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Transnational Corporations and Development Policy

Critical Perspectives

Edited by

Eric Rugraff, Diego Sánchez-Ancochea and Andy Sumner

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Andy Sumner

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Notes on Contributors

Andrew Crabtree is an external Lecturer at the Copenhagen Business School where he holds a course on poverty and the private sector. He has a broad range of interests and coming publications include work on the capabilities approach, sustainable development and mental health. He is also the Guest Editor for a special issue of the World Review of Science, Technology and Sustainable Development entitled Mental Health and Development. He lived and worked in China during the mid 1980s.

Niels Fold is Professor at the Department of Geography and Geology, University of Copenhagen. His research focuses primarily on governance and upgrading of global agro-industrial value chains based on tropical products, but he has a broad interest in trade and industrial restructuring in developing countries. Recent publications include Transnational Sourcing Practices in Ghana's Perennial Crop Sectors. *Journal of Agrarian Change*. January 2008 and *Cross-continental Food Chains* (co-edited with Bill Pritchard), Routledge 2005.

Stine Jessen Haakonsson is a PhD Fellow at the Department of Geography and Geology, University of Copenhagen, and the Danish Institute for International Studies (research group on Trade and Development). Her research is focused on the restructuring of the global pharmaceutical value chain in the new WTO trading system. Her main research area is the influence of the WTO TRIPs Agreement on the pharmaceutical industries in Uganda and India. Recent publications are: TRIPs and Public Health: The Doha Declaration and Africa. *Development Policy Review*, January 2007 and The Changing Governance Structures of the Global Pharmaceutical Value Chain, 2007, mimeo.

Soeren Jeppesen is Associate Professor at the Centre for Business and Development Studies at Department of Intercultural Communication and Management at Copenhagen Business School in Denmark. His research focuses on the characteristics of small and medium firms in developing countries, on technological upgrading, and on the role of corporate social responsibility in Africa. Recent publications include Danish-South African Business Linkages: Means to Upgrade Local Firms? In Hansen, M. W. & Schaumburg-Müller H. Eds. *Transnational Corporations and Local Firms in Developing Countries – Linkages and Upgrading*, Copenhagen Business School Press 2006 and Enhancing Competitiveness and Securing Equitable Development: Can Small, Micro and Medium-Sized Enterprises (SMEs) Do the Trick? *Development in Practice*. May–June 2005.

Marianne Nylandsted Larsen is Assistant Professor in Development Geography at the Department of Geography and Geology, University of Copenhagen, Denmark. Her research is concentrated on market liberalisation and agricultural restructuring in developing countries and on agro-food standards and international trade in agro-food products. Recent publications include Market Coordination and Social Differentiation: A Comparison of Cotton Producing Households in Tanzania and Zimbabwe, *Journal of Agrarian Change*, January 2006 and Competition and Coordination in Liberalized African Cotton Market Systems, *World Development*, March 2004.

Claire Mainguy is Professor (maître de conférences) in Economics at the Robert Schuman University, Strasbourg, France. She is a co-editor of the *European Journal of Development Research* and focuses her scientific interests on Foreign Direct Investment, regional integration, and African export competitiveness. Among her recent publications on FDI are La mondialisation par les investissements étrangers au Mali, *Cahier du Gemdev* n°31, 2007; Les investissements directs étrangers dans les pays en développement, Special issue, *Région et Développement*, November 2004.

Jørgen Dige Pedersen is Lecturer in International Politics at the Department of Political Science, University of Aarhus. His research has been concentrated on development and international political economy issues with a specific focus on India. Publications (in English) include Explaining Economic Liberalization in India: State and Society Perspectives. *World Development*. February 2000; India's Industrial Dilemmas in West Bengal. *Asian Survey*. July/August 2001 and *Globalization, the State and Development* (Palgrave Mcmillan, 2008).

Eric Rugraff is Lecturer in Economics at the University of Strasbourg and researcher at the Bureau d'Economie Théorique et Appliquée (BETA). His research concentrates on Transition Economics and the strategy of multinational companies. He is co-convener of the European Association of Development Research and Training Institutes-Working Group 'Transnational Corporations and Development'. Recent publications include Export-Oriented Multinationals and the Quality of International Specialization in the Central European Countries. *European Journal of Development Research*. December 2006 and Multinational Firms and Industrial Relations in Central Europe: an Institutionalist Approach. *Industrial Relations/Relations Industrielles*. 2006.

Diego Sánchez-Ancochea is University Lecturer in the Political Economy of Latin America at the University of Oxford, and Governing Body Fellow of St. Antony's College. His research concentrates on state-society interactions, income inequality and public policy in small Latin American countries. He is the co-editor of *Responding to Globalization: The Political Economy of Hemispheric Integration in the Americas*, Palgrave Macmillan, 2008 (with Kenneth Shadlen) and has also published articles in different international journals.

