The Role of Foreign Direct Investment in a Globalizing Economy [*]

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1. Introduction

There is little question that economic activity – of all types – is moving in the direction of globalization, rather than away from it. As one approaches the end of the twentieth century, there is little doubt that the world is moving towards the globalization of production and markets, in the same way as national, rather than local, firms were emerging a hundred or more years earlier. It is also evident that at both a corporate and a country level, cross-border economic activity is becoming increasingly interdependent. Indeed, perhaps the most distinctive feature of globalization – as compared with other forms of internationalization – is that it integrates the international value added activities of firms and countries in such a way that the prosperity of any one firm is inextricably bound up with that of its foreign production and marketing activities. Also the welfare of any one country is closely dependent on that of other countries with which its residents transact business.

As we shall explain in a moment, globalization, deep integration, and the activities of multinational enterprises (MNEs) go hand in hand. But before taking up this point further, we shall first identify the key attributes of globalization, and the reasons for its growing pace over the past decade or so. We shall then proceed to consider the past and present role of foreign direct investment (FDI), and other forms of cross-border activity, in affecting the pattern and

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consequences of globalization; and finally, we shall outline some of the changes now taking place in the motivation and character of MNE activity, as market oriented economies are moving into a new phase of capitalism – what have variously been referred to as "alliance", "collective", and the "new" capitalism.[1]

2. Globalization, its meaning, and the reasons for its growth

There have already been a plethora of books, articles and newspaper stories written on the nature and extent of globalization. Of the various definitions of globalization, our own preference is for the one given by Anthony McGrew, who in a jointly edited book *Globalization and the Nation States*, published in 1992 (McGrew and Lewis 1992, p. 23), writes:

> Globalization refers to the multiplicity of linkages and interconnections between the states and societies which make up the present world system. It describes the process by which events, decisions, and activities in one part of the world come to have significant consequences for individuals and communities in quite distant parts of the globe. Globalization has two distinct phenomena: scope (or stretching) and intensity (or deepening). On the one hand, it defines a set of processes which embrace most of the globe or which operate worldwide; the concept therefore has a spatial connotation [...]. On the other hand it also implies an intensification of the levels of interaction, interconnectedness or *interdependence* between the states and societies which constitute the world community. Accordingly, alongside the stretching goes a deepening of global processes.

In short, then, globalization is leading to the structural transformation of firms and nations, and is creating new relationships and new dependencies. Sometimes, the transformation is primarily being played out at a regional level, e.g. NAFTA, APEC and the European Union; and sometimes it takes place at a global level. More often than not, however, the advantages of global or regional integration have to be set against the advantages of adapting products or production processes to the particular needs of national consumers or country specific supply capabilities. Hence, the coining of the term "glocalization".

The main causes of globalization are well known. We shall focus on just two. The first is the pressure on producers – by consumers and competitors alike – to continually innovate new products and to upgrade the quality of existing goods and services. At the same time, the escalating costs of research and development (R&D), coupled with ever truncated product life cycles, are compelling firms both to down-size the scope of their production, and to search for wider markets. Moreover, as technological advances become more generic, firms are increasingly finding that they need to combine their core competencies with those of other firms. Hence, the emergence of strategic alliances and inter-firm networks, to which we shall give more attention later in the article.

The second cause of globalization – which in many ways is better described as a removal of an obstacle – is the renaissance of market oriented policies pursued by national governments and regional authorities. In the last five years alone, more than thirty countries have abandoned central planning as the main economic system of allocating scarce resources, while over eighty countries have liberalized their policies towards inward FDI. The privatization of state owned enterprises, the liberalization of markets – especially for services – and the removal of a host of structural distorting government regulations, have all worked to ease the cross-border movement of assets, products and people both within MNEs and between independent firms, or groups of firms of different nationality.

Underlying and reinforcing these two explanations for globalization and fashioning its character, have been changes in the organization of economic activity. At a micro level, these changes are best exemplified by the emergence of a more flexible, yet systemic, approach to production, together with a growing appreciation by firms of the need to form close and ongoing relationships with other firms to fully capture the benefits of their own competitive advantages. At a macro level, they mirror the changing costs and benefits of the alternative modalities of allocating scarce resources; and, in particular, they reflect the demands being made by globalization on national governments and supranational regimes.

Since we are in the midst of these tecno-economic and socio-institutional changes, it is premature to judge either their extent or their consequences for the world economy. But the clues we have been able to discern so far point to a very different path of economic

[1] See, for example, Gerlach (1992), Lazonick (1992) and Dunning (1994).

development than the one we have experienced over the past half century.

