated world economy, policy makers must coordinate more carefully the traditional instruments for domestic economic management with policies relating to international economic relations, including, in particular, foreign direct investment (FDI) and other forms of TNC activity.

Part One of this volume examines and analyses recent global and regional trends in FDI and TNC activities and presents a longer-term perspective on these trends in the context of the globalization of economic activity. Part Two focuses on employment, human resource development and industrial relations in TNCs, against the background of the expanding volume, wider dispersion and deeper integration of the activities of TNCs. Part Three considers the changing roles of TNCs, trade unions and governments within an increasingly globalized economy, with particular reference to labour-market issues.

Global and regional trends

Recent trends in FDI and TNC activities illustrate the deep and ongoing changes occurring in the world economy. The broad picture that emerges is characterized by the recovery from the FDI recession, the outstanding -- although uneven -- performance of host developing countries, the growth in the number and reach of TNCs and the changing character of the world economy on account of the integration brought about by TNCs at the level of production.

The recovery from the FDI recession ...

After a two-year slow-down in outflows (from \$232 billion in 1990 to \$171 billion in 1992), FDI outflows began recovering in 1993, reaching \$195 billion. Not all major home countries contributed equally to the recovery. Still, the recovery from the FDI recession is seeing a slow return to the previous configuration of major home and host countries.

This configuration had substantially changed during the FDI recession: Japan slipped from first place as a source of FDI to third place, behind the United States and France. The United Kingdom -- the largest outward investor during most of the second half of the 1980s -- moved down to fifth place, after Germany. The decline of world FDI outflows during 1991 and 1992 consisted primarily of reduced outflows from Japan and, to a lesser extent, from some Western European countries, mainly to the United States. The large decline in Japanese outflows -- accounting for 44 per cent and 65 per cent, respectively, of the total declines during these two years -- can be explained by a combination of adverse cyclical factors and some special factors. Among the latter, particularly noteworthy are the weakened financial position of many Japanese TNCs resulting from plummeting stock prices at home, compounded by underperforming investments in Europe and the United States undertaken during the investment boom of the late 1980s. The decline of FDI outflows from Western Europe was not as large as that of Japanese outflows, primarily because the differential timing of the economic recession across Europe partly mitigated the overall decline of FDI flows. In addition, the implementation of the Single Market programme continued to create intraregional opportunities for FDI by European and other TNCs. In comparison with both Japan and Western Europe, United States FDI outflows remained at a high level during the recession and increased substantially in 1993. This reflected the more diversified geographical profile of the country's outward FDI, which permitted United States TNCs to exploit FDI opportunities in some regions and countries, in spite of the recession.

On the inward investment side, the economic recession saw a collapse of investment flows to the United States -- the largest host country during the 1980s and early 1990s -- to 2 per cent of world inflows in 1992 (compared to over one-third in 1989). In absolute values, inflows declined from \$69 billion in 1989, the peak year, to \$3.4 billion in 1992. The decline of cross-border mergers and acquisitions, which play an important role in the market-entry strategies of TNCs, was substantially responsible for the fall in FDI flows into the United States and major countries in Western Europe.

With the recovery from the FDI recession, the earlier pattern of major host and home countries is beginning to re-emerge. On the inflow side, the United States has resumed its position as the largest host country, with its inflows reaching almost \$32 billion in 1993. On the outflow side, the United States has strengthened its position as the largest source of FDI, investing abroad a record \$50 billion. The United Kingdom regained its position as the largest home country in the European Union, lost during the FDI recession to France. The developing countries, too, contributed to the recovery of outflows. Outflows from Germany and Japan have not yet started to recover, but they stopped decreasing, signalling, perhaps, that they have reached the bottom of the cycle. Approval data for Japanese outflows for fiscal year 1993/1994, in particular, augur well.

... is being led by a vigorous expansion of FDI in developing countries ...

Even during the FDI recession in the developed countries, flows into developing countries continued to boom, one of the outstanding features of recent global FDI trends. In 1993, developing countries attracted a record \$80 billion in estimated FDI, twice the amount of flows in 1991 and the same as the level of total world inflows in 1986. As a result, the share of developing countries in world FDI flows reached about 40 per cent in 1993, a share unsurpassed in decades. Foreign-direct-investment flows in 1992 were the largest component of net resource flows to developing countries, comprising one-third of the total; they constitute over one-half of total private flows to those countries. The most important factors making developing countries attractive to foreign investors were rapid economic growth, privatization programmes open to foreign investors and the liberalization of the FDI regulatory framework.

However, the growth of FDI flows to developing countries is unevenly distributed among regions and groups of developing countries. Most FDI inflows are still concentrated in 10 to 15 host countries overwhelmingly in Asia and Latin America. China has become the largest host country in the developing world, accounting for nearly three-quarters of the increase in FDI flows into developing countries in 1992 and over half of the estimated increase in 1993. Indeed, with \$26 billion inflows, China has become the second largest host country in the world in 1993, after the United States, with important consequences for its external trade: the share of foreign affiliates in the country's exports increased from 9 per cent in 1989 to over one-quarter in 1993, while the total volume of exports increased from \$53 billion to \$92 billion.

On the other hand, the least developed countries as a group have received little FDI. Indeed, their share of total developing-country inflows declined from an annual average of 2.1 per cent in 1986-1990 to 0.6 per cent in 1992. In absolute value, the \$300 million received by them in 1992 was less than the inflow received by individual developing countries, e.g., Pakistan, in that year. This unevenness is also reflected in the regional pattern of FDI. Most of the increase of FDI flows has been concentrated in East and South-East Asia, as well as in Latin America and the Caribbean. Flows to Africa -- which includes the largest concentration of least developed countries -- did not increase between the second half of the 1980s and the early 1990s; as a result, the share of Africa in developing-country inflows was halved to 6 per cent between these two periods.

The highlights for each developing country region are as follows:

- **South, East and South-East Asia** have been experiencing the fastest economic growth in the world, and remain the largest host region, accounting for 57 per cent of total developing-country FDI in 1992. China's performance has been central in this respect. Flows into the newly industrializing economies slowed down, however, as a consequence of the restructuring of FDI in response to the loss of some locational advantages and to their efforts to become attractive to high technology or skill-intensive investments. These economies continue to be significant outward investors and are moving labour-intensive

activities to other countries in Asia. As a result, intraregional FDI is growing; countries such as China, Indonesia, Malaysia, Thailand and, increasingly, Viet Nam are particularly attractive locations for such investment. Prospects are quite promising that this region will be able to sustain the present level of FDI inflows, if not improve on it, given that most principal factors determining FDI flows are favourable. Even if FDI flows into China should slow down, as latest signs suggest, there are still a number of markets in the region -- most notably India -- that have yet to be fully tapped by foreign investors.

- Average investment flows into **Latin America and the Caribbean** during the early 1990s were more than twice as high as those during the 1980s. This revival of inflows reflects the recovery of economic growth, market-oriented reforms and a liberalized FDI framework. While FDI through TNC participation in privatization and debt-equity conversion programmes is still important in some countries, others, such as Chile and Mexico, are now succeeding in attracting substantial amounts of investment outside such programmes. Prospects for sustaining the present growth of FDI flows appear to be quite favourable. Progress towards greater economic integration, both within this region and with North America, would be an additional factor generating and attracting FDI.
- Despite the widespread liberalization of FDI policies by many governments in **Africa** during the 1980s, FDI inflows did not increase between the second half of the 1980s and the early 1990s. Averaging around \$3 billion a year, FDI flows to the entire region are considerably less than those received by, for example, Malaysia in the early 1990s. Small markets with low growth rates, poor infrastructure, high indebtedness, slow progress in introducing market- and private-sector-oriented economic reforms and low levels of technological capabilities all reduce the attractiveness of many African countries to foreign investors. Inflows are concentrated in oil exporting countries, especially Egypt and Nigeria. However, a number of small African countries, such as the Seychelles and Equatorial Guinea, have attracted considerable FDI inflows in relation to the size of their economies. That suggests that a differential analysis is required when assessing the investment potential of African countries. Still, although some countries are clearly more successful in attracting FDI than others, prospects for FDI in Africa as a whole and especially in sub-Saharan Africa are not so favourable. External assistance, particularly official development assistance, will therefore continue to be of great importance to create the premises for self-sustained growth, including an FDI-friendly environment.

... but only moderate FDI increases in Central and Eastern Europe.

The remarkable expansion of FDI flows to developing countries has belied the fear that the opening of **Central and Eastern Europe** -- and the efforts of the countries of that region to attract such investment -- would divert investment flows from developing countries. In fact, the growth of FDI flows to Central and Eastern Europe has fallen far short of the growth of flows to the developing countries. The modest inflows also greatly dampened expectations regarding the role of FDI in the transition from centrally planned to market economies. Flows into the region totalled an estimated \$5 billion in 1993 (about the size of flows to Mexico). Cumulated FDI flows were approximately \$13 billion in 1993 (barely more than the FDI stock in Thailand). Investments are unevenly distributed within the region, concentrated in those countries that have made the most progress in establishing a market-oriented economic system. Nevertheless, FDI in some key industries (such as automobiles), the establishment of new linkages with Western Europe, the transfer of modern technology and management practices to foreign affiliates and supplier firms and the provision of previously unavailable services assist in speeding the transition and fostering economic recovery. In addition, TNCs help indirectly in the transition to a market economy by exerting pressures for institution-building, privatization and competition. As regards the future, the region has a good potential to attract foreign investors: many countries are middle-income

economies with sizeable domestic markets and pent-up consumer demand for goods and services and have a large industrial base; some countries are rich in natural resources and have considerable human resource endowments and relatively low labour costs; and the proximity to the European Union market could entice TNCs to reorganize affiliate networks regionally. Even then, however, it is not likely that the result would be a large-scale transfer of production capacities from developed countries to those of Central and Eastern Europe. Rather, what is more likely is an incremental increase in production located there, partly to satisfy local markets, partly as a result of regionally integrated production.

The expanding TNC universe ...

The universe of TNCs in the early 1990s was composed of at least 37,000 parent firms that controlled over 200,000 foreign affiliates worldwide, not counting numerous non-equity links. Two-thirds of these parent firms -- 26,000 -- were from 14 major home developed countries, an increase of 19,000 since the end of the 1960s. Foreign affiliates generated sales of more than \$4.8 trillion in 1991, slightly more than world exports of goods and non-factor services (some one-third of which were intra-firm) and twice the sales figure at the beginning of the 1980s. The influence of the largest TNCs on output, employment, demand patterns, technology and industrial relations should not be underestimated: the world's largest 100 TNCs, ranked by foreign assets, held \$3.4 trillion in global assets in 1992, of which about 40 per cent were assets located outside their home countries. The top 100 control about one-third of the world FDI stock.

... has linked national production systems in the broader context of globalization.

Transnational corporations and their activities have not only grown in quantitative terms. They also have had a qualitative impact on the world economy, within the broader process of globalization.

The driving forces of technological progress and competition, combined with liberalization, have lowered barriers to international flows of goods, services and factors of production, increased the scope for international specialization and led to an unprecedented expansion in international economic transactions. Transnational corporations have played a leading role in this process -- as traders, investors, disseminators of technology and movers of people -- thus strengthening the links among national markets. Beyond that, the distinguishing role of TNCs is that they organize the production process internationally: by placing their affiliates worldwide under common governance systems, they interweave production activities located in different countries, create an international intra-firm division of labour and, in the process, internalize a range of international transactions that otherwise would have taken place in the market.

The strategies pursued by TNCs are of central importance to understanding the globalization process. The activities of parent firms and affiliates can be linked through *stand alone* strategies, in which the links are one-way, concentrating on ownership, finance and technology; *simple integration* strategies, in which affiliates, in addition, often provide inputs to their parent firms; or the linkages can take place through *complex integration strategies*, driven by the desire to exploit global economies of scale and a higher degree of functional specialization involving locating specific corporate activities in a number of locations around the world. Although all three strategies co-exist, most recently there has been a shift towards complex integration strategies, a corresponding division of the value chain into discrete functions and their location wherever they can be most effectively carried out in light of the overall needs of a firm.

Common governance is reflected in the fact that some one-third of world trade is intra-firm in nature (with its composition shifting towards intermediate goods) and that some 80 per cent of

international payments for royalties and fees (as a measure of transfer of technology) are undertaken on an intra-firm basis. Combining the domestic assets of TNCs with the assets of foreign affiliates suggests that as much as one-third of world output is under the common governance of TNCs and hence potentially part of an integrated international production system -- the productive core of the globalizing world economy.

Employment, human resource development and industrial relations

Globalization has important implications for the organization of labour markets.

Until quite recently, the world of work has been shaped by local and national factors. At least since the Second World War, the level of employment has been a major consideration influencing the policies of national governments. The quality of employment depended on the sectoral distribution of production and the behaviour of individual firms with respect to wages, working conditions and training programmes, albeit in the context of wider government policies relating to the labour market and education and training. Most people, at least in the developed countries, expected a lifetime's employment, if not in the same company, then most likely in the same locality or country. Trade union and employer organizations bargained within an established framework of national industrial relations. All that is now changing under the pressure of globalization, as the increased mobility of capital meets the more location-bound asset that is labour.

More specifically, the growth and organization of international production under the governance of TNCs has several implications for the organization of domestic labour markets:

- The conditions underlying firm-level competitiveness are changing, relying less on traditional natural assets and more on created assets, above all assets in the form of skills and knowledge. Such assets are therefore an important factor influencing the locational advantages of countries as hosts to TNCs.
- The importance of skilled human resources, as well as the proliferation of cross-border production linkages via FDI, subcontracting arrangements and strategic alliances and the adoption of complex integration strategies by TNCs create both challenges and opportunities for mutually beneficial relations between employers and employees.
- As the organizational scope of TNCs widens, both geographically and functionally, and as the mobility of capital increases, labour and governments must adapt more quickly to changes in the international competitiveness of their industries and firms.
- Increasing reliance on market forces redefines the relationships of firms, labour and governments with one another, including those in the areas related to employment and the workplace.

In addition, the recent increase in unemployment has refocused the attention of policy makers on the links between TNCs and the generation, location and upgrading of jobs. Although the fundamental factors underlying current unemployment problems relate to macroeconomic and structural imbalances in developed countries and resource constraints in developing countries, TNCs, as a major force in the internationalization of economic activities, influence the quantity and quality of jobs available worldwide. Their influence is particularly important in manufacturing and services and, within these, in certain industries and countries. In all these respects, the influence of TNCs on labour markets and workplace conditions is, of course, not independent of established industrial relations practices.

As a direct result of these changes, labour markets and industrial relations are beginning to emerge slowly from their national confines and to adapt to a world economy that, in other respects, is more integrated than at any time in its history, and is becoming progressively more so.

Quantitatively, employment in TNCs has grown more slowly than FDI worldwide...

Transnational corporations are estimated to employ some 73 million persons at home and abroad. Although this represents only around 3 per cent of the world's labour force, employment in TNCs accounts for nearly 10 per cent of paid employment in non-agricultural activities worldwide, and close to 20 per cent in developed countries considered alone. In addition, the indirect employment effects of TNC activity are at least equal to the direct effects and probably much larger. Backward linkages, such as the purchasing of raw materials, parts and components from subcontractors and external suppliers, are among the principal channels whereby TNCs can indirectly contribute to employment generation. The importance of these effects has grown in recent years, as firms have progressively focused on smaller but higher-value segments of the production process, relying increasingly on national and international outsourcing for technological, cost or flexibility reasons. An example is the footwear company Nike whose core staff consists of 9,000 persons, but, through subcontracting, employs an additional 75,000. Overall, however, it is estimated conservatively that each job in a TNC generates at least one additional job elsewhere in the economy. Thus, at a conservative estimate, the total number of jobs associated with TNCs may be placed at 150 million at the beginning of the 1990s.

As world FDI stock expanded during the 1980s and early 1990s, the total number of persons directly employed by TNCs at home and abroad increased as well, though at a considerably lower rate. The reasons include a trend towards capital deepening and labour-saving technologies, the spread of national and international subcontracting arrangements that generate employment in outside TNCs, and efforts by TNCs to reduce costs through rationalization and employment downsizing. In fact, total employment in a large sample of the top industrial TNCs at the end of the 1980s was lower than in 1980, and it is likely to have declined further since then. However, when all TNCs are considered, total employment in TNCs has grown somewhat.

... and employment in foreign affiliates rose, particularly in affiliates in developing countries, compared to that in parent firms.

Parent corporations account for nearly two-thirds of total direct employment in TNCs. However, during the 1980s and early 1990s, the limited growth that took place in direct employment in TNCs was concentrated in foreign affiliates. For example, employment in United States parent TNCs fell slightly during 1985-1990, while that in their foreign affiliates rose during the same period. In the case of Swedish manufacturing TNCs, employment at home declined sharply during 1986-1990, while that in foreign affiliates rose, resulting in an increase in the share of foreign affiliates from 41 per cent to 61 per cent of total employment. Particularly significant was the growth of employment in Japanese foreign affiliates, which more than doubled during the second half of the 1980s.

When it comes to the distribution of the growth of employment in foreign affiliates, those in developed countries are estimated to account for a somewhat smaller share of the moderate increases that took place between the mid-1980s and the early 1990s, in spite of the high absolute amounts of FDI flows to, and stocks in, these countries. One of the reasons for this is the pronounced sectoral shift of FDI towards services where one FDI dollar is associated with perhaps only half of the jobs associated with one FDI dollar in manufacturing. Furthermore, a restructuring and consolidation of corporate networks has often led to a reduction in employment. However, in spite of slow growth in foreign affiliate employment in developed countries due to

these factors, foreign affiliates account for about 3 per cent of paid employment in these countries, with this figure rising to 10 per cent or more of manufacturing employment in most developed host countries.

The greater part of the increase of employment in foreign affiliates in recent years has taken place in developing countries, rising from 7 million in 1985 to an estimated 12 million in 1992. But the picture is quite uneven with respect to the distribution of foreign affiliate employment and its growth among host developing countries, in general reflecting disparities with respect to the pattern of FDI flows. A considerable share of the increased employment was concentrated in East and South-East Asia, in particular China, and in export processing zones in that region and elsewhere. Still, the level of foreign affiliate employment remains low in most developing countries. With the exception of small countries, such as Singapore, Jamaica or Botswana, the share of employment by foreign affiliates is 2 per cent or less of total employment. However, the figures hide the fact that TNCs are concentrated in modern manufacturing industries with implications for economic growth, long-term employment generation and employment quality. Indeed, TNCs account for one-fifth or more of total paid employment in manufacturing in a number of developing countries.

Qualitatively, foreign affiliates can make a contribution ...

These figures do not say anything about the qualitative aspects of employment in foreign affiliates, be it in developed or developing countries.

... both in terms of working conditions ...

To begin with, the workforce directly employed by foreign affiliates typically -- but not always -- enjoys better wages, conditions of work and social security benefits relative to those prevailing in domestic firms. The explanatory factors include the size of foreign affiliates and their tendency to be concentrated in more capital- and skill-intensive industries and the importance of skills and quality of work for generating competitive advantages. Thus, TNCs have the potential to exert a positive qualitative influence on wages and working conditions in host countries. Particularly in developing countries, the higher wage levels in foreign affiliates are likely to be an influence for raising wages, at least of certain kinds of labour. When it comes to other conditions related to work, TNCs generally adopt standards that are not less favourable than those of comparable national employers and are sometimes above the national average.

... and human resource development.

Perhaps even more importantly, TNCs often provide labour with the opportunity to acquire additional knowledge and skills, and this is particularly so in the case of affiliates operating in developing countries. Indeed, the essential characteristic of TNCs is that they bring together in the workplace international knowledge and skills with the human resources present in a particular location. Accordingly, host country employees and the host economy as a whole can benefit from the upgrading of skills already possessed through employment in TNCs and, especially, the acquisition of new vocational and management skills through formal and on-the-job training in foreign affiliates.

The major role of TNCs in human resource development stems from the learning opportunities and training that they provide for their employees. The extent and nature of training varies according to the country, industry and activity in which a TNC is engaged, as well as firm-specific strategies with respect to FDI and human resource management. On the whole, TNCs provide

at least as much, if not more, training for their workers in developed and developing host countries as domestic firms. Because of their size and international character, TNCs are able to offer formal and non-formal training programmes that are, in some respects, better than those provided by many domestic firms, especially in developing host countries. Larger TNCs often establish training centres and use in-house or external expertise to provide off-the-job training for their employees. Large, as well as small and medium-sized TNCs send affiliate employees to their operations in the home country for experience and training on the job, while large TNCs also rotate managerial staff to different locations for learning. Another channel for the transfer of skills that TNCs typically use is expatriate staff. Human resource development through training is particularly important in the more sophisticated manufacturing activities and in service TNCs where training is a principal channel for the transfer of soft technologies.

The transnational structure and the large size and scope of many TNCs thus hold a distinctive potential for the development of the skills and knowledge of their employees and the further dissemination of those capabilities in an economy through backward and forward linkages. Realizing the potential depends, however, not least on the human resource capabilities that a country already has. The reason is that the ability to attract FDI, particularly into industries and activities that involve human capital investments by TNCs, depends to a significant extent upon the availability of an educated and skilled labour force ready to absorb new skills, know-how and knowledge. Countries in which the level of education and skills is sufficient to provide TNCs with the labour quality that they seek are, therefore, likely to attract such FDI inflows. In addition, as TNCs move -- either on the basis of labour-market conditions or as a result of other reasons - - towards higher skill-intensive activities, the availability of an educated and skilled labour force becomes a condition for sustaining the shift of TNCs into activities with greater potential for human resource development. A virtuous circle of interdependence can be set in motion, with positive results for labour, TNCs and the host economy.

Although industrial relations practices continue to frame workplace issues in TNCs...

Decisions affecting the quantity and quality of employment in TNCs are the responsibility of management. But these decisions are not taken in isolation. Trade unions -- in the context of national industrial relations systems -- continue to be important to articulate, explain and present workers' views to management. However, there has been, particularly over the past decade, a tendency for management to take up certain employment issues in the context of human resource management, thus removing them from the domain of collective industrial relations. The expanding influence of TNCs over domestic economic activity is accompanied by perceptible changes in industrial relations practices, both within TNCs and in industrial relations in general.

... the transnational organization of production poses special challenges for nationally organized labour ...

The central characteristic shaping the relationships between trade unions and TNCs is the difference between the international organizational scope of TNCs on the one hand and the mostly national scope of labour organizations on the other. Within this basic asymmetry, the greater flexibility of TNCs to shift productive assets assumes particular importance because the real or perceived threat to relocate production can have implications for the effectiveness of unions, first to organize themselves and then to take action. This may be further exacerbated if governments seeking to attract FDI see trade union presence as a possible deterrent to foreign investors. Another aspect of the transnational character of TNCs is that their decision-making processes are often more complex than in purely domestic firms. This makes access to information and to ultimate decision makers more difficult than in the national context. On the other hand, the

growing interdependence of national units constituting corporate networks makes them more vulnerable to disruption by union action.

While the issues that arise out of the differences in the organizational scope of TNCs and trade unions are real, it appears that they do not play a dominant role in day-to-day interactions. Industrial relations practices have, historically, been designed and implemented at the national level, often in close association with governments, although there are signs suggesting that the scope for national systems of industrial relations to determine autonomously labour practices and bargaining relationships is becoming more limited and that TNC-based industrial relations structures are becoming more important. Still, in most instances, TNCs have adapted their own practices to host country norms. Furthermore, the long-term strategies and structures of TNCs are, on the whole, not determined by considerations relating to trade unions and, hence, do not necessarily always change when there are (temporary) disagreements between management and workers. In fact, motivated by their self interest, TNCs normally recognize unions (indeed, unionization often appears to be higher in foreign affiliates than in domestic firms), invest in their workforce and deal with trade unions with a view towards establishing effective relationships.

... but also opens new avenues for cooperation.

Such relationships have become all the more important as the pressures of competition require that firms need to "reinvent" themselves continuously through the introduction of innovatory practices and corporate restructuring. Often these require the formal or at least informal cooperation of organized labour to be effective. Perhaps more profoundly, the growing importance of created assets and the adoption, by many TNCs, of flexible production methods and new organizational paradigms increases the need for workers' commitment to the performance of the firm. Such a need can be best sustained in the framework of a cooperative approach to industrial relations. As a result, employees are increasingly recognized as important stakeholders in the enterprise, with a strong interest in ensuring its success. While there may be disagreement about how this is best achieved, how the benefits of success should be shared, how unions may be involved and how national systems of industrial relations may be affected, one effect of expanding integrated international production is the recognition that all employees have much to contribute to the well-being of the enterprises in which they work. Growing acceptance of this view may permit the development of new cooperative arrangements for the conduct of industrial relations within TNCs.

Although the relocation of jobs through FDI is limited ...

Foreign direct investment is often associated with a process of structural transformation in host economies, a transformation that may be expected to generate growth and hence employment in the long term. As part of that process, the rise of international production is associated with a certain redistribution of jobs, especially at the regional level, and an increase in the speed of the broader process of industrial restructuring that is taking place on the global level. On the whole, however, the number of jobs relocated from developed to developing countries through FDI is small, compared with the size of the total labour force in developed countries.

The reasons are varied. To begin with, services account today for a substantial share of FDI flows to developing countries; given the (still) limited tradability of most services, most FDI in this sector is therefore by necessity location-bound, i.e., markets (domestic and international) cannot be served by trade. Other market-oriented FDI also typically does not lead to a relocation of jobs, e.g., when barriers to market access make it difficult, if not impossible, to serve certain markets through trade. Moreover, although labour costs are important for certain activities in certain industries, they are not, by themselves, among the most important determinants for the location

of FDI. Furthermore, differences in labour costs between developed and developing countries are, to a certain extent, offset by corresponding differences in labour productivity. Finally, despite a few notable cases, TNCs do not often close down, on account of labour-cost considerations alone, production facilities in one country to re-establish them in another country; rather, to the extent that a shift in production occurs, it typically involves an incremental process in which new production facilities are established in developing countries or countries of Central and Eastern Europe. Broader and more important macroeconomic and cyclical factors, technological change and labour-market inflexibilities are the principal influences on the growth and distribution of employment.

... governments seek to influence FDI to gain or maintain jobs.

Nevertheless, given the unemployment problems facing most countries, it is a frequent objective of governments in developed as well as developing countries to retain or attract TNC operations with a view to maintaining or adding to jobs available. In fact, competition for FDI may tempt governments to offer concessions in the social and labour fields as an incentive to attract TNCs and to create much needed jobs. This reflects a genuine policy dilemma faced, in particular, by developing countries, between the need to create jobs and the need to raise labour standards. Policy formulation in this respect should recognize the complex factors determining employment and go beyond simple measures for attracting additional FDI inflows *per se* or, in the case of home countries, discouraging outward investment. In the current context of growing global competition and integrated international production, the key policy issue is how to attract or retain value-adding activities in a way that maximizes the long-term contribution by TNCs to national production capacities while maintaining desired local employment levels.

Home countries need to recognize that, barring a major reversal of policies, globalization is a firmly entrenched process which, to an increasing extent, is becoming a parameter of national economic development. Foreign direct investment is an integral part of this process and is often a precondition for firms to preserve or expand international markets; not to undertake it could, therefore, lead to a loss of competitiveness. Today, the capacity to organize activities in an integrated way across different countries is a critical element in ensuring the efficiency and competitiveness of firms and, hence, their capacity to generate employment. The implication is that it may be better for home countries to ensure the competitiveness and eventual survival of their TNCs by encouraging them to focus on higher value-added activities than risking that they become less efficient producers. To be sure, the structural adjustments that this implies may be socially disruptive and entail substantial costs, especially for less-skilled labour. Governments will wish to ensure that these costs are minimized. Human resource development policies, especially retraining, have an important role to play in this respect. Policies designed to slow the pace of the adjustment process may facilitate the transition but, at the same time, may create other hidden or overt costs; efforts to steer the adjustment process require therefore a careful analysis of the costs and benefits involved.

The employment effects of globalization make themselves felt not only at the aggregate level but also at the firm level. In particular, complex strategies have implications for the quantity, quality and location of the jobs generated by TNCs and the relations of these firms with trade unions. While the shift to complex strategies may lead to some decline in direct employment within the TNCs concerned, it also increases the opportunities for host countries to receive more and higher value-added FDI. Furthermore, as TNCs locate higher value-added and more specialized activities in their foreign affiliates, training requirements to improve the quality of host country personnel increase. The trend towards complex strategies, therefore, suggests that integrated international production reinforces the higher wage/high skill profile of foreign affiliates. Thus, important employment effects of FDI derive from the way in which value-adding

activities are structured and integrated within the production networks of TNCs. Growing recognition of these positive effects has contributed to increased competition among governments for FDI.

In this respect, enhancing the quality of the labour force is likely to be a main avenue for policy action by developing and developed host countries to attract FDI. Human resource development is, indeed, within the realm of influence of local or national policy makers. It should be noted, however, that this may be a necessary, but not a sufficient condition to attract FDI, among other reasons, because the supply of highly skilled human resources is growing across locations. Moreover, TNCs are most likely to be attracted by a combination of an educated labour force and a social and physical infrastructure capable of generating high productivity, especially in large and expanding markets.

Policy challenges

The essence of the policy challenges in a more integrated international production system is how best to ensure that the forces of international competition and cooperation work in a complementary manner to enhance global economic welfare and contribute to a more equitable distribution of the resulting benefits. Two broad tendencies underpin this challenge: on the one hand, the ongoing process of liberalization implies a greater reliance on market forces; on the other hand, private economic actors need to take on new responsibilities in relation to the social implications of their expanded opportunities. As a result, the relationships among the principal actors -- firms, trade unions, governments -- are being redefined. This raises specific problems in the context of TNCs and FDI policy, illustrated here in relation to issues related to employment, human resource development and industrial relations.

The widespread liberalization of FDI policies ...

In the FDI area, liberalization is the most important policy trend of the 1990s, as part of broad-based efforts to attract foreign investors. This trend is embedded in a broader liberalization movement -- covering international trade in goods, external financial transactions, transfer of technology and, more recently, services and some aspects of labour movement -- that seeks to enhance economic efficiency through the elimination of market distortions caused by restrictive or discriminatory governmental measures. These policies are interrelated and mutually supportive. Together, they are one of the preconditions for, and allow the further development of, the emerging integrated international production system, while receiving additional impetus from it.

A number of important multilateral and regional agreements bearing on FDI issues (in particular, the Uruguay Round of Multilateral Trade Negotiations, the North American Free Trade Agreement and the Single European Market) and the increasing number of bilateral investment treaties (64 of them were concluded in 1993) have provided further momentum to unilateral FDI liberalization drives at the national level. These efforts are leading to a level of convergence of government approaches towards FDI never before achieved. Yet this process of liberalization has been far from homogeneous, and there are still considerable differences in the nature, breadth and depth of the measures taken. As the normative frameworks for FDI around the world become increasingly similar, these differences become more important for attracting foreign investors, and there is a real possibility that efforts to attract FDI can lead to increased "policy competition" among governments. Such competition could potentially be carried into more policy areas than in the past, since the increasingly integrated nature of international production elevates more and more policies from the domestic to the regional and international domains.

The liberalization of FDI policies involves the following main elements:

- First, the tempering or removal of market distortions resulting from restrictions applied specifically (and hence discriminatorily) to foreign investors; and the granting or withholding of incentives and subsidies that discriminate in favour or against TNCs. The most significant liberalization steps taken relate to restrictions on the entry and establishment of foreign investors, although all countries still keep some activities closed to FDI. In the developed world, restrictions are mainly found in the natural resources and services sectors. In developing countries, the picture is more complex. There, liberalization has had a tendency to focus mainly on export-oriented manufacturing industries, or projects involving advanced technology; more recently, the liberalization drive in these countries has expanded to services and natural resources. But, in general, it has not yet reached the levels typically found in developed countries. Similarly, although compulsory and minority shareholdings have declined in importance over the years as a means of restricting entry of FDI generally, ownership restrictions continue to be used as a tool for controlling FDI in specific industries and activities. In particular, this and other forms of local control over foreign affiliates' decision-making are used in large investments in strategically important industries or in cases of privatization of public monopolies. Operational restrictions, for example on the employment of non-nationals, are still being used. However, performance requirements have in recent years shown a tendency to lose their compulsory character and, instead, tend to be related to positive inducements. General authorization procedures have been abolished in most developed countries and are tending to disappear gradually in developing countries as well (except for TNCs operating in certain specific industries), and are being replaced by requirements for registration or notification. Recent incentive programmes appear to discriminate less in favour of foreign affiliates. When they do, it is to attract them to certain industries, or to link them to exports, training or the introduction of advanced technology.
- The second category of measures involves the establishment of standards for the treatment of foreign investors. National treatment is central in this respect. Most developed countries grant national treatment to foreign investors, and an increasing number of developing countries are embracing that standard as well. The same applies to fair and equitable treatment. Similarly, developing countries have strengthened legal protection provided to foreign investors, including the possibility of recourse to international dispute-settlement mechanisms. Finally, in recent years, governments have made considerable efforts to publicize and disseminate information on their policy, normative and administrative frameworks relating to FDI and to ensure that this information reaches potential foreign investors, thus increasing the transparency of their FDI frameworks.
- Thirdly, the liberalization process requires regulations aimed at ensuring the proper functioning of the market and promoting broader economic and social concerns. These include, for example, competition rules, prudential supervision of banking and financial services, the protection of intellectual property rights, appropriate health, consumer and environmental standards and an effective system of accounting and reporting. More and more countries around the world are strengthening their frameworks in these areas.

In addition to liberalization measures, other policies of host countries are also important for a favourable investment climate; and, as liberalization progresses, they become increasingly so. Thus, the existence of a reasonably comprehensive legal framework for business activities and a properly functioning legal order are required to provide predictability and stability. In addition, well functioning administrative infrastructures are necessary to ensure the effective implementation of the legal framework. Moreover, the close interlinkages between FDI, trade and technology imply that their respective policy frameworks need to be consistent to achieve maximum results. Still other important aspects of a favourable investment climate include such things as political and

economic stability, the establishment of a sound macroeconomic framework, the upgrading of a country's human resources and the strengthening of its physical infrastructure. These objectives are not easy to achieve immediately. But a number of promotional measures such as, for example, entering into bilateral and multilateral commitments to guarantee foreign investors against non-commercial risks, can help to attract investors in the short term. In sum, the process of liberalization of FDI regimes does not imply a weakening of the role of Government but rather a redefinition of some of its functions and the strengthening of others. In particular, internal policies that are aimed at facilitating the integration of the local economy in the international production system are becoming increasingly important.

... means that TNCs are given more freedom and, hence, need to assume greater responsibility ...

The liberalization of FDI policies and related international transactions means that TNCs are given more freedom to shape their strategies and structures. With this increased freedom comes also a greater ability to influence national and international economic activity and, hence, more responsibility, particularly social responsibility. This is recognized by firms, for instance, when they adopt codes of corporate ethics, and by shareholder and other groups, for instance, when they advocate the social responsibility of firms.

The concept of corporate social responsibility helps firms to define and organize their relations with society. It first assumes that an enterprise is a distinct, identifiable entity with the capacity both to act and assume responsibility for its actions. Secondly, it describes the nature of a corporation's relationship with society which includes not only following narrow legal requirements but also includes broader actions as defined by a firm's social charter. Finally, the concept helps to determine which social groups fall within a corporation's circle of social responsibility and why.

General concepts of corporate social responsibility pertain equally to both domestic and transnational enterprises. However, applying these concepts to TNCs established in a diverse global setting raises special considerations and issues that may modify a firm's specific definition of its social responsibilities. In fact, it gives rise to a tension -- and an interactive dynamic -- that is specific to TNCs: on the one hand, the duty to behave as good corporate citizens in the host countries in which they are established; and, on the other hand, the duty of adhering to broader self-imposed social responsibility standards formulated to apply to their corporate systems as a whole.

In its application to TNCs, the concept of social responsibility relies on, among other things, the notion of appropriate roles as ordered by the subsidiarity principle, according to which social responsibility is best exercised by actors closest to a given situation. Societies are administered by governments, which bear primary rights and responsibilities regarding the welfare of their people. By contrast, corporations are principally responsible for matters most directly related to their own economic purpose and function, operating within prevailing legal frameworks. However, voluntary corporate actions pursuing broader social goals can derive from business capabilities and impacts. In exceptional circumstances, TNCs may even need to assume added responsibilities where other actors, including governments, do not or cannot carry out critical duties. In this sense, the role of TNC social responsibility appears broadest in developing countries and countries with economies in transition, and where governmental or free-market regulating mechanisms are not yet fully formed or effective.

Operating international production systems in different national and cultural settings raises difficult issues as to how to determine the content and scope of a TNC's social responsibility and apply it throughout its corporate network. The growing number of international strategic

alliances and the expansion of low- or non-equity forms of investment also increase the difficulty in maintaining a corporate identity that can support social responsibility actions through a consistent set of policies implemented over widely dispersed and perhaps only partially controlled foreign affiliates. Historically, many TNCs exhibited ethnocentric tendencies flowing from a heavy reliance on directives from centralized headquarters in the parent firm's home country. As the emerging integrated international production system introduces more dispersed operational authority, it could enhance a TNC's learning experiences, thus improving its responsiveness to the needs of its host societies. A TNC will still require a common core of values if it is to maintain a unified corporate identity, but its internal norms might evolve more from a dynamic interaction between corporate and host country values, eventually matching more closely public expectations regarding how corporations should behave in relation to evolving international standards.

A number of initiatives by the business community to establish voluntary standards -- and by individual firms to adopt their own corporate codes of conduct -- show that there is widespread awareness among TNCs of their social responsibility, as part of a broadly defined notion of self interest that includes a corporation's stakeholders. A review of these standards and codes suggests a range of topics relevant to TNC social responsibility. Among them, those relating to employment and human resource development are particularly pronounced. Many TNCs have set forth their policies in this respect in their corporate codes, ranging from brief statements of principle to detailed policy manuals.

... and that trade unions can count less on government and, hence, need to rely more on their own efforts ...

Trade unions represent another group with a direct stake in shaping the broader policy framework concerning employment and workplace issues. As trade unions must deal more and more with TNCs, one would expect them to seek ways to match the organizational scope of TNCs by transnationalizing their own structures. However, because of many obstacles, including differences in labour market legislation, the problem of defining mutual interest among differently organized national groups of workers and the difficulties of organizing workers arising from the increasingly fluid relations within TNC networks, this approach is of only limited significance for the time being. For these and other reasons, trade unions internationalize some of their actions, as a means of strengthening their leverage in their relations with TNCs. Thus, while the social responsibility of TNCs is grounded internationally but implemented locally, the approach of trade unions is grounded locally but implemented internationally.

Trade unions are taking two broad approaches to international action. On the one hand, efforts to strengthen cross-border trade-union solidarity and cooperation have led to the establishment of international bodies, among other things, to monitor TNC industrial relations and coordinate responses whenever and wherever appropriate. On the other hand, trade unions have looked to international normative frameworks to influence directly the behaviour of TNCs. The two approaches are not mutually exclusive, as is apparent from the Western European context. The combination of the two is likely to strengthen trade-union leverage in the face of international production.

As to cross-border trade-union solidarity, international trade-union organizations are of two types -- alliances of national trade-unions centres or confederations and organizations established at the industry level in the form of international trade secretariats. In many respects, the functions of these organizations overlap. However, the former have a stronger representational role in dealing with other international agencies, whilst the latter deal primarily with issues arising at the firm and industry levels.

On a day-to-day basis, both of these types of organizations collect information and exchange it among affiliated members. In the case of some international trade secretariats, priority has been given to bringing together workers from the same TNCs, but employed in different countries, to form world councils. These councils have been important in creating a network of relationships among unions, but most TNCs have resisted accepting them as more formal negotiating partners, and the financial and organizational pressures on them are enormous.

Beyond this informational role, international solidarity takes place through a series of increasingly intensive stages: the simple voicing of support for union action within a particular TNC; the provision of financial assistance and advice; direct pressures on headquarters; and full-scale corporate campaigns dealing with fundamental issues of trade-union organization. A high degree of planning and sophistication is required for more strategic responses.

At the national level, industrial relations are most often conducted through a body of formal rules and regulations framed by governments. Trade-union efforts to replicate at least part of this framework at the international level have helped to establish various standards and guidelines, a number of which directly address the activities of TNCs, including some in the area of industrial relations. The two most important are the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy of the International Labour Organization and the Guidelines for Multinational Enterprises of the Organisation for Economic Co-operation and Development. They include general provisions on industrial relations, in particular, concerning locational flexibility, union recognition, effectiveness of action, access to decision makers and information, and consultation. Despite widespread initial enthusiasm for these instruments from the international labour movement, experience with them has led to a declining interest reflecting, in part, the slow and complex implementation mechanisms of these instruments. But, primarily, it is their voluntary nature that appears to have constrained their more widespread use.

Despite the somewhat disappointing experience with international guidelines, trade unions have begun to renew their interest in international efforts, this time focusing on minimum labour standards. Issues raised regarding international labour standards have generally been associated with increased trade linkages. Deeper integration at the level of production through TNCs complicates this issue further. Although the greater mobility of TNCs has been seen as a potential threat to labour standards in developed countries, the worldwide affiliate networks of TNCs open up new possibilities to influence labour standards globally. However, care has to be taken that this approach is not misused for protectionist purposes.

Particularly in light of the experience gained with international regulatory approaches, as well as the broad-based reach of the liberalization movement, a new realism has characterized the efforts of the international trade-union movement over the past decade. One important manifestation of this has been a refocusing on efforts at the regional level. Developments in Western Europe -- in the face of corporate restructuring to meet the opportunities of the enlarged Single Market and widespread efforts at policy harmonization -- have placed great pressures on traditional industrial relations practices. That region has also seen the most innovative responses from trade unions. In many respects, they represent a coming together of the two main approaches described earlier. During the 1980s, European voluntary works councils were established in a number of TNCs. Although largely informational, in some cases they have begun to take a more substantive consultative role. These initiatives at the corporate level have been complemented by legislative efforts through the European Union to extend information and consultation procedures in TNCs established in the European Union, most importantly, through a draft Directive on the formation of European Work Councils. If and when this Directive is implemented, perhaps as many as 1,000 Councils may be established. Although a purely regional initiative, the Directive is likely to have relevance beyond the European Union.

... while governments need to be pro-active in human resource development policies.

Despite the general trend towards a greater role of markets, the role of national governments in education and human resource development remains undisputed. If anything, in fact, this role has become more important, especially in developing countries, although the manner in which it is being pursued is changing. As competitiveness and economic growth are increasingly determined by created assets, it is important that governments coordinate their policies for human resource development with measures to promote FDI and channel it into priority areas for human resource development. Since TNCs must balance their competing requirements of globally efficient operations and locally responsive strategies, government policies for harnessing the capabilities of TNCs for human resource development must also strike the right balance in terms of supporting national goals while taking into account the needs of TNCs to be competitive in global markets.

All national policies that are directly or indirectly related to human resource development have some impact on the appeal of a country to foreign investors. A literate human resource pool with basic education and skills; matching national education programmes with the needs of the private sector; and, particularly, implementing educational programmes that lead to the development of a workforce that is flexible and well adjusted to the evolving requirements of participation in a global economy are likely to add to the ability of a country to attract FDI. To achieve a competitive edge in international production, some countries or regions go further and match training programmes to specific needs of TNCs. This enhances their chances to attract foreign investors, but the costs of such programmes must be carefully evaluated in relation to their benefits.

Since the main impact of TNCs on human resource development takes place through the training they provide to their employees in skills related to their production operations, as well as through training provided in the context of forward and backward linkages, government policies aimed at maximizing human resource development benefits should encourage FDI in industries and activities that offer the greatest potential for training as well as skill intensive local linkages. Assuming that the initial human resource base of a country provides sufficient absorptive capacity, fiscal or other incentives could be offered to FDI in industries or functional activities that are considered most promising in this regard.

Host countries can also implement initiatives and policies that are directly targeted towards maximizing the human resource development contributions of TNCs that are already established in these countries. Thus, many countries have stipulated legal or administrative requirements for the provision of training for employees by foreign affiliates, under policies aiming at an overall improvement in skills acquired by the country's labour force. Often, they involve a mandatory contribution by TNCs, for instance, as part of payroll levies. Another focus of policies in this respect are localization programmes regarding staff in foreign affiliates. At the same time, policies may link investments by TNCs in education and training to incentives provided to those firms. Collaborative schemes between governments and TNCs to implement training programmes are another means whereby host countries can mobilize foreign affiliates for human resource development.

Investment in, and the effective use and management of, human resources are critical for countries as well as TNCs in today's competitive global economy. Education, therefore, needs to adapt to changing requirements, including those of the private sector in a globalizing world economy. At the same time, if countries wish to tap the potential of TNCs in technologically sophisticated activities for human resource development, they must pursue policies that ensure adequate domestic absorptive capacity for skills and knowledge. Finally, governments need to ensure that the results obtained in terms of human resource development by TNCs are commensurate with the resources spent, whether from public or private sources. Perhaps the greatest

potential that international production offers for human resource development lies in closer cooperative relationships between TNCs, trade unions and governments in the identification of skill shortages, training priorities and appropriate policy initiatives.

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The process of liberalization of international economic transactions in general and FDI policies in particular -- and, more broadly, the worldwide acceptance of the market as the principal allocator of resources -- is redefining the relations of the principal actors in the market with each other. The new freedom created for firms by liberalization means that they need to shoulder more responsibility, and social responsibility in particular. Trade unions, still largely rooted in their national environments, can count less on governments than in the past and, therefore, need to rely more on their own efforts, being confronted, as they are, with a globalizing world economy. Governments, finally, need more than ever to ensure that the principal assets of their countries - - their people -- are as qualified as possible to be able to deal with the fast-changing demands of the emerging integrated international production system. The network of micro-economic connections at the firm level is now so woven into the cross-border fabric of internalized and externalized patterns of producing and distributing goods and services that policy makers have few options but to recognize the new landscape of international production and international competitiveness.