Andy Sumner is a Fellow of the Knowledge, Technology and Society Research Team at the Institute of Development Studies in Brighton. He is a cross-disciplinary economist. His primary foci of interest are poverty reduction strategies, the politics of policy making and research impact and accountability. He has conducted work for DFID, the Global Development Network, IFAD, UNDP, UNICEF, UNESCO, UNHABITAT, UNDESA, UNU and Save the Children. His work to date has focused on East/Southern Africa and South/East Asia.

Meera Tiwari is Senior Lecturer in Development Studies at the School of Social Science, Media and Cultural Studies, University of East London. Her research focuses on the understanding of multidimensional poverty within the capability approach lens, the impact of economic globalisation on poverty and the evaluation of the Millennium Development Goals. She is also studying how emerging technologies can be used for reducing multidimensional poverty. Recent publications include An Overview of Growth in the ICT Sector in India: Can This Growth Be Pro-Poor? *The World Review of Science, Technology and Sustainable Development*. 2006 and Chronic Poverty and Entitlement Theory. *Third World Quarterly,* 2007.

Ingeborg Vind is a PhD Fellow in Economic and Development Geography at the Department of Geography and Geology, University of Copenhagen. Her research concentrates on global production networks, TNCs and regional development in Southeast Asia. She has recently published Multi-Level Modularity Vs. Hierarchy: Global Production Networks in Singapore's Electronics Industry. *Danish Journal of Geography*. June 2007.

Paul Yankson is Professor at the Department of Geography and Resource Development at the University of Ghana, Accra, Ghana. His research concentrates on urban and regional development issues, including: small and medium scale enterprise development, mining, decentralised governance and poverty reduction. His recent publication is Decentralised Governance, Access to Social Services and Poverty Reduction in the Gomoa District, Ghana. *International Development Planning Review* (IDPR). 29 (3).

Introduction

Andy Sumner, Eric Rugraff and
Diego Sánchez-Ancochea

0.1 Challenging orthodoxies

This book is for students and researchers of Global Political Economy, Globalisation and Development Studies. It is pitched at a level whereby postgraduates and academic staff will get something out of the book as will final year BA students.

Does this book matter? We think so. Books on Transnational Corporations (TNCs) and specifically TNCs and development have been less common in recent years perhaps reflecting a perceived consensus in TNC research. Indeed, the role of transnational companies has become taken for granted in development over the last 10–20 years. Searching for critical research on TNCs is not an easy task. Few question the underlying assumptions that foreign investment per se is good for development. However, over the last few years some policy makers have begun to challenge these orthodoxies (notably in Latin America but elsewhere too). In this book we aim to contribute further questioning of the orthodoxy.

We argue that Foreign Direct Investment (FDI) has different impacts in different contexts and the a policy regime and different types of FDI can produce quite different consequences for 'development'. In this book we set out what we know and expand into new areas of comparative analysis from a range of different perspectives including global, national and sectoral level.

We also address the continuing emergence of Southern TNCs (by which we mean TNCs originating in developing countries although 'Southern' is not a precise term, rather it is a metaphorical term for what was the 'Third World' or Less Developed Countries). In the 1980s just a small group of developing countries had significant outward FDI, namely, Argentina, Brazil, Hong Kong, India, Korea, Singapore, and Taiwan. In contrast, one might now add Chile, China, Egypt, Malaysia, Mexico, Russia, South Africa, Thailand and Turkey as significant sources of outward FDI.

0.2 A new global political economy

FDI to and from Less Developed Countries (LDCs) is booming. In 2005 inward FDI to LDCs grew to US$335 billion accounting for over one-third of global FDI inflows.

China was the number one destination, but even Africa, assumed to have few inflows in general, received FDI inflows of US$31 billion in 2005. Further, outward FDI from LDCs – that is Southern TNCs – grew to US$117 billion in 2005 and accounted for 15 per cent of global outward FDI and over a third of FDI to developing countries. Again, although China via Chinese TNCs accounted for a significant proportion (US$11 billion), West Africa actually accounted for more (US$16 billion) (UNCTAD, 2006: 4–6). The global economy continues to be shaped and reshaped by TNCs and much more so than before, TNCs from the South.

This book was triggered by these and other changes in contemporary context around FDI and FDI policy. Three are worth highlighting at this stage. First, a continuing rise in the significance of FDI – economically and thus politically. There has been a dramatic growth in FDI to developing and transition countries, unevenly distributed in dollar terms but significant in many countries as a percentage of total investment flows/capital stock. At the same time there has been a major push to institutionalising the rights of TNCs in international, regional and national, legally-binding, instruments.

