Contents

1
Transnational Corporations and Economic Development: An Introduction

Ludo Cuyvers and Filip De Beule

This volume, which is dedicated to Prof. Daniel Van Den Bulcke on the occasion of his retirement, contains chapters from scholars on subjects which can all be placed under the heading of international business, transnational corporations (TNCs), developing countries, and economic development. These are also the four pillars that have fascinated Danny Van Den Bulcke for most of his academic career. Although each of these subjects has been studied for many decades and has attracted much attention, there has been a changing perception and stance towards international business and transnational corporations, in particular, and their role in development over the years.

The presence and activities of transnational corporations in general and their role in development and in the developing world, in particular, have been the subject of much controversy. The first serious discussions about the effects of foreign direct investment (FDI) on host countries date back to the late 1950s, when neo-classical economists started to analyse the implications of capital movements in standard models of international trade. Treating foreign direct investment simply as a capital flow between countries, it was shown that foreign investment and trade could be substitutes for each other and that both were welfare-improving. The liberal attitude towards FDI during the immediate postwar period was consistent with this theoretical understanding.

The unreservedly positive picture of the impact of FDI on host-country welfare changed dramatically by the end of the 1960s. Academic literature began to emphasize the connection between market imperfections and foreign investment, with a focus on market structure issues. In line with Hymer (1960), foreign direct investment was often seen as a result of oligopolistic home-country markets, and it was feared that FDI would spread the market imperfections of those industrialized countries to the rest of the world. The earlier discussions about the potential gains from the inflow of foreign capital in terms of tax revenues, economies of scale and external economies gave way to analyses of transfer pricing, uneven development and dependency in general. The scepticism was often based on negative experiences in the late 1960s and early 1970s, with some blatant examples of incorrect behaviour by particular companies, for example inappropriate influence of political decisions, exploitative wages and poor social conditions. As such, until the beginning of the 1980s the general approach to transnational corporations and developing host countries reflected considerable suspicion and reservation.

By the 1980s, there was a general warming of attitudes to FDI not just in the development literature but also on the part of the national governments traditionally strongly hostile to TNCs. There are several explanations for this change of mind. In general terms, there has been a change in terms of government policy, international business theory and company behaviour. First, thanks to the progression in the theory of international production, there was a better understanding and appreciation of the nature and advantages of TNCs in host countries. The connection between market imperfections and the activities and effects of TNCs were better understood and appreciated. TNCs could benefit developing countries because market imperfections generally are more widespread in developing countries than in industrialized countries. In particular, markets for intermediate products such as technology, capital and supporting services are not functioning in many developing countries.

Second, the experience of developing countries – with some exceptionally successful countries drawing heavily on FDI and many regimes restrictive to TNCs doing fairly poorly – led to serious rethinking of their role. Specifically, the failure of import substitution in Latin America and Africa, and autarchic development policies in Mao's China; the apparent success of the more outward-oriented Asian tigers; and the debt crisis of the early 1980s, led to a change in attitudes of governments towards transnationals. The general change in focus was that foreign direct investment was perceived as being an important determinant of economic growth in developing countries.

Due to an increasing globalization of economic activity and the integration of international production and cross-border markets by TNCs, it is also becoming increasingly difficult – if not impossible – for a country to exempt itself from this process. Given this considerable and growing importance of international production to the world economy, the influence of TNCs on the economic future of a country can be huge. Besides, the key ingredients of contemporary economic growth such as created assets – for example technology, human capital, learning experience and organizational competence – are not only becoming more mobile across national boundaries, but are also increasingly housed in transnational organizations and systems.

More generally, there was a renewed faith of most countries in the workings of the market economy, as demonstrated, for example, by the wholesale privatization of state-owned enterprises and the deregulation and liberalization of markets. While these events are being most vividly played out in Central and Eastern Europe and in China, the need to remove structural market distortions has also been acknowledged in many other parts of the world.