With respect to the micro-organization of business activity, there are several forces at work which are leading firms to replace the Fordist or mass production system. First, improved living standards – particularly in the Triad nations[2] – have caused consumers to reorient their spending habits. There is a greater expectancy of fault-free products, continuous product improvement, and the innovation of new goods and services. At the same time, competitive pressures are demanding that firms reexamine their cost control procedures, spanning all areas of business activity, from inventories to manning levels and to advertising budgets. Lean production is now the order of the day.

Second, the new technologies of the 1980s and 1990s, such as computer aided design and manufacturing techniques, and the miniaturization of components, are not only enabling firms to exercise more rigorous quality control, but are permitting them to make use of multi-purpose machinery and equipment.

Third, contemporary technological and organizational advances are demanding a much closer synthesis, and more interactive learning, between the innovatory and production functions of the firm. Indeed, in the words of two scholars (Kenney and Florida 1993, p. 303), "the factory itself is becoming a research laboratory – a setting for both product and process innovation". In this new environment, knowledge and intellectual labor are being mobilized on a collaborative basis; and the skills, ideas and experience of shop floor workers are being actively tapped to raise product quality and productivity. Such innovation driven production both facilitates the functional integration of tasks and, more explicitly, socializes the organization of production.

3. Modalities of globalization

Another distinctive feature of globalization is the impact on the modes of undertaking cross-border business activity. For most of modern industrial history, i.e. since the third quarter of the eighteenth century, arm's length trade in goods, services and financial assets has been the main means of conducting international commerce. However, by 1914, FDI, which transfers a package of resources and capabilities *within* the same firm, had already begun to assume some importance in linking national economies – particularly between the Metropolitan countries and their colonies, and between North America and Western Europe. But, it was not until after the second World War that FDI really took off as a mechanism for delivering goods and services to foreign markets; and it has only been since the 1980s that outbound MNE activity has become a significant form of international economic activity by other than a few of the advanced industrial economies.[3] It has also only been during the last decade that world – and particularly the industrialized world – has witnessed such an explosive growth in mergers and acquisitions (M&As) and cooperative cross-border arrangements. Like FDI, such M&As and alliances are both a cause and a consequence of globalization.

The following tables offer a few statistics which portray the growth of international transactions; *inter alia,* they reveal that the modality of these transactions have moved from those making for *shallow* to those making for *deep* integration. First, consider Table 1. The most noticeable feature of this table is that world trade, world investment and the number of non-equity technology transfers and/or cross-border associations have all increased at a faster rate than the world GNP since 1980s.[4] FDI, in particular, rose extremely rapidly in the second half of the 1980s. More recent data suggests that 1993 and 1994 saw a resurgence in FDI outflows, particularly from the US and some developing countries, e.g. China.[5] A separate set of data, set out in Table 2, shows that, for the great majority of countries, the significance of both trade and FDI to their domestic economies has risen substantially over the last decade or more.

Next, we turn to the role of FDI and the role of MNEs in the globalizing economy. Some critical statistics of the level and geographical composition of outbound and inbound FDI stocks are set out in Tables 3 and 4. Table 5 makes some estimates of the role of FDI compared with that of exports and licensing as a means of servicing three leading industrial markets. Table 6 presents some "bullet" points about the main features of MNE activity; and Table 7

[2] I.e., which comprise the US, the European Union and Japan.

[3] For further details the reader is invited to consult Dunning (1993a) and UNCTAD (1994).

[4] Measured in SDRs, these growth rates would have been rather different; in particular, the FDI growth rates in the 1980s would have been lower, and those since 1990 higher.

[5] See UNCTAD (1995).