Second, a shift in the modalities of FDI. There has been a shift in the characteristics of FDI to developing and transition countries. There has been a geographically uneven shift in the form and type of FDI toward services, towards mergers and acquisitions and towards South-South FDI in particular. There are also newer forms of FDI such as out-sourcing that require attention.

Third, a change in the types of government policy towards FDI. From the 1980s to the end of the century there was a widespread, fairly geographically even, radical shift towards FDI-friendly government policies. These were based on maximising the quantity of FDI through financial incentives and subsidies as major policy tools. This however, as noted above, has being tentatively questioned in recent years. Thus concern needs not only to be with the inflows of FDI but with policies which are likely to mediate impacts.

0.3 What do we know?

The *precise* nature of the relationship between FDI and 'development' in developing and transition countries is somewhat unclear both conceptually and empirically. This is not least because of data and definitional problems. FDI is the main proxy for TNC activity and is typically defined as an increase in the equity position of a non-resident owner holding more than 10 per cent of shares or voting power in a firm (i.e., with a lasting interest and control). The definition does not incorporate out-sourcing and various sub-contracting arrangements. Further, data collection inconsistencies across countries is a major issue which UNCTAD's annual World Investment Report seeks to deal with increasingly. Although UNCTAD has guidelines on FDI accounting, data for FDI are of questionable consistency for international and temporal comparison. For example, data may include double counting, and/or omissions of reinvested earnings, or intra-company loans, overseas commercial borrowings (trade credits, financial leasing), and portfolio holdings over 10 per cent held by institutional investors may not be fully included. In light of these problems, how can we best know what is happening? In this book we seek multiple perspectives in order to triangulate but are very aware of the over-reliance on FDI data. Readers should thus read our book critically too. Research is only as strong as its raw data. This needs to be reiterated more often with TNC research.

Much of what we think we know is based on cross-country research. Such research has been contentious and ambiguous likely reflecting the heterogeneity of FDI and country contexts. In general, the economic benefits of TNCs seem to be highly conditional on policy regimes. For example, in general FDI is good for aggregate economic growth. *However,* this is likely to depend on other factors that may be missing in many countries such as certain levels of human capital or financial market development. The evidence on FDI and per capita incomes, poverty and inequality is far more contradictory and difficult to conclude upon.

FDI crowds-in local firms and provides positive spillovers. *However,* this seems to be the case in regions and time periods of non-liberal FDI policy regimes. Furthermore, capital flight in the form of profit repatriation is recorded in regions of the world with more liberal FDI policy regimes. In Sub Saharan Africa up to 90 per cent of FDI inflows are lost in profit repatriation. FDI overall has a positive impact on the current account. *However,* these benefits are concentrated in a handful of countries and may depend on non-liberal policy. FDI may have detrimental impacts on government revenue due to fiscal incentives, subsidies (and *not* even including transfer pricing) totalling up to US$1.5 billion per company per country in some case studies. Finally, in certain countries employment in FDI is very high. *However,* globally FDI creates relatively few jobs. In summary, there is a significant diversity and ambiguity in 'development' impacts, and what policies/approaches governments should take to TNCs is unclear.

Despite this lack of clear-cut evidence upon which to base policy, few countries are not actively seeking FDI and this is not donor-led but seems to be 'received wisdom' within the development discourse: 'it is due to [local] policy makers beliefs that attracting more FDI is in the best interest of their countries' (Korbin, 2005: 67).

0.4 This book and our approach

Research to date has been somewhat inconclusive partly due to the data problems noted above but mainly because there has been such a wide variation in country experience. The above noted cross-country studies take limited account of different kinds of FDI and different kinds of countries and policy regimes. In the above Vietnam (FDI policy interventionists) is treated the same as Mexico (FDI liberalists). There are also differences in the scale of operations, the relationship with parent company, country of origin and so on; the mode of entry (greenfield, joint venture or merger and acquisition), the forms of financing (equity, reinvested earnings or intra-company loans), the functions of FDI (raw material seeking, market access seeking, efficiency seeking or export platform seeking) as well as the attributes of the host economy (level of economic development, human capital, infrastructure, resource endowments and social, political and cultural characteristics) are not sufficiently considered. Moreover, the policy regime and the bargaining power of the country play a role too (consider for example, incentives/subsidies, performance requirements, laws, regulations and their degree of enforcement – for example health and safety at work and trade union laws and environmental health legislation, and so on). In summary, we would argue that the inconclusive nature of our current understanding is due to the level of heterogeneity of FDI and host countries.

With the above in mind we have sought to emphasise a plurality of means to analyse TNCs and their impacts. These include perspectives which are global, national, sub-national, sectoral and sub-sectoral as well as by 'new players' – in particular Chinese, Indian and South African TNCs.

