International Business in a Changing World Environment *

I would like, in this paper, to consider some aspects of the interface between international business — primarily in the guise of the multinational enterprise (MNE) — and the Governments of the countries which are host to its activities; and within a changing world economic and political scenario. I propose to outline *why, how* and *in what ways* this inter-face has been shaped by, or has shaped, the events of the past 25 years, and then to speculate a little about the prospects for the remainder of the 20th century.

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100 or 125 years ago, I might have chosen for my theme US business in a changing domestic economic environment. For the years following the Civil War saw the transformation of many regional American corporations into national corporations, and the emergence of multi-activity enterprises and the multiplication of plants, under the same ownership, in different parts of the US. And it is, perhaps, worth recalling that the spread of Northern US companies into the South was regarded by some observers at the time, with almost the same suspicion and unrest as that exhibited more recently by some Southern (developing) countries towards international corporations from the Northern hemisphere.

It is, I think, a useful starting point to any understanding of the modern MNE to regard it as an extension of the domestic multiplant firm. In both instances, a company seeking to service a market beyond its immediate catchment area must have some kind of advantage, (which

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we shall call an ownership specific advantage),[1] over and above that possessed by its competitors, or potential competitors, producing in that market. In both instances too, it must be more profitable to supply the market from a foreign, rather than a domestic location; and for the firm possessing the advantage to use (i.e. internalise) this advantage, rather than sell the right so to do to other firms.

The growth of the multiplant and/or multi-activity domestic enterprise in the second half of the last century may be explained by a series of separate, but interconnected, events. The first was the introduction — in both Europe and the US — of the joint-stock company and the principle of limited liability, which, by lessening the risk for entrepreneurial capital, aided the finance of the technological and organisational advances of the time, and paved the way for the growth of the large business corporation. The second event was the emergence of technology, including organisational technology, as the major vehicle of economic development. I would like to spend a few lines elaborating on this point.

From earliest times, economic progress has been conditioned by the availability of human and natural resources; and the efficiency by which these resources are administered to meet man's demands. In the first stage of development, typified by a Robinson Crusoe type economy, the technology is primitive, and is freely available or easily copiable; the economic system is elemental, and man's standard of living essentially rests on the abundance of natural resources immediately available, and his capacity to convert these resources into finished products. To make progress from such a situation, one of two things is normally necessary; first, the economy must obtain the goods it needs, but is unable to produce for itself, from elsewhere; second, ways must be found of increasing the quality and productivity of its own resources.

Trade, technological advances, and improvement in economic management, have proved important vehicles of growth in the past, and, in some countries, e.g. Japan, have more than compensated for deficiencies in natural resources. What is less obvious is that, as the more accessible non-renewable resources are depleted and the benefits of trade become fully exploited, the role of technology and organisation becomes more decisive. Now, technology has several unique features. Like natural resources, its production and use has to be organised; but,

[1] I.e. it is specific to the firm owning it.

unlike them — it is costly to create, frequently mobile across space, and often assumes the characteristics of a public good (in the sense that once produced it can be made available to additional consumers at a zero or low marginal cost).[2] Because of these properties, society has devised various mechanisms, including the patent system, to allow the generators of some kinds of technology,[3] privileged rights to its use, at least for a period of time — i.e. the technology becomes ownership specific. Not all types of technology, of course, are patentable or need to be patented. For example, the system (and often customer) specific computer technology of a company like IBM requires an extremely costly infrastructure which competitors find difficult to emulate. But it is the gain or erosion of such property rights, and the efficiency of their usage, which explains much of the birth, growth and death of firms in modern industrial society.

There are three main types of ownership advantages which give both domestic and multinational firms an edge over their competitors. The first is an exclusive or preferential access to a particular input or market (which might be directly acquired or negotiated with independent buyers or sellers); where the firm owns these rights it may have the option of leasing them to other firms either in its home or a foreign country. The second advantage is the possession of a unique intangible asset, e.g. a patent or a trade mark. Such an asset is locked into the firm and is often the output of its own research and development or marketing departments, or the accumulation of managerial expertise. Like the first, however, it is often capable of being transferred to other firms, by way of a technical service agreement, management contract and the like.