Table 1

WORLDWIDE FOREIGN DIRECT INVESTMENT AND SELECTED ECONOMIC INDICATORS, 1992, AND GROWTH RATES FOR 1981-1985, 1986-1990, 1991 AND 1992
(Billions of dollars and percentage)

Indicator	Value at current prices, 1992	Annual growth rate (per cent)			
		1981-1985[a]	1986-1990[a]	1991	1992
FDI outflows	171	3	24	–17	–11
FDI outward stock	2,125[b]	5	11	10	6
Sales of foreign affiliates of TNCs[c]	4,800[d]	2[e]	15	–13	–
Current gross domestic product at factor cost	23,300	2	9	4	5
Gross domestic investment	5,120	0.4	10	4	5
Exports of goods and non-factor services	4,500[d]	–0.2	13	3	–
Royalty and fees receipts	37	0.1	19	8	5
Strategic alliances[f] (number)	327[g]	258	388[h]	297	395

[a] Compounded growth rate estimates, based on a semi-logarithmic regression equation.
[b] 1993.
[c] Estimated by extrapolating the worldwide sales of foreign affiliates of TNCs from Germany, Japan and the United States on the basis of the relative importance of these countries in worldwide outward FDI stock.
[d] 1991.
[e] 1982-1985.
[f] In high technology sectors.
[g] Average per annum.
[h] Average per annum 1981/1992.

Sources: UNCTAD, Division on Transnational Corporations and Investment, based on International Monetary Fund, balance-of-payments tape, retrieved in April 1994; and unpublished data provided by the World Bank, International Economics Department.

sets out the reasons for the fastest growing form of FDI in the 1980s, viz. by way of M&As.

In reviewing these data, we would like to especially emphasize seven points.

1) Inbound and outbound FDI stocks as a percentage of the GDP of virtually all countries has substantially increased over the last 25 years; these data are, perhaps, the best indicators we have on the growth of "deep" integration.

2) Outbound FDI is still predominantly accounted for by the leading industrial countries, although such investment by some developing countries, noticeably Korea, Taiwan and China, is increasing quite rapidly.

Table 2

TWO INDICATORS OF EXTENT TO WHICH A COUNTRY IS GLOBALLY INVOLVED
(percentages)

FDI (stock) to GDP ratio 1980 and 1992 Inward + Outward Investment divided by GDPx2				Trade to GDP ratio 1980 and 1991 Exports + Imports divided by GDPx2			
*		1980	1992	*		1980	1991
1	Netherlands	18.3	33.6	1	Singapore	206.9	196.72
2	Belgium/Luxembourg	5.2	23.6	2	Hong Kong	104.1	144.12
3	Switzerland	18.1	22.0	3	Belgium/Luxembourg	58.0	107.90
4	United Kingdom	13.6	21.8	4	Malaysia	44.9	90.52
5	Canada	14.4	21.2	5	Netherlands	44.9	61.05
6	Malaysia	13.5	20.9	6	Ireland	55.2	51.79
7	Australia	4.9	18.5	7	Switzerland	32.5	49.13
8	Sweden	3.6	14.7	8	Taiwan	n.a.	46.81
9	France	3.2	10.6	9	Austria	27.3	46.42
10	Spain	2.8	10.5	10	Norway	30.9	45.30
11	Chile	1.7	9.9	11	Denmark	27.0	45.03
12	Norway	1.2	9.2	12	Thailand	23.5	43.70
13	South Africa	13.4	9.0	13	Hungary	n.a.	39.22
14	Germany	5.5	8.6	14	Portugal	32.0	38.65
15	Finland	1.2	8.2	15	Chile	n.a.	37.56
16	USA	5.8	7.7	16	United Kingdom	22.5	37.44
17	Venezuela	1.3	6.3	17	Sweden	26.2	34.22
18	Thailand	1.5	5.8	18	Venezuela	25.5	32.52
19	Italy	2.0	5.4	19	Germany	23.2	32.48
20	Austria	2.6	5.2	20	Korea	34.2	31.59
21	Hungary	n.a.	4.2	21	New Zealand	23.3	30.82
22	Japan	2.2	3.9	22	Indonesia	23.4	30.07
23	Czechoslovakia	n.a.	3.1	23	France	18.9	29.94
				24	Canada	24.2	28.04
				25	Greece	22.0	26.08
				26	Finland	29.8	25.91
				27	South Africa	30.1	24.77
				28	Turkey	9.8	23.53
				29	Pakistan	18.5	23.51
				30	Italy	22.5	22.02
				31	Australia	14.3	20.80
				32	Spain	13.8	20.71
				33	Mexico	10.4	18.15
				34	Japan	12.7	13.52
				35	USA	9.1	12.52

* 1992/1991 rankings.

Sources: World Economic Forum and IMEDE 1993; World Bank 1994; UNCTAD 1994; United Nations 1986.