Furthermore, one of the main contributions of this book is its regional breadth. It incorporates studies from different regions of the developing and the transition world in Africa, Asia, Latin America and Central Europe; recognizing the new types of foreign investment and new debates on public policy. The different chapters also incorporate key variables to understand the impact of FDI. The book is thus structured as follows. There are five parts which, in turn, provide an historical and global overview, policy perspectives, new 'players', macro perspectives and sectoral case studies. In Part I a historical review of the evolution of TNCs and development is given. This is followed by a discussion of what we think we know on the development impacts of TNC. In Part II we discuss the shifts in government policy trends with regard to TNCs – both internationally and with particular reference to the case study of Central America. Part III consists of two chapters on the emerging role of 'new players'. Here the TNCs of India and China are the focus. In Part IV we take a macro-perspective and discuss TNCs in Central and Eastern Europe's transition countries, in Africa (Mali and South Africa) and in Asia (India). Finally, we present three chapters in Part V based on sectoral analysis. These cover

TNCs in the electronic sector in Vietnam, the gold mining sector in Ghana and the pharmaceutical sector in India.

To summarise, we seek to critically address a range of questions. Notably, how have TNCs changed in the last 50 years? What do we know about developmental impacts? Have we reached a FDI policy tipping point? Are North-South trade agreements good for FDI-led development? Is South-South FDI good for development? How can we explain the behaviour of TNCs in Central Europe? Is the impact of FDI similar in all developing countries? Does FDI reduce poverty? What is the developmental impact of FDI in different sectors such as electronics, mining and pharmaceuticals?

We hope we provide some insight into these questions, the heterogeneous nature of TNCs and development and how policy makers might seek to understand and better manage TNCs rather than be managed by TNCs.

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Part I

TNCs and Development: an Overview

1

How Have TNCs Changed in the Last 50 Years?

Eric Rugraff, Diego Sánchez-Ancochea and Andy Sumner

1.1 Introduction

Transnational Corporations (TNCs) have been a driving force behind the dramatic transformations the global economy has experienced in the last three decades. They have contributed to the expansion of trade and investment flows and have also promoted the creation of new economic linkages between developed and developing/transition countries. Their role is essential to understand many recent trends like the evolution of outsourcing, the increase in South-South economic relations and China's growth, and to evaluate future prospects for economic development.

This chapter analyses the major changes in the strategies of TNCs and their implications for the geography of Foreign Direct Investment (FDI), leaving an evaluation of the impact of FDI on development for Chapter 2. The chapter pays particular attention to the growth of offshoring arrangements and to the increasing share of FDI in the service sector.

Much of the discussion in the chapter highlights the growing importance of Asia in general, and China in particular, in today's global economy – a theme that is picked up by some of the case studies in the rest of the volume. China has become the primary destination of efficiency seeking foreign investment and has also succeeded in creating its own domestic suppliers. China and, to a lesser extent, other Asian countries such as Vietnam are formidable competitors in the global economy, and the rest of the developing and transition world is struggling to keep up with them. China and some of its neighbours have also created indigenous TNCs and are steadily increasing foreign outflows to various parts of the world – a strategy mimicked by other developing/emerging economies like Russia, Mexico and Brazil.

The chapter is divided in four sections. Section 1.2 describes the changing strategy of TNCs in the global economy and its implications for the sectoral and, especially, regional distribution of foreign investment. We devote particular attention to the increase in offshoring, but also acknowledge the importance of more traditional investment strategies (market-seeking and natural-resource seeking). Section 1.3 describes the growth in South-South investment and identifies the main players leading this trend. The chapter finishes with some conclusions.

1.2 Globalisation and the new strategies of TNCs

TNCs have grown steadily in size and numbers in the last few decades. Their number rose from 7,000 in 1970 to 37,000 in the early 1990s and more than 77,000 with more than 770,000 foreign affiliates by 2005 (Malhotra, 1997; UNCTAD, 2006: 10). Yet their importance goes beyond this data or any data on FDI. By outsourcing various phases of their production process to third parties, TNCs have promoted the creation of thousands of medium and large suppliers in developed, developing and transition countries. They are thus contributing to the expansion of global trade (what some have called 'trade in tasks') and to the creation of potential opportunities (and risks) for developing/transition countries in the global economy. This section focuses on the main changes that TNCs have experienced since the beginning of the 1980s with particular emphasis on their impact on developing countries.