Host developing countries also improved their capabilities to deal with TNCs. The more advanced ones showed the ability to absorb leading-edge technologies transferred by TNCs, and to even attract R&D facilities. TNCs themselves changed their patterns of behaviour, and many new sources of FDI emerged, reducing the threat of domination by a handful of giant enterprises. The debt crisis – and more recently the Asian financial crisis – also showed that FDI was more stable in difficult periods than other forms of capital inflows, such as bank loans and portfolio investments.

Also, the criteria for judging the success of FDI by host governments have changed over the years in a way which has made for a less confrontational and a more cooperative stance between host countries and foreign investors. More particularly, the emphasis in evaluating inbound TNCs over the past two decades has switched from the direct contributions of foreign affiliates to economic development, to their wider impact on the upgrading of the competitiveness of host-countries' indigenous capabilities and the promotion of their dynamic comparative advantages.

Third, the events outlined above have also affected the attitudes, organizational structures and behaviour of business corporations. Companies have found it increasingly necessary to capture new markets to finance the escalating costs of research and development and marketing activities, both of which are considered essential for preserving or advancing the competitiveness of firms. Firms have been no less pressured to reduce costs and improve the quality of raw materials and components. As a growing number of countries are building their own pools of skilled labour and technological capacity, foreign investors are finding it more and more desirable to diversify geographically their information gathering and learning capabilities.

Finally, in the increasingly more complex global environment, TNCs are being forced to pay more attention to achieving the right balance between the forces making for the global integration of their activities and those requiring them to be more oriented and sensitive to localized supply capabilities, consumer tastes and needs, and new concerns such as ecology and ethical behaviour. This systemic view of TNCs implies very different governance structures than those implemented by traditional foreign investors. Rather than acting as an owner of a number of fairly autonomous, or stand alone, foreign affiliates, each of which is expected to earn the maximum economic rent on the resources invested in it, the systemic TNC aims at managing its portfolio of spatially diffused human and physical assets as a holistic production, financial and marketing system.

In sum, global economic events, particularly those driven by technological advances, and the realignment of economic systems and policies, have fundamentally altered the perception of governments of host countries of how FDI can contribute towards their economic and social goals. These same events have also caused a reappraisal by firms of why and how and, indeed, where they need to engage in international transactions.

Since the late 1990s, scholarly interest in globalization and development has been growing exponentially. This volume picks up on this growing interest, particularly in topics, such as the role of innovation and R&D, clustering, divestment, terrorism and strategy. These topics have gone through an internationalization process themselves to the extent that most issues are no longer thought of on a country-by-country basis but increasingly on a global scale, although some regional patterns persist, which might be due to political, economic or historical reasons, such as regional integration in Europe, North America or Asia. Much recent work thereby disregards former research on the subject. A volume that covers not just the current state of the art, but also tackles its dynamic history, is therefore long overdue. It will also benefit the growing number of young researchers that have not lived this history. However, the volume does not just dwell in the past, but deals with up-to-date topics using the current body of research.

In the following chapter John Dunning reviews and criticizes the attitudes and deliberations of, and actions taken by, the United Nations and its various constituent agencies over the last forty years, with respect to the role of transnational corporations in economic development and international relations. During this period, the world has witnessed a number of exciting and far-reaching changes in the global, political and economic scene, and in the objectives and priorities of its constituent institutions and organizations. These, as Dunning argues, have markedly affected the significance of both TNC-related activity and of foreign direct investment – the main modality by which TNCs engage in such activity – and also of the perceptions by developing countries of the formers' contribution to their economic and social goals. The evolving relationship between TNCs and the rest of society – be it national or global – over the past four decades has emphasized two things above all. Firstly, it has strongly reflected the economic, social and technological context in which the interface has been fashioned. Such a context, which also includes the values of the main stakeholders in the wealth-creating process, is partly exogenous and partly endogenous to the players themselves. Secondly, one should also point to the role of incentive structures and enforcement mechanisms in influencing how changes in the external economic environment may affect the role of TNCs and their contribution on national economic goals, an aspect which has been underplayed by both scholars and practitioners, including the UN. Such institutions which range from formal rules and regulations to informal norms, conventions, moral suasion and social mores, embrace both top-down sanctions and incentives to bottom-up spontaneous ideas and actions on individual and corporate stakeholders. It is the network of private and public institutions – the institutional matrix of societies – which, along with the resources, capabilities and markets possessed or accessed by them, will determine both the objectives of their constituents, and the way they are advanced. Underpinning and influencing these institutions are values, which, in turn, reflect the belief systems of the individuals and organizations implementing them.