Table 3

STOCKS OF OUTWARD FOREIGN DIRECT INVESTMENT, BY MAJOR HOME COUNTRIES AND REGIONS 1967-1992
(billions of US dollars)

Countries/Regions	1967			1973			1980			1992		
	Value	% of total	% of GDP	Value	% of total	% of GDP	Value	% of total	% of GDP	Value	% of total	% of GDP
Developed Market Economies	109.3	97.3	4.8	205.0	97.1	5.1	503.6	97.2	6.2	1869.6	96.8	10.2
United States	56.6	50.4	7.1	101.3	48.0	7.7	220.2	40.0	8.2	488.2	25.3	8.3
United Kingdom	15.8	14.1	14.5	27.5	13.0	9.1	79.2	14.8	15.2	221.2	11.4	24.5
Japan	1.5	1.3	0.9	10.3	4.9	2.5	19.6	6.6	3.4	250.4	13.0	6.8
Germany (FDR)	3.0	2.7	1.6	11.9	5.6	3.4	43.1	7.8	5.3	178.7	9.2	10.0
Switzerland	2.5	2.2	10.0	7.1	3.4	16.2	22.4	7.0	37.9	73.8	3.8	30.6
Netherlands	11.0	9.8	33.1	15.8	7.5	25.8	42.4	7.6	24.7	131.7	6.8	41.1
Canada	3.7	3.3	5.3	7.8	3.7	6.1	21.6	3.9	8.2	87.5	4.5	17.7
France	6.0	5.3	7.0	8.8	4.2	3.8	20.8	3.8	3.2	160.9	8.3	12.2
Italy	2.1	1.9	2.8	3.2	1.5	2.4	7.0	1.3	1.8	68.7	3.6	5.6
Sweden	1.7	1.5	5.7	3.0	1.4	6.1	7.2	1.3	5.8	50.5	2.6	22.9
Other[1]	5.4	4.8	0.8	20.0	9.5	1.7	15.4	3.2	1.9	157.4	8.1	7.1
Developing countries	3.0	2.7	0.6	6.1	2.9	0.6	13.3	2.8	0.7	62.4	3.2	1.3
Total	112.3	100.0	4.0	211.1	100.0	4.2	516.9	100.0	4.9	1932.3	100.0	8.4

[1] Australia, Austria, Belgium, Denmark, Finland, Greece, Ireland, New Zeland, Norway, Portugal, South Africa, Spain.

Sources: World Bank, *World Development Report*, various editions; UNCTAD, *World Investment Report*, various editions; Dunning 1993b.

Table 4

STOCKS OF INWARD FOREIGN DIRECT INVESTMENT, BY MAJOR HOST COUNTRIES AND REGIONS 1967-1992
(billions of US dollars)

Countries/Regions	1967			1973			1980			1992		
	Value	% of total	% of GDP	Value	% of total	% of GDP	Value	% of total	% of GDP	Value	% of total	% of GDP
Developed Market Economies	73.2	69.4	3.2	153.7	74.0	3.8	394.1	78.0	4.7	1520.1	78.0	8.3
Western Europe	31.4	29.8	4.2	79.9	38.4	5.6	211.6	42.0	4.8	838.3	43.0	11.2
United Kingdom	7.9	7.5	7.2	24.1	11.6	13.9	63.0	12.5	12.0	173.3	8.9	19.2
Germany	3.6	3.4	1.9	13.1	6.3	3.8	47.9	9.5	5.8	129.6	6.7	7.2
Switzerland	2.1	2.0	8.4	4.3	2.1	9.8	14.3	2.8	14.1	32.6	1.7	13.5
United States	9.9	9.3	1.2	20.6	9.9	1.6	83.0	16.4	3.2	419.5	21.5	7.1
Other[1]	31.9	30.2	4.2	53.2	25.6	4.2	99.5	19.7	6.5	324.9	16.7	14.7
Japan	0.6	0.6	0.3	1.6	0.8	0.4	3.3	0.7	0.3	38.7	2.0	1.1
Developing countries	32.3	30.6	6.4	54.4	26.1	5.4	111.2	22.0	5.4	420.2	22.0	8.9
Africa	5.6	5.3	9.0	10.2	4.9	8.7	13.1	2.6	4.1	45.7	2.3	12.0
Asia	8.3	7.8	3.9	15.3	7.4	3.6	35.8	7.1	5.0	221.3	11.4	4.1
Latin America and the Caribbean	18.5	17.5	15.8	28.9	13.9	12.3	62.3	12.3	8.4	149.0	7.6	12.3
Total	105.5	100.0	3.8	208.1	100.0	4.1	505.3	100.0	4.7	1948.1	100.0	8.4

[1] Australia, Canada, Japan, New Zeland, South Africa, Algeria, Egypt, Tunisia, Morocco.