1.2.1 From old to new transnationalisation

While transnational corporations were relatively important since the nineteenth century, their expansion accelerated after the Second World War. It is at that time that large manufacturing corporations, particularly from the United States, began expanding into various European markets. In 1975, for example, the United States was responsible for 44 per cent of all foreign direct outflows, while Western Europe received 41 per cent of global inflows (Dicken, 1998: 57). According to Weaver (2000: 111), 'by establishing production (or at least assembly) operations within the EEC [Economic European Community] or a Latin American nation, US producers could expand sales without disrupting market arrangements within the United States, neutralize other competition, and exercise significant market power in local markets.' European countries were growing rapidly and closeness to their consumers was important to compete successfully with new domestic firms. While FDI was initially concentrated in developed countries, TNCs soon moved to some developing countries as well. These corporations set up wholly owned subsidiaries that produced mainly for the domestic market (Evans, 1998). In their strategy, they received the support of many governments, especially in Latin America, that tried to promote industrialisation through highly interventionist and protectionist economic policies.

Starting in the mid 1970s and accelerating during the 1980s, the volume and characteristics of FDI experienced dramatic changes. The model of stand-alone subsidiaries was slowly replaced by complex global production networks involving suppliers from all over the world. The aim of TNCs was no longer to secure markets alone, but also to reduce costs by moving labour-intensive production stages to other countries. At the same time, foreign investment accelerated in sectors that had previously been reserved for domestic firms, including telecommunications, banking and other services.

A combination of factors was behind the changing behaviour of TNCs in the new global era:

- The successful economic model of the post-Second World War, which delivered high profits and real wages simultaneously, broke down at the beginning of the 1970s (Glyn, 2006; Piore and Sabel, 1984). Growing labour strength together with a gradual deceleration of productivity reduced corporate profitability in most countries within the Organization for Economic Cooperation and Development (OECD). In their search for higher profits, firms implemented new strategies to cut labour costs and weaken trade unions.
- Competition from Japan and other East Asian countries grew in different sectors of the economy. Initial competition in electronics and apparel soon extended to other economic activities, including the motor vehicles sector.
- New methods of production that made mass production obsolete and facilitated the creation of outsourcing arrangements were developed. Through the so called 'flexible volume production' or 'lean production', for example, large Japanese firms like Toyota outsourced the production of many components to independent suppliers (Zysman, 2004). In Europe – mainly in Northern Italy and Germany – small and medium firms with craft methods of production became successful competitors in luxury goods and other niche markets. Their system of 'flexible specialisation' allowed them to supply high quality goods with individual qualities since the late 1970s.
- Massive reductions in transaction costs (costs of transportation and communication) have accumulated since the mid-1960s. The combination of computers and the internet has caused a dramatic explosion of ways to communicate and has reduced communication costs dramatically. A 40-page document, for example, can be sent from Madagascar to Cote d'Ivoire by courier (taking five days) for $75, by fax (30 minutes) for $45 and by email (two minutes) for less than 20 cents. Maritime costs are currently one-third of their level in 1920 and air transport costs fell by more than 50 per cent in the period 1950–98 (Milberg, 1998). The cost of a three-minute telephone call from New York to London decreased from $245 in 1930 and $50 in 1960 to only 35 cents in 1999 (UNDP, 1999: 28).

The internationalisation of production has dramatically increased the importance of TNCs, as reflected by foreign investment flows. Table 1.1 offers

Table 1.1 Global foreign direct investment. Annual averages for each period, 1970–05

	1970–75	**1980–85**	**1990–95**	**2000–05**
FDI inflows*	19.5	58.6	224.3	840.7
% GDP	0.4	0.5	0.9	2.4
% GFKF	1.9	2.2	4.0	11.3
FDI outflows*	20.6	47.3	248.4	783.5
FDI inward stock*	—	672.7	2190.5	7787.6
FDI outward stock*	—	633.0	2282.9	8535.0

Note: * Billions of nominal US dollars.

Source: Own calculations with data from UNCTAD electronic database of FDI.

some statistics on the evolution of FDI in absolute terms and in relation to production and investment. FDI inflows have steadily increased from an annual average of US$19.5 billion in 1970–75 to more than US$840 billion in 2000–05. Their growth has outpaced that of production and investment, so that FDI is now more important for global economic performance than ever before. The contribution of FDI to total capital accumulation, for example, increased from less than two per cent at the beginning of the 1970s to more than 11 per cent of global investment in the most recent period.[1] TNCs are also responsible for the expansion of foreign trade and much of the innovation that takes place in the world. According to data from UNCTAD, intra-firm trade represents around one third of total trade, while trade between TNCs and third parties accounts for an additional one third (Kosacoff et al., 2007).

The new organisation of the global economy has also triggered modifications in the geography of foreign investment. Developed countries are still the main receivers of inflows with 70 per cent of total foreign direct inflows in 2000–05 (Table 1.2). Yet developing countries have increased their participation in the last few decades: between 1970–75 and 2000–05, their share in total inflows increased from 24 per cent to 30 per cent. In terms of the stock of FDI, the changes were less dramatic during the 1980s but have accelerated in more recent times. Between 1990–95 and 2000–05, the share of emerging economies in the total stock of FDI grew from less than 23 per cent to nearly 28 per cent.