John Dunning points out that the way in which the multiple stakeholders in the national and global economy prepare or adapt their institutions and enforcement mechanisms to external technological and economic events will, in the end, determine how and in what way TNC activity can best serve the interests of the people in the world. He believes it is incumbent on the UN to give more attention to examining the institutions and belief systems underpinning and influencing the actions of TNCs or of governments. As the social and economic aspects of TNC-related activities are too intertwined to be considered independently, a holistic and integrated institutional approach is needed, and centralized modern governance has to be integrated with more decentralized modes.

In Chapter 3, Vitor Simões endeavours to show that international disinvestment analysis requires, on the one hand, the clarification and 'fine-tuning' of the concept of disinvestment and, on the other, the convergence of a set of explanatory factors, often intertwined. He is doing both. The suggested framework also has implications for host-country economic policy. With regard to explanatory factors, it is convincingly argued that four dimensions are relevant. While each dimension may be seen in isolation, their interrelationships should be analysed, which may take different patterns for each specific disinvestment case. The analytical tools of sectoral and territorial context are seen as of paramount importance to understand disinvestments.

Simões suggests a co-evolution between local economic conditions and subsidiaries' characteristics and competences, and he points out that the subsidiary is not an innocent player or a pawn that passively suffers the consequences of decisions taken at headquarters level; sectoral vicissitudes or host-country policy changes and consequently subsidiary strategy, competences, dynamics and initiative cannot be omitted when studying disinvestment processes. Under the condition that its negative social effects are well-managed and that it goes together with economic restructuring and upgrading in the host country, disinvestments may even have a positive side. It is, however, the key responsibility of the policy-makers in the host countries to prevent disinvestments and to promote the relevance of the foreign subsidiaries for the TNC network.

In the fourth chapter, Sylvain Plasschaert investigates company profit taxation in the European Union as a key incentive in the promotion of foreign direct investment. Although the 25 member states of the European Union are engaged in an evolving sequence of further economic integration, in the field of corporate taxation several national tax obstacles still impede the smooth operation of a level playing field. The European Treaties mandate no harmonization in the field of direct taxation. Plasschaert critically evaluates the rationales that are behind the proposals for comprehensive or 'holistic' formats of company taxation in the EU, and also comments on the issue of which types of TNCs should be eligible to holistic schemes.

The author argues that the adoption of a fiscal group concept, even if limited to the definition of the taxable base and not extending to the tax rate, would achieve a significant reduction in compliance costs not only for TNCs but also for the national tax administrations. Moreover, such adoption would bring company profit taxation in line with the ever-increasing pan-European ambitions of firms in EU-member countries.

Chapter 5 by Alain Verbeke and James R. Dewald is entitled 'Managerial Responses to Borderless Risk'. The authors point out that with globalization, many risks that TNCs and internationally operating businesses are confronted with have also become global. In an innovative way, they analyse the impact of the Al-Qaeda September 11 attacks on the United States, and the subsequent changes in public policy, from the perspective of the international business manager. From this angle, these events mark the shift from a world of geographically well-defined risk towards a world of borderless risk. A new framework is developed and presented which can be helpful to the international manager to consider future strategies for resource protection within a new world of borderless risk. Verbeke and Dewald developed their conceptual framework in close collaboration and thorough discussion with four well-known top managers of large TNCs, with headquarters in Canada. They conclude that managerial attention needs to be devoted to the development of new firm-specific assets in a variety of resource areas. Senior managers in TNCs should engage in formal assessments of the risks faced by each of the resource areas such as raw materials and intermediate products, finished products, fixed assets, information, human resources and external relations, in particular government and community-based relations, human-resources management and protection of finished products.