Source: As for Table 3.

TABLE 5

ALTERNATIVE MODALITIES OF SERVICING
JAPANESE, U.K. AND GERMAN MARKETS BY FIRMS
1989

	Japan			
	Affiliate sales	Exports	Licensed sales	Total
All industries (US$ bil.)	49.7	42.8	20.9	113.4
Per capita (US$)	403.7	347.7	169.8	921.2
% of total	43.8	37.7	18.4	100.0
	United Kingdom			
	Affiliate sales	Exports	Licensed sales	Total
All industries (US$ bil.)	125.3	20.8	3.2	149.3
Per capita (US$)	2190.5	363.6	55.9	2610.0
% of total	83.9	13.9	2.1	100.0
	Germany			
	Affiliate sales	Exports	Licensed sales	Total
All industries (US$ bil.)	71.7	16.8	2.7	91.2
Per capita (US$)	1156.5	271.0	43.5	1471.0
% of total	78.6	18.4	3.0	100.0

Affiliate sales represent sales of US manufacturing affiliates (excluding exports) in the three countries.
Exports represent all exports to the three countries by all US firms (N.B. part of these may be included in affiliate sales).
Licensed sales represent royalties and fees paid by unaffiliated Japanese, U.K. or German firms to US firms multiplied by 20 (it being assumed that royalties and fees were calculated as 5% of gross sales).
Sources: US Department of Commerce (1992 and 1993); Weinberg (1993).

3) The slowdown in FDI growth between 1990 and 1992 – and this has been partially reversed in the last two years – was partly cyclical, and reflected the recession in the US and Europe. It was also partly a reflection of a sharp cut-back in Japanese FDI, which, *inter alia*, was a reaction to the huge outflow of such FDI in the second part of the 1980s, and to a less dynamic domestic economy.

4) For the reasons set out in Table 7, M&As were the major form of FDI in the 1980s, but they were considerably fewer in the early 1990s; 1993 and 1994 have, however, seen some resurgence in M&A activity.

TABLE 6

MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY
SOME FACTS 1992

- There were 35,000 MNEs (2,700 from developing countries) with 150,000 affiliates (65,000 in developing countries).

- FDI stock at the end of 1992 was $2 trillion. Of this amount, 68% was accounted for by France, Germany, Japan, the United Kingdom and the US. Developing countries accounted for about 3-5% of the worldwide FDI.

- The sales of foreign affiliates of MNEs in 1992 was estimated to be $5,5 trillion (compared with $4,0 trillion of world exports). The slowdown in outbound direct investment since 1990 has been mainly concentrated in the Triad countries and is primarily the result of the falling profits earned on past FDI, and the "bursting of the Japanese bubble" of outbound FDI.

- China was the leading developing country recipient of FDI flows in 1991 and 1992. Asia received 56% of the total flows to developing countries, and Latin America 36%.

- The largest 1% of TNCs accounted for one-half of stock of FDI.

- Worldwide cross-border acquisitions accounted for 59% of FDI outflows between 1986 and 1990, but only for about one-quarter in 1991 and 1992.

- 75-80% of all FDI stock in 1992 was in sectors requiring above average human skill, capital or technology intensity.

- 50-55% of all FDI in 1992 was in the tertiary (service) sector.

- FDI and strategic alliances are growing faster than other forms of international transactions.

- Some 79% of the stock of inward investment at the end of 1992 was in developed countries, though in 1991 and 1992 developing countries accounted for 28% of all new FDI. Central and Eastern Europe accounted for almost 3% of worldwide inflows of FDI in 1992.

- Over the period 1988-1992, FDI from privatization schemes amounted to over $5.2 billion, or 43%, of the total FDI inflows to Central and Eastern Europe and $8,7 billion, or 17%, of the total FDI inflows into developing countries.