FDI in developing countries is increasingly concentrated in East Asia. The growth of foreign inflows in this region was particularly fast during the 1970s and 1980s, when Japanese TNCs accelerated their involvement in neighbouring economies. Between 1970–75 and 1990–95, the share of Asia in global investment inflows increased from 7.1 per cent to 21.1 per cent. In the period 2000–05, the stock of FDI in Asia was 60 per cent of that in

Table 1.2 Various regions. FDI inflows (stock and flows), percentage of world total, 1970–05

	1970–75	1980–85		1990–95		2000–05	
	Flows	**Stock**	**Flows**	**Stock**	**Flows**	**Stock**	**Flows**
Developed economies	75.9	73.7	69.3	77.2	67.4	72.1	69.9
Developing economies	24.1	26.3	30.7	22.6	31.7	25.8	27.4
Africa	5.6	5.9	2.9	3.2	2.0	2.5	2.2
America	11.0	7.3	10.8	6.4	8.3	8.1	8.9
Asia	7.1	13.0	16.8	12.9	21.1	15.2	16.3
Economies in transition	0.0	0.0	0.0	0.1	0.9	2.0	2.7

Source: Own calculations with data from UNCTAD electronic database of FDI.

all developing countries. FDI in transition economies has concentrated in the Central European countries which joined the European Union in 2004. German firms have played a leading role in the integration of these countries in the European division of labour since the beginning of the 1990s. With a ratio of FDI stock/GDP in 2005 around 50 per cent (UNCTAD, 2006: 307), Hungary (55.9 per cent) and the Czech Republic (48.1 per cent) even belong to the TNCs' world preferred countries. By contrast, Africa has remained relatively marginalized in the globalisation of investment and its share in the global stock of FDI has steadily decreased from six per cent in 1980–85 to just 2.5 per cent in the most recent period.

The concentration of FDI within developing countries is even clearer in Table 1.3, which presents FDI inflows in the ten largest receptors for 1990 and 2005. Their share in the total stock of FDI in developing countries increased by ten percentage points, from 60 per cent in 1990 to almost 70 per cent in 2005. China and Hong Kong were responsible for increasing concentration as their combined share grew from 18.4 per cent to 32.1 per cent. The rest of the list was dominated by Asian and Latin American countries, with just one African country in 2005.

The global economy has thus moved to a new stage characterised by the transnationalisation of capital, the creation of global value chains and the growing participation of some developing and transition countries in global flows of trade and investment. In order to understand the magnitude and characteristics of these changes better, it is useful to pay special attention to the fragmentation of production triggered by outsourcing. We should also review more traditional strategies of TNCs in their search for new markets in the service sector and new supplies in natural resources.

Table 1.3 Selected developing countries. Stock of FDI, billions of US$ and percentage of total in developing countries, 1990 and 2005

1990			2005		
Country	**Stock**	**%**	**Country**	**Stock**	**%**
Hong Kong	45.1	12.6	Hong Kong	533.0	20.1
Brazil	37.2	10.4	China	317.9	12.0
Singapore	30.5	8.5	Mexico	209.6	7.9
Mexico	22.4	6.3	Brazil	201.2	7.6
China	20.7	5.8	Singapore	186.9	7.0
Egypt	11.0	3.1	Chile	73.6	2.8
Malaysia	10.3	2.9	South Africa	69.4	2.6
Chile	10.1	2.8	British Virgin Islands	67.4	2.5
Taiwan	9.7	2.7	Republic of Korea	63.2	2.4
South Africa	9.2	2.6	Thailand	56.5	2.1
Argentina	8.8	2.5	Argentina	55.2	2.1
Total ten countries	215.0	60.3	Total ten countries	1833.8	69.1

Source: Own calculations with data from UNCTAD electronic database of FDI.

1.2.2 The fragmentation of global manufacturing

As impressive as the numbers on FDI are, they underestimate the increasing importance of TNCs. As a result of the organisation of production in a global scale discussed above, different outsourcing arrangements between TNCs and independent suppliers have been developed. In principle, one could consider that relations between large companies and suppliers are arm's length operations that have more to do with foreign trade than with transnational production. Yet there is abundant evidence that this would be an inadequate assumption, as relations between leading firms and suppliers are similar to relations between subsidiaries and parent companies within the same firm. According to Milberg (2004: 16),

> the relation among firms in networks or quasi-hierarchies is closer to that of a single firm and its majority-owned affiliate. Information may be shared between lead and supplier firms that traditionally would be kept within the firm. Technical and communications support might be provided by the lead firm in order to smooth the delivery of supplies.