Chapter 6 by John Cantwell and Katherina Glac is concerned with locational clustering and its relevance for economic development. Their analysis starts with the observation that while overall the integration of activity between countries has become closer, there is an increasing concentration of some specialized knowledge-based functions within selected sub-national regions. These factors, taken together, have contributed to a revival of the interest in location as a major topic in the international business literature, because both TNCs and host regions have recognized the importance of location as a potential source of competitive advantage that helps to ensure development and growth. The authors offer an overview of the work in this area to date, outlining the interactions between location characteristics and TNC strategy and activity, as well as the underlying forces that shape these interactions, with specific emphasis on the developmental effects.

They point out that the globalization process not only brought a greater dispersion of certain kinds of economic activity, but also that 'sticky places within such slippery space' (Markusen, 1996) are emerging especially with respect to knowledge-intensive activities. These developments evidently make the location decision increasingly important, which has led in turn to a rising awareness by TNCs of locational advantages as a competitiveness enhancing and sustaining factor. Therefore, the understanding of the processes and phenomena involved in a variety of locational types has become fundamental. This is even more important if it is realized that the interplay between TNC activity and the development of a host economy is complex and does not always result in a virtuous cycle, thus preventing the use of one-size-fits-all recommendations and approaches. Cantwell and Glac argue that a careful analysis of the individual characteristics of a place, its history, its resource availabilities and capabilities is crucial if the host-country authorities and policy-makers want the locational benefits and dynamics to lead to economic development. However, even then there is no guarantee for success.

Chapter 7 by Daniëlle Cloodt and John Hagedoorn presents an analysis of major historical trends and sectoral patterns in international R&D partnering between independent companies from 1971 to 2000, through formal agreements (for example contractual agreements and joint ventures). The ongoing process of globalization has increased global competition and enlarged the complexity of technology, together with the risks and costs of innovation. This in turn has exercised a strong impact on the growth of these international inter-firm R&D partnerships, particularly in technology-intensive industries. The authors focus on differences between the developed economies, newly industrialized countries, less-developed countries, and in particular the East European former communist countries. The opening of the markets of the latter group has evidently expanded the scope for international partnerships to China, Eastern Europe and the former Soviet Union. Using the MERIT-CATI database, Cloodt and Hagedoorn study patterns in R&D partnerships in several industries, in different regions of the world over the above-mentioned period of time. They find that international R&D partnerships are dominated by companies from the developed economies, particularly from the USA. Companies from OECD countries participate in nearly 99 per cent of all the international R&D partnerships, and more than 90 per cent of these partnerships are within the OECD. They also find that some 85 per cent of the recently established international partnerships are of a contractual nature, so that today the former dominant position of joint ventures in inter-firm R&D agreements is almost completely lost.

Chapter 8 by Ludo Cuyvers and Michel Dumont looks into the determinants of the East Asian economic growth performance. Unlike the still much-debated issue of the role of liberalization versus government intervention, there is somewhat more unanimity in the profession as to the role of international technology transfer and spillovers. The obvious question is then, why the East and Southeast Asian economies, in contrast with so many other developing countries, benefited from these spillovers. The authors point to institutional factors and policy instruments that enhance the absorptive capacity of firms (for example investment in education and human capital).

In the empirical part of the chapter, Cuyvers and Dumont use a global vector error-correction model, which takes intra-regional dependence between the countries considered into account. Their results suggest that exports have led economic growth in Hong Kong, Indonesia, South Korea and Malaysia with only a significant positive feedback of growth on exports for Hong Kong. On the other hand, imports had a positive impact on growth in the Asian tiger countries Hong Kong and South Korea but a significant negative effect on growth in Indonesia and Malaysia. The authors are inclined to look at the latter finding as indicating the impact of 'export enclaves', that is foreign-owned plants producing more for exports than for the domestic market; because of lacking backward linkages, the production in these enclaves contributes little to domestic technological development and economic growth. Another important finding is that regional economic growth had a significant long-term effect on domestic growth, which lends support to the 'flying-geese' theory of economic development. This theory states that the industrialization process was transmitted from Japan to the backyard Asian tiger economies, and in a later stage to the 'next tier' newly industrializing countries (NICs) (which the authors call 'pussycat countries'). Although this transmission process is said to be triggered by FDI, the authors are unable to test this, due to lacking data.