Table 7

THE INTERNATIONAL BUSINESS ENVIRONMENT AND MERGERS AND ACQUISITIONS IN THE 1980S

Forces driving mergers and acquisitions	Application to cross-border mergers and acquisitions
Growing competition, globalization and favourable government policies	To achieve internationalization and geographical market diversification and to increase market share rapidly, firms prefer to engage in merger and acquisitions as opposed to greenfield investments as a faster way to do so. Merger-friendly government policies encouraged the wave of mergers and acquisitions of the 1980s.
Higher efficiency in the face of growing competition and globalization	To achieve scale economies and synergies in value-adding activities, firms build integrated international production networks aimed at improving efficiency of the firms as a whole. Mergers and acquisitions allow the speedy establishment of such networks.
Access to technology and reduced costs of research and development	To gain access to new technology, share the risks and costs associated with technology development and reduce the time needed for product innovation, TNCs may acquire firms engaged in research and development or merge with such firms to access their technological capabilities.
Response to the Single Market programme of the European Community	The Single Market programme created competitive pressures, as well as opportunities for European Community and third-country firms for mergers and acquisitions aimed at rationalizing production and distribution of goods and services within the European Community and increasing market share.
Availability of low-cost financing options after the financial liberalization of the 1980s in many developed countries	To take advantage of the substantial growth in the availability of credit, innovations in corporate finance and the valuation of many companies below break-up values.
New investment opportunities in developed countries during the boom period in the second half of the 1980s	To take advantage of favourable investment opportunities created by economic growth to expand into new markets or activities. Periods of economic growth are also associated with a greater availability of investible funds from corporate profits or loans to finance mergers and acquisitions.

Source: UNCTAD (1994).

5) FDI is strongly concentrated in high technology, information intensive and growth oriented manufacturing and service sectors.

6) There has been a marked increase in FDI activity in developing countries since 1990. Partly, this reflects the robustness and renaissance of market oriented policies of many developing countries, e.g. China and India; and partly, the faster rate of growth of the leading inward investors, compared with that of other countries. Of the FDI flows directed to developing countries, in 1991 and 1992, China accounted for 17.1%, the rest of Asia for 39.9%[6] and Latin America and the Caribbean for 36.2%.

7) The significance of both outbound and inbound FDI in the globalizing economy varies considerably between countries. Table 5, for example, shows that in 1989, the affiliates of US firms in Japan accounted for only 43.8% of the foreign-related sales in Japan, compared with 83.9% in the UK and 78.6% in Germany.

Two other characteristics of the FDI of the last decade which are not demonstrated in the statistics just presented also need emphasizing. These are:

(i) The primary motivation for the foreign activities of firms has changed from that of seeking *markets* and *natural resources* to that of exploiting domestic competitive advantages and of acquiring additional resources and capabilities perceived necessary to *sustain and advance* these competitive advantages, and

(ii) firms – particularly MNEs – are becoming more pluralistic in their modes of capturing the benefits of globalization; and the way firms coordinate (i.e. integrate) their trans-border activities is an amalgam of hierarchical and cooperative capitalism.

These two latter features of contemporary business activity, as well as those already identified – and especially the growth of strategic alliances – suggest that the role of FDI in the international market economy is in the process of important change. For most of the period of modern capitalism – whether FDI has been undertaken to obtain natural resources and labor, to secure or protect markets, or to promote a more cost effective distribution of its foreign activities –,

[6] India's "approved" inward investment flows rose from a miniscule $73 million in 1990 to $2,858 million in 1992. The "actual" FDI flows rose from $11.3 million in 1991 to $577 million in 1993.

its main *raison d'être* has been to exploit the core competencies of the investing corporations, and to do so by internalizing cross-border intermediate product markets. Spurred on by local market opportunities, much of US direct investment in Europe in the 1960s and 1970s, and of Japanese investment in Asia, Europe and the US in the early 1980s, was of this kind. For the most part, too, this FDI was of a "stand alone" or discrete character in the sense that its success was judged mainly by the ability of the investing companies to exploit their home-based competitive advantages and to coordinate related intra-firm value activities across national boundaries.

Since around the mid-1980s, however, the same features which have fostered globalization – and of these, technological advances and the renaissance of the market system are, perhaps, the two most important – have also impacted on both the motives and determinants of MNE activity, and on the strategy of the investing firms. Increasingly – and as reflected especially by the dramatic increases in intra-Triad M&As – firms are expanding their territorial horizons, not so much to exploit existing competitive advantages, but to protect or enhance these advantages and their global market positions by acquiring, or gaining access to, new resources and capabilities. In the late 1980s, there was hardly a day when the financial press did not report a new takeover of a US firm by a European firm – or *vice versa* –, which was usually justified by the acquiring firm in terms of "the need to strengthen our technological or product base *vis à vis* our global competitors"; or, "to rationalize our cross-border production capabilities or to capturé new scale or synergistic economies"; or, "to better access unfamiliar markets and distribution networks".