A useful way to understand the recent changes in the global economy – and one that informs some of the chapters in this book – is provided by the Global Value Chains (GVC) approach. Based on case studies of various industries, the literature on GVC tries to explain how companies in different sectors have reorganised their operations and how they coordinate different stages around the world (Gereffi, 2005). A global commodity chain or global value chain consists of '"nodes" or operations that comprise pivotal points in the production process: supply of raw materials, production, export, and marketing. Such export networks are increasingly important (...) resulting in a new logic of transnational integration based on geographical specialization and tightly linked international sourcing' (Appelbaum and Gereffi, 1994: 43).[2]

While measuring outsourcing (from both subsidiaries and third parties) is complicated due to the lack of adequate data, many studies have elaborated useful approximations in the last few years. Much of this literature relies on two different measures of outsourcing developed by Feenstra and Hanson (1996). The 'broad measure of outsourcing' divides all imported intermediate inputs by the total expenditure in non-energy intermediates in each industry. The 'narrow measure of outsourcing' is restricted to those inputs that are purchased from the same two-digit SIC (standard industrial classification) industry as the good being produced. According to both authors, this second one is a better measurement of outsourcing because it does not include the purchase of basic inputs for the production of a final good (e.g., the purchasing of leather to produce shoes, for example, should not be considered outsourcing). Based on both of these indicators, Feenstra and Hanson (1999) show that the ratio of imported inputs to total expenditure in non-energy intermediates increased from 6.5 per cent in 1972 to 11.6 per cent in 1990. The narrow measure of outsourcing also reflects a similar trend (cited in Milberg, 2004: 10).[3]

The use of other indicators confirms a similar upward trend in outsourcing. Feenstra (1998), for example, finds that the ratio of merchandise trade to merchandise value added increased by at least 15 percentage points in the richest countries (with the exception of Japan and Norway) between 1970 and 1990 and concludes that a TNC-led disintegration of production is taking place. According to Yeats (2001), machinery and transport equipment components comprised 30 per cent of total exchanges in machinery and equipment in 1995 – a significant increase over 1978.

Case studies of different industries offer an even more convincing picture of the importance and complexity of outsourcing. Friedman (2005)'s discussion of the production of a *Dell PC* is a good illustration. According to his account, a *Dell PC* has inputs from more than six countries, including China, Malaysia, Korea and Singapore. Purchase of an *Inspiron* notebook also involves call centres from India and design centres in the United States and Taiwan. Data from the World Trade Organization (WTO) cited in Navaretti and Venables (2004) shows that producing a prototypical American car involves goods and services from Korea, Japan, Germany, Taiwan, Singapore, the United Kingdom, Ireland, Barbados and the United States.

Many global value chains are actually more regional than global. In sectors like apparel, electronics and motor vehicles, we have witnessed the emergence of three different regional poles: one around the European Union, including its new members and some Northern African countries like Morocco, one around the North American Free Trade Agreement (NAFTA) together with the Caribbean Basin and one around Japan, China and other emerging Asian economies. Lall et al. (2004: 429–432) offer evidence of this trend in their analysis of the electronics and automotive industry in East Asia and Latin America. In East Asia, 71 per cent of electronics imports and 50 per cent of the exports in 2000 came from other East Asian countries. In Mexico – the main Latin American exporter of electronics – 73 per cent of electronics imports come from the United States and 90 per cent of its exports went to the same country.[4] Central Europe has emerged as an export platform for German motor vehicle producers and especially for *Volkswagen* (Nunnenkamp, 2004) and has become a regional production location in electronics (Radosevic, 2005). Hungary has positioned itself as a major low-cost supply base in the region: in 2003, electronics represented a share of 30 per cent of the Hungarian manufacturing exports (OECD, 2005). The exports of motor vehicles and vehicle parts – mainly to other European countries – were evaluated at 15 per cent in Poland, 16.8 per cent in the Czech Republic, 18.3 per cent in Hungary and 28.6 per cent in Slovakia in comparison to an average of 15.3 per cent in the OECD countries (OECD, 2005).

According to Dicken (1998: 386), ‘the tendency of most of the leading automobile producers is towards the creation of distinctive production and marketing networks within each of the three regions of the global triad.’ In fact, 75 per cent of motor vehicle trade in Europe and 76.4 per cent of that in North America was internal. In Asia, the percentage was significantly lower, but internal trade of inputs and transfer of technology were also large.