In Chapter 9, Haiyan Zhang investigates how FDI contributed to the development of the electronics industry in China. The author analyses aggregated firm-level data to emphasize the agglomeration economies in the Chinese electronics industry on the one hand, and to assess the effects of FDI on the geographical agglomeration of Chinese electronics industries on the other hand. From the statistical and geographical mapping analysis, Zhang draws several conclusions. First of all, agglomeration has significantly contributed to labour productivity and industrial growth, especially in the regions of China where there is a strong concentration of FDI, thus confirming the finding of previous studies on the impact of industrial clusters on productivity. Yet, Zhang points out that the positive impact of industrial clusters on the productivity and regional growth of the electronics industry in China seems closely related to FDI, which has improved the productivity, either through the higher productivity of foreign plants, or through strategic original equipment manufacturing (OEM) in foreign joint ventures which improves productivity of its manufacturing operations in order to reduce costs.

Secondly, the agglomeration trends in China's electronics industry are positively related to the regional competitiveness in the international market, which is measured by the export ratio of its industry. The results show that the regions with stronger agglomeration tend to have higher export ratios, meaning that China's electronics manufacturing clusters are highly integrated into global production networks, especially in the coastal regions where foreign subsidiaries and domestic subcontracting firms are clustered in export processing zones for low-cost outsourcing manufacturing.

Thirdly, the findings of Zhang's research show that both the agglomeration and FDI are negatively related to local competition. This is clearly in contrast with the findings of the existing literature, which assumed that agglomeration as well as FDI tends to favour local competition and that the high competitive pressure in a cluster and the associated push to innovate provide the dynamic advantage of the cluster.

Finally, it is shown that the concentration of FDI and the geographical agglomeration are positively related to the innovation capability of the industry. Internationally integrated networks within the firm may lead to an improvement of innovation capacity both of the TNC and of the host location. Inter-firm networks, established between TNC subsidiaries and local firms may, in addition, amplify the advantages of geographical agglomeration in some particular lines of technological development, reinforcing the existing sectoral pattern of technological specialization of local systems. Therefore the innovative activity tends to cluster due to knowledge spillovers.

Chapter 10 by Philippe De Lombaerde and Erika Pedraza Guevara is devoted to FDI productivity spillovers in the Andean region. The authors start from the observation from the empirical literature that observed spillover effects of foreign direct investment on the activity and efficiency of domestic firms experienced a major qualitative step forward thanks to the availability and recent incorporation of firm-level data, were often not as expected. The authors present new results on productivity spillovers using Colombian manufacturing firm-level panel data for the 1995–2000 period. They test (1) whether foreign ownership is associated with an increase in productivity at the plant level, and (2) whether foreign ownership in an industrial sector affects the productivity of domestically owned firms in the same industry. Their results show no or very weak (and not significant) spillover effects. If positive effects on the productivity of domestic firms are found at all, they are apparently completely absorbed by the most productive domestic firms.

As privatizations have widened the scope of TNCs regarding geographical range and target sectors, such as energy, communications, transport and basic industries, by bringing about closer international integration of highly regulated industries and, particularly, by directing FDI towards less-developed countries, Juan Duran sets himself the task in Chapter 11 of addressing the potential of privatizations for the internationalization of companies. He examines the impact of privatizations on FDI. Duran outlines new scenarios that emerged over the last two decades, and describes the relationship between privatizations and corporate internationalization. Against this background, large Spanish public operators in telecommunications, electricity, fuel, gas, air transport and banking were privatized from the late 1980s and became TNCs themselves by acquiring other privatized businesses in host countries, especially in Latin America. The impact that the privatizations have had on the level of economic development according to the investment development path are also discussed.

Finally, in Chapter 12, Peter Buckley and Filip De Beule examine the past, present and future direction of research in international business and suggest ways forward. These include the various aspects of globalization, geography and location, international mergers and acquisitions, restructuring and new international institutions. This research agenda clearly appears to be fully in line with much of the research that Daniel Van Den Bulcke has contributed to during his academic career, both as an individual and as a team member.

Index