The critical feature of *strategic asset seeking* FDI[7] is that the acquiring firm in a takeover, or both partners in the case of a merger, accepts (accept) that its (their) internal, or stand-alone, resources and capabilities are insufficient to sustain its (their) international competitiveness, and that it (they) needs (need) to draw upon resources and capabilities of *other* firms to achieve this goal. This is one of the characteristics of the emerging "collective", "relational" or "alliance" capitalism of the 1990s. And, although by internalizing the markets for these resources and capabilities it would appear that global hierarchies are being strengthened, this is not always the case.

[7] Which is the fourth type of FDI, along with *market seeking, resource seeking* and *efficiency seeking* FDI.

This is because asset acquiring investment is frequently accompanied by asset shedding, as firms have sought to concentrate on those activities which (they perceive) will best protect or advance their core competencies. Strategic asset acquiring investment is, then, best regarded as an integral part of a restructuring of the resources and capabilities of firms, and as a response to globalization.

At the same time, it is becoming increasingly clear that FDI, while a necessary condition, is not a sufficient condition for a successful global corporate strategy. Indeed, FDI is not always the most efficient means of accessing foreign assets. Often, a firm does not want to acquire *all* the assets of a foreign firm, but only those which directly advance its competitive position. In such cases, the conclusion of inter-firm alliances to achieve a specific objective may be preferable to FDI. These alliances may serve as alternatives to vertical integration; and sometimes to horizontal or lateral diversification.

Moreover, the shedding of value adding activities does not mean that firms now rely more on arm's length markets for the intermediate products they buy or sell. More often than not, the market imperfections which promoted the internalization in the first place still remain; indeed, the strategic need to maintain an influence over the quality and supply of inputs, or the processing of downstream activities, and the pace and direction of innovation in times of competitive pressures, is even greater (Quinn and Hilmer 1994). So, in addition to FDI, firms have been engaging in a myriad of bilateral or multilateral cooperative arrangements, in order to capture the economic benefits which a "stand alone" strategy cannot achieve.

In practice, it is extremely difficult to assess the role of strategic alliances as part of the internationalization process of firms – or, indeed, to value their outcome either from the perspective of the participants or of the countries involved. Yet, it is important that policy makers seeking to attract FDI – e.g. to upgrade their competitiveness or to assist their own firms in capturing global markets – should recognize that, in some cases, the objectives may just as well be reached by the formation of cross-border alliances. Indeed, research suggests that those countries whose governments have striven to provide the right environment for alliance formation – e.g. Japan, Korea and Taiwan – are often also those which do best in the global economy.

While there are many reasons why firms conclude alliances with other firms,[8] the great majority of those concluded over the past decade have been for four main reasons. These are:

1) to acquire new product or process technologies and organizational competencies – and especially those perceived necessary to advance the core competence of the acquiring firms;

2) to spread the risks of high capital outlays, or reduce the time of product development;

3) to capture the economies of synergy or scale, and

4) to gain access to new markets or distribution channels.

It should be observed that each of these motives runs parallel to strategic asset acquiring FDI (see Table 7).

As might be supposed, cross-border alliances – like FDI – are concentrated in particular industrial sectors; and, in the main, these are similar to those in which FDI is concentrated (e.g. the dynamic technology and information intensive product and service sectors).

Of course, cross-border strategic alliances are not the only form of cooperative arrangements. These range from very specific technical service and subcontracting agreements, to less formal – but no less significant – modes of inter-firm cooperation found in business or industrial districts, and also to *keiretsu*-type relationships. But, although the type of arrangements vary, all represent a kind of quasi-internalization of cross-border assets and should be considered as an integral part of the total portfolio of the firm's assets.

We believe that asset acquiring FDI and cooperative arrangements are key features of the contemporary global economy and of alliance capitalism; and that, while the first is primarily a response of Western nations to the demands of the global marketplace, the second is primarily an East Asian response. But there is plenty of casual evidence to suggest that both forms of corporate restructuring are now spreading throughout the industrialized world – and throughout parts of the industrializing world as well.[9]

[8] See Dunning (1993a), chapter 9, in particular p. 250.

[9] The exception is that strategic asset acquiring FDI is still very limited in Japan – not so much by legal restrictions as by less tangible entry barriers, e.g. to do with business customs and practices, and *keiretsu* relations in Japan.