The regionalization of the value chains, however, has been increasingly disrupted by the emergence of China as the ‘world’s factory’. Between 1990 and 2005, Chinese exports grew at an annual average of 17.1 per cent (in constant dollars of 2000), while imports also increased rapidly.[5] Between 1990 and 2002, the share of China’s exports in the world’s total grew from 5.0 per cent to 14.9 per cent in low technology (from 8.0 per cent to 20.0 per cent in the fashion cluster), from 1.3 per cent to 3.8 per cent in medium technology and from 0.6 per cent to 7.0 per cent in high technology (Lall and Weiss, 2005: 9–10).

There is no doubt that offshoring has played a significant role in this success story. Chinese firms and foreign subsidiaries have become major suppliers of TNCs in sectors like electronics, toys, semi-conductors, furniture and apparel. In 2003, for example, one-eighth of total Chinese exports to the United States was purchased by *Wal-Mart*. According to some estimations, TNCs are responsible for around 85 per cent of Chinese high tech exports and for 75 per cent of technology-related sales abroad (examples cited in Gereffi, 2006: 19).

China's emergence as the main player in global offshoring has complex consequences for various developing and transition countries. While discussing them in detail goes beyond the realm of this chapter, it is important to emphasise the asymmetric effects in different regions. Some East Asian countries, for example, will suffer market losses in third countries, but will also benefit from the consolidation of regional value chains (Lall and Albaladejo, 2004). In fact, China's trade deficit with East Asia increased tenfold between 1990 and 2002, from US$4 billion to US$40 billion (Kaplinsky, 2005: 17). For Mexico and the Caribbean Basin, the impact in terms of trade flows and FDI may be more problematic as they face growing difficulties to compete in sectors like apparel due to their cost disadvantage. Hourly labour costs in the apparel sector (including social benefits) range from US$0.7 and 0.9 in China, compared to US$2.7 in Costa Rica, US$1.7 in the Dominican Republic, US$1.6 in El Salvador, US$1.5 in Guatemala and Honduras and US$1.0 in Nicaragua (data from 2002). Productivity is also higher in China, which also benefits from low-cost raw materials. Not surprisingly, Mexico and countries in the Caribbean Basin are losing market share in the United States. Mexico's share in US apparel imports, for example, decreased from 14 per cent in 2001 to 8 per cent in 2005. The Dominican Republic and Costa Rica have suffered similar drops. Central Europe has also been affected by Chinese competition in its attempt to develop new sectors through FDI. Several TNCs like *Flextronics* or *IBM*, for example, have relocated labour-intensive activities from Hungary to China (Szanyi, 2006).

1.2.3 More traditional types of foreign investment

Offshoring may be the defining trend of the behaviour of TNCs in the global era, but it is by no means the only one. A look at the largest TNCs reveals that transnationalisation is also taking place for more traditional reasons. Table 1.4 reflects the main sector of the largest 100 TNCs – which accounted for an estimated 11 per cent of foreign assets, 16 per cent of sales and 12 per cent of employment by all TNCs in 2004 (UNCTAD, 2006: 31). We have divided the sectors between those that are participating in offshoring and those that are not. The classification is somewhat arbitrary as all firms can participate in offshoring of some services like back-office, but it provides us with a useful picture. The majority of all TNCs are specialised in activities in which offshoring is not possible (petroleum) or not yet dominant (heavy industry). Investment in all these cases is driven by the search for natural resources or for new markets.

Table 1.4 Sectoral distribution of the largest 100 TNCs (by foreign assets), 2004

Sector	Number
A. Part of offshoring	**35**
Electrical and electronic equipment	7
Motor vehicle	13
Pharmaceutical	11
Textiles	2
Computer and related activities	2
B. Non offshoring	**60**
Telecommunications	10
Petroleum, energy and mining	12
Electricity, gas and water	9
Food, beverages and tobacco	6
Wholesale trade, transport and storage	5
Retail	5
Heavy industry*	11
Media	2
C. Undefined	**5**
Diversified	5
Total	100

Note: * Heavy industry and paper includes non-metallic products, metals and metal products, chemicals, steel, lumber and paper.

Source: Own calculations with data from UNCTAD (2006).

FDI in the service sector has grown particularly fast in the last 15 years, going from US$1,762 billion in 1990 to US$5,883 billion in 2005 (Table 1.5). Its share in the world's stock of FDI increased from 49 per cent to 62 per cent, while the contribution of both manufacturing and, especially, the primary sector significantly declined. The increasing dominance of services in the global economy, which has been particularly intense in developed countries, has obviously contributed to this trend. As total gross capital formation moves away from the agricultural sector and from most manufacturing activities, the share of these sectors in FDI is also bound to go down.

Yet there are also additional factors to explain the expansion of FDI in the service sector. The fragmentation of production discussed in the previous section is one of them, but even more important has been the expansion of market-seeking FDI in services like utilities and telecommunications. Large companies with unique knowledge assets (including technology, marketing, management and also the capacity to relate with