The third ownership advantage is different from the other two and reflects the ability of hierarchies to organise related productive activities more efficiently than the market. It stems not so much from the possession of a particular asset but from the economising of transaction costs when such transactions are under the same governance. Such an advantage includes better access to, and ability to assimilate, information flows, the economies of synergy and the spreading of overhead costs, the diversification of risks, the capacity to protect property rights and the efficient scheduling of production consequent upon inter-

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[2] A journal article is a good example.

[3] E.g. and particularly those which may fairly easily be reproduced — even though they are costly to produce.

nalising input flows or final good markets. For example, a branch plant of an existing firm can benefit from the research and development or marketing facilities of its parent company, which a *de novo* competitor would have to reproduce for itself. Because of their high transaction costs, the rights to these assets cannot be bought and sold, i.e. externalised, in the same way as can the first and second kind, for their value depends on their being centrally co-ordinated and controlled. Nevertheless, they often confer an important economic leverage on the firms possessing them, [4] which according to many economists [5] is the main *raison d'être* for the existence of large diversified firms, including MNEs.

This last reason for the growth of multiplant firms over the last century has to do partly with the economies of product or process specialisation, and partly that of supplying distant markets from alternative production sites — i.e. what we might call location specific factors. Again there is a parallel between domestic multiplant and MNE activity; the basic question is the same — viz. where is it best to site a plant to supply a market? The literature offers three sets of answers. The first is where costs are lowest. Given that technology is firm rather than branch (or plant) specific, then production costs will be determined by spatial differences in the prices and productivity of factor inputs; while transfer costs will vary according to distance, the nature of the product being marketed and government imposed inducements to, or restrictions on, trade. However, the point worth stressing is that multiplant operations are likely to be most pronounced when the ownership advantages of a firm are of a kind which favour the geographical separation rather than the concentration of production units. The second answer 'why multiplant firms?' is that a physical presence of a firm in a market may improve a firm's competitive viability and may make it more difficult for a prospective competitor from entering that market: a lot of import substituting foreign direct investment, as described in the product cycle literature (Vernon (1966, 1979)), originates in this way.

Thirdly, firms may produce in different locations to minimise transaction costs over space, and to take advantage of international product and process specialisation. In this respect, improvements in transport initiated by the railroad in the 19th, and the aircraft in the

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[4] Referred to in the literature as transaction power (seeing DUNNING (1982), TEECE (1982)).

[5] Notably CHANDLER (1977) and WILLIAMSON (1981).

20th century, have had a decisive impact on the location of economic activity — as have advances in communications technology. While in one way, such innovations have worked alongside new product and process technology to centralise economic activity; in another, by reducing obstacles to the movement of goods, people and information, they have contributed to its spatial diversification.

II

So much for the domestic multiplant firm as one of the antecedents of the modern MNE. Let me now turn to consider another, which is still very much a part of international business — viz the trading company. Trade is usually the first introduction of a firm into the international economic arena; indeed, domestic trade, in the form of exports from a production unit located in one part of the country to a customer in another, tends to precede the establishment of production units in that latter region. The reasons for this are straightforward; initially an enterprise, because of its uncertainty about market prospects, or its ability to produce in an unfamiliar environment, is reluctant to incur the heavy setting up and monitoring costs which this usually involves. So the first step from a domestic to a foreign market, tends to take the form of trade. But trade, like international production, requires a firm to have one or two types of advantage over a firm in the country to which it is selling; either, it must have access to resource endowments not available to firms in the buying country and not transferable between the two countries, *or* it must possess ownership specific advantages which, although they may reflect the structure of resource endowments of the country from which they originate, are capable of being deployed in another country. Just as economic growth is increasingly dependent on advances in technology and organisation, so the pattern of trade is increasingly reflecting the mobile ownership advantages of firms, rather than the immobile resource endowments of countries. But, whereas in the case of the first kind of trade, resources have to be used where they are located, in the second, this is not necessary, and trade will be replaced by foreign production, wherever the location specific endowments (which require to be combined with the ownership advantages of firms) most favour foreign countries.

Driven by purely economic considerations, business corporations would prefer to ignore political boundaries and view the world as a single market. And it is true that national frontiers do not necessarily

herald a discrete change in the amount or disposition of factor endowments. The 49th parallel and many borders in Western Europe make little *economic* sense. Resources are more unevenly distributed within the US than, for example, between Washington and British Columbia or Michigan and Southern Ontario. In such cases, there may be a greater economic affinity between firms on one side of their national border and markets on the other, than between the same firms and distant parts of the domestic market.

If we interpret economic distance as the cost of overcoming the obstacles of space between an enterprise's place of production and its markets, including the transaction costs of surmounting language, cultural and other barriers, then, given the size and nature of markets, it will normally seek to service those nearest to it. Now, Governments may increase or lessen this distance. In the past, economic and political ties and a common legal and commercial system between metropolitan European powers and their colonies helped to lower spatial costs; export free zones are performing this function today; trade and monetary integration, as it exists within parts of the EEC, has a similar effect. Import controls or political differences e.g. as is vividly demonstrated between East and West Germany, or South and North Korea, work in the opposite direction. Both by the economic systems they operate and the macroeconomic policies they pursue, Governments may exercise a decisive influence on transfer costs and the profitability of international business.

The purpose of Government intervention in economic distance is primarily to alter patterns of resource allocation to achieve social objectives. Sometimes, it may be directed to encouraging import substitution activities; sometimes to strengthening the competitive viability of indigenous *vis à vis* foreign enterprises, sometimes to gain tax revenue or protect the balance of payments. A great deal of foreign direct investment in the post-war period — especially in developing countries — has been prompted by host Government intervention, either in response to penalties imposed on trade, or to incentives to local production; likewise, Governments by regulating the conditions for foreign direct investments have sometimes fostered externalised transfers of technology via licensing and management contracts.

Scholars interested in comparative economic systems find it is helpful to classify countries by use of (what is called) the ESP paradigm.[6]

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[6] See, for example, KOOPMAN and MONTIAS (1971).

Countries differ from each other, e.g. in respect to their stage of development or propensity to attract international business, according to their economic *environment* (E), *systems* (S), and *policies* (P). By *environment* is meant the resources, including technology, available to a particular country and the ability of its enterprises to use these to service domestic or foreign markets. By *system* is meant the organisational framework within which the use and allocation of scarce resources is decided; is, for example, the market the main administrative mechanism or is it some form of Government fiat or some combination of the two? By *policy* is meant both the objectives of Governments and the measures taken by them or related institutions to advance these objectives, within the system and environment of which they are part.

Clearly, the three elements of the paradigm are inter-linked; each affects and is affected by the other; a change in Government policy may dramatically recast the economic system, e.g. as in the case of Chile and the Republic of China, while, over a longer period, its involvement in educational and research and development programmes may no less impinge on the environment.

Most of the literature on international economics tends to concentrate on the *environmental* influences of trade and foreign direct investment. Certainly, the classical and neo-classical trade models assume a market system in which there is atomistic competition, no Government intervention, and zero economic distance. Later theories acknowledge market imperfections and, implicitly at least, by accepting the possibility of ownership specific advantages — including scale economies — and positive transaction costs, some of the characteristics of a mixed economy. From the start, explanations of international production have more explicitly taken system and policy factors into account. For example, in a survey of the 44 most commonly quoted factors said to determine the investments of firms in developing countries, one half were