4. FDI and globalization

Let us now draw together the main threads of this article. Where it has been permitted and where it has been in response to market forces, FDI – like trade – has had a generally positive effect on both economic growth and the international division of labor. The relationship between trade, FDI and cross-border cooperative ventures is ambivalent. In some cases – e.g. in response to barriers to trade – FDI may be a substitute for trade; in others – e.g. in most natural resource based and efficiency seeking investment – it is likely to be trade enhancing. For the most part, and until recently, FDI and cooperative arrangements have been regarded as substitutes for each other; with the latter often being regarded as a second best alternative to FDI.

In today's globalizing economy, however, and with the emergence of alliance capitalism, FDI and trade are becoming more complementary and supportive of each other. This new trend is particularly well demonstrated by the activities of the large MNEs in the industrialized countries; and governments do well to recognize this fact in the formation of their policies towards trade, FDI, innovation and competition – which, all too often, are conceived and implemented in isolation of each other. We have argued that FDI is one of the deepest forms of structural integration between countries; for, not only are the resources and capabilities of one country transferred to that of another, but their use – as well as that of the complementary assets of the recipient country – is controlled, or influenced, by the transferring firms. Thus, the motives for FDI, and the conditions under which it is undertaken, are, through the "embedded" factor, likely to determine its impact.

As this century draws to a close, it is clear that MNE activity – which comprises a composite of FDI, collaborative agreements and trade – can be divided into two categories. The first is traditional value added activity designed to exploit the existing resources and capabilities of firms. This is to combine these with foreign location bound resources in order to service markets more efficiently than is possible by using alternative means. Existing theories and paradigms of FDI generally explain this kind of activity quite well. This traditional type of MNE activity is likely to continue to take place, especially in the low to middle income developing countries, and by first-time and smaller MNEs. However, it is being increasingly supplemented by the formation of cross-border alliances and networks – particularly by firms from countries which lack the necessary physical, legal or commercial infrastructure to pursue "stand alone" FDI strategy (e.g. China and the erstwhile Communist countries).

The second kind of MNE activity is more difficult to get a handle on, and, in many respects, mirrors the maturation of the large domestic firm. It is very much a creature of the current generation of technological advances, and of alliance capitalism. Its main impetus is to protect the existing market shares of the investing firms by cost reducing and innovation, and also to gain access to new markets. We have called such MNE activity strategic assets seeking, and have asserted that it comprises both cross-border M&As, and vertical and horizontal inter-firm alliances and networks. Up to now, as we have said, such activity is mainly confined within the industrialized world; but in the future, it may well embrace MNEs from the more advanced developing countries – and, particularly, we suspect, those in East Asia.

On the face of it, this second kind of MNE activity involves even deeper global interdependence than the first. This is because it often trans-nationalizes the ownership of national firms, and transfers the seat of control of such activities from where they are undertaken to another country. In doing so, this kind of FDI is more likely to substitute for domestic investment than the first kind. It also makes the "Who is us" question posed by the US Secretary of State Robert Reich some years ago[10] more difficult to answer.

Finally, alliance capitalism and strategic asset acquiring cross-border activity poses new challenges for national governments and sopranational agencies – not to mention scholars, as they seek to better understand the causes and effects of FDI. The key issue is whether such activity promotes static and dynamic efficiency, by promoting synergistic economies, reducing information asymmetries, sharing the risks of innovatory activity and promoting long-term comparative advantages; or, whether it reduces competition by increasing the concentration of economic power and inhibiting a country's dynamic comparative advantage. To put the matter another way, do joint ventures, *keiretsu*-type relationships and networks reduce endemic market failure, or do they increase structural market failure? Answers to these questions, and the policy response to them, will determine both the extent and pattern of the globalization of economic activity, and its impact on the economic welfare of the participating countries.

[10] See Reich (1990).

5. A policy footnote

This article has argued that globalization is leading to a closer structural integration of the world economy; and that FDI and cross-border inter-firm alliances are the main vehicles by which this is being accomplished.

If this diagnosis is correct, it follows that just as GATT and related supranational regimes were (and are) necessary to ensure a level playing field for international trade, so similar instruments will be required to ensure that MNE related activities fulfil their proper function in making for a better international allocation of the globe's resources and capabilities. According to Sir Leon Brittan of the European Commission, investment liberalization should be at the top of the agenda of the OECD, the WTO, the UNCTAD, and, indeed, the G7 Summit. In his words "the levelling of the worldwide playing field for investors is in the interest of all our societies" (Brittan 1995).

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