PART TWO

TNCs AND EXPORT COMPETITIVENESS

INTRODUCTION

One of the contributions TNCs can make to host economies in the developing world is to enhance their export competitiveness. Export competitiveness has many facets, the most obvious implying higher exports. But it also means diversifying the export basket, sustaining higher rates of export growth over time, upgrading the technological and skill content of export activity, and expanding the base of domestic firms able to compete globally; thus, competitiveness is sustained and it is generally accompanied by rising incomes. TNCs can help raise competitiveness in developing countries in some or all of these ways, but tapping their potential is not easy. Attracting export-oriented TNC activities is itself an intensely competitive business, and even some of the countries that have succeeded may find it difficult to sustain competitiveness as their wages rise and market conditions change. Coherent and consistent policy support is essential to ensure that attracting export-oriented TNC activities are embedded in a broader national development strategy. This is particularly important as there is a possible tension between the principal objective of Governments – which is to maximize *national* welfare – and the principal objective of TNCs – which is to maximize their *global* corporate competitiveness. Export competitiveness is important and challenging, but it should be seen not as an end in itself but as a means to an end – which is development.

The link between FDI and trade is not new but well worth revisiting, especially in the light of the growing attention to the challenge posed by competitiveness,[1] but also in the light of the changing nature of international production systems, the growth of supplier networks and new multilateral disciplines. In *WIR99*, as part of the examination of FDI and the challenge of development, one chapter was devoted to the link between FDI and trade. The principal conclusions were that TNCs exert a strong influence on the patterns of world trade, that much of the international flow of goods is handled within TNCs in the form of intra-firm trade, and that inward FDI has contributed to boosting the export performance of a number of developing host countries. This year's report builds on the findings of *WIR99* by looking in greater detail at the role of TNCs in increasing export competitiveness and the corporate strategies that are driving most of the recent changes in the pattern of international trade. These have to be understood in order to achieve a better understanding of the role that policy can play to foster export competitiveness in association with TNCs.

Accordingly, Part Two of *WIR02* explores the changing nature of export competitiveness and the role that TNCs play in enhancing it in different countries and activities. Part Three then deals with the policies developing countries (and economies in transition) might consider to attract export-oriented FDI and benefit from it.

That export competitiveness[2] is of growing interest to countries at all levels of development is clear: the sheer volume of analysis and benchmarking testifies to the importance that Governments attach to it. Developed countries regard competitiveness as a prerequisite for maintaining high levels of income and employment.[3] Developing countries find it essential for development. Improved export competitiveness allows countries to earn more foreign exchange and so to import the products, services and technologies they need to raise living standards and productivity. Greater competitiveness allows developing countries to diversify away from dependence on a few primary-commodity exports and move up the skills and technology ladder, which is essential to sustain rising wages. It also permits the realization of greater economies of scale and scope by offering larger and more diverse markets.

New forms of export competitiveness, geared to international systems of production, can allow developing countries to enter technology-intensive activities that they could not otherwise undertake. In the process, it allows them to build new productive capacities. Exporting feeds back into the capacities that underlie competitiveness: exposure to world competition provides enterprises with greater access to information and technology than exposure to domestic competition alone and leads to more vigorous efforts to acquire new skills and capacities.[4] An export-oriented economy also tends to attract more efficient TNC activities, which reinforces the upgrading.

There is ample recent evidence that export-oriented development is not only feasible but also rewarding. However, raising export competitiveness means more than liberalizing trade and investment. The most successful countries had to make determined efforts to develop new capabilities and to attract foreign capabilities to complement domestic ones. All drew heavily on new technologies from TNCs, and many, but not all, relied on FDI or non-equity forms to spearhead the process.

This is not to argue that building export competitiveness is a complete strategy for economic development. It is only one of a number of elements needed for development. It has to be complemented by measures to ensure that the non-export sectors of an economy grow and that the benefits of growth are spread throughout the economy. If the export sector is de-linked from the rest of the economy, it is possible to improve export competitiveness without raising growth rates or living standards for the population at large. This is, however, rare; a number of exporting economies have been able to grow on the back of their export drives, including by moving up the technological ladder from labour-intensive activities towards technology and skill intensive ones (UNCTAD, 2002a).

TNCs can contribute to the export competitiveness in host countries. Their contribution is important in technology-intensive and internationally branded products, but it goes much further. They have always been significant players in primary exports and the main source of new industrial technologies for local exporters (through arm's-length licensing and original-equipment-manufacture arrangements). With the spread of global value chains in many low- and medium-technology activities, TNCs are now involved in the whole spectrum of manufactured exports. In some low-technology segments, other international players are also active, and TNCs often take the role of coordinating local producers in addition to setting up their own affiliates. In many technologically complex activities, TNCs are particularly important because a large part of trade is internal to their international production systems.

While the growth of international production systems is well recognized, it is less well known that there is a growing tendency for firms, even large TNCs, to specialize more narrowly and to *contract out* more and more functions to independent firms, spreading them internationally, to take advantage of differences in costs and logistics. Some are even opting out of production altogether, leaving contract manufacturers to handle it while they focus on innovation and marketing. The main suppliers and contract manufacturers are themselves often large TNCs, with global "footprints" matching those of their principals and with their own subcontractors and suppliers. However, TNCs also increasingly use national suppliers and contractors in host economies. Specialization does not stop here: leading TNCs are also entering into joint innovation arrangements with other firms – competitors, suppliers or buyers – and with institutions such as research laboratories, universities and so on. Thus, the emerging global production system is becoming more multifaceted , but with tighter coordination by lead players in each international production system.

What lies behind these trends? Three forces are driving them. The first is policy liberalization, which opens up national markets and allows all kinds of FDI and non-equity arrangements. The second is rapid technological change, with its rising costs and risks, which makes it imperative for firms to tap world markets and share the costs and risks. Technological change – in particular, falling transport and communication costs, the "death" of distance – also makes it economical to integrate distant operations and ship products and components across the globe in a search for efficiency. The third, reflecting both of these, is increasing competition, which results in unexpected forms of relocation to new sites, with new

ownership and contractual arrangements, and involving new activities.

All the signs are that the export role of TNCs in host countries, through both FDI and non-equity arrangements, will grow further. It will continue to take new forms and incorporate new locations. The potential for generating exports from developing countries and economies in transition is thus high. But, as noted, tapping this potential is not easy.

Part Two of *WIR02* deals with these themes. It starts with the characteristics of international production systems, exemplifying them for a number of firms. It describes changes in global competitiveness patterns, the direct role of TNCs in exports (their indirect contribution is difficult to trace quantitatively) and the main country "winners" in export competitiveness. The *main messages* of the analysis are as follows.

Trade patterns are changing rapidly, with technology-intensive activities growing consistently faster than others. As a group, developing countries and economies in transition have done well in export competitiveness, rapidly raising their market shares and upgrading into advanced activities.

TNCs have played an important role in the exports of many countries, directly by establishing in those countries affiliates incorporated into the TNCs' international production systems, and indirectly by entering into contractual arrangements, especially with suppliers linked to the TNCs' production systems. However, such systems are still largely concentrated by country, region and activity. It is possible that the export dynamism seen in the leading "winners" will spread to other developing countries and economies in transition as international production gathers pace and increases in scope. But there are risks and there are opportunities. First the risks:

- The bulk of TNC-related export activity in developing economies and economies in transition is concentrated in a handful of economies, mainly in East and South-East Asia and in regions contiguous to North America and the European Union, although TNCs are also significant players in many countries that are not major global exporters.
- It is unclear whether some large production systems *can* spread further, for technological reasons. Once production has been rationalized to serve regional or world markets, first movers tend to build strong cumulative advantages, reaping economies of scale and scope and drawing upon clusters of suppliers and institutions.
- The entry-level requirements of competitive production are rising. Not only is technological progress pushing up skill requirements, TNCs also increasingly need efficient supplier networks that can operate globally and at much higher levels of technological sophistication than before.
- Even "insiders" to international production systems face uncertainty about their prospects. A number of low-technology systems such as textiles, clothing and footwear, on which many countries have relied, may have peaked in growth. The more high-technology systems are imposing more stringent demands on participants. Host countries that cannot muster new capabilities may lose their competitive edge: even first-mover advantages may not last without upgrading.
- A concentration of exports from developing countries on a few manufacturers might lead to oversupply and a subsequent deterioration of the terms of trade – often referred to as the "fallacy of composition" dilemma (UNCTAD, 2002a, ch. 4).
- Some trade arrangements that caused a spreading of international production in some low-technology industries will be phased out or else eroded by further trade liberalization. The Multifibre Arrangement is an example.

But there are also opportunities:

- International production *is* spreading and can be expected to do so as countries further liberalize trade and investment regimes and improve their infrastructure and skills, and as competition pushes firms to spread their activities more widely to strengthen their competitive advantages.
- Leading TNCs are increasingly drawing independent enterprises into their production systems: input suppliers, service providers and strategic partners. This offers considerable scope to

enterprises from host economies that build the capabilities to meet TNCs' needs.

- TNC suppliers and contract manufacturers are going transnational to retain competitiveness and to serve lead firms effectively, opening new sources of export-oriented FDI for developing countries.
- Rising costs and congestion may at some stage offset first-mover advantages, and activities then spread to cheaper and less congested areas.
- The increased tradability of services as well as of specialized service functions associated with international production systems will open entirely new areas for an international division of labour.
- Advances in transport technology may open up new possibilities for high-value agricultural and other primary products.
- New globalized activities will emerge as the economic logic of relocation and networking spreads. This is already evident in the software industry, where the "death" of distance is most evident, but it will also affect other service and manufacturing activities.

It is too early, of course, to forecast the net outcome of all these trends. The results are very likely to be industry- and context-specific. The forces driving international production systems are strong, but competition for export-oriented TNC activities is also rising. Achieving and sustaining export-competitiveness calls for higher local capabilities in all activities and all countries. If developing countries and economies in transition are to strengthen competitiveness (with or without direct TNC participation), they will have to strengthen their capabilities, attract and stimulate activities suited to their endowments, and upgrade them over time.

Notes

1 For a discussion of the broader question of TNCs and competitiveness, see *WIR95*.

2 "Export competitiveness" is taken here in the broad sense outlined above. Thus, it does not mean raising world market shares by keeping wages low, but sustaining world market shares while raising incomes.

3 For instance, the OECD has this to say: "Competitiveness [should] be understood as the ability of companies, industries, regions, nations and supranational regions to generate, while being and remaining exposed to international competition, relatively high factor income and factor employment levels on a sustainable basis" (OECD, 1994, p. 23). The Government of the United Kingdom's *Third White Paper* on competitiveness starts: "Improving competitiveness is central to raising the underlying rate of growth of the economy and enhancing living standards... The need to improve our competitiveness is not imposed by Government, but by changes in the world economy. Improving competitiveness is not about driving down living standards. It is about creating a high skills, high productivity and therefore high wage economy where enterprise can flourish and where we can find opportunities rather than threats in changes we cannot avoid" (United Kingdom, Cabinet Office, 1996, p. 10). For an analysis of the concept of competitiveness, see Lall, 2001.

4 There is a debate on whether exporting leads to greater enterprise productivity or *vice versa*. The relationship between the two is probably interactive (Westphal, 2002). The technology capability literature establishes that export-oriented economies enjoy healthier and more competitive capabilities than inward-looking ones, though even the former may need a period of infant-industry protection when building advanced capabilities in local enterprises (Lall, 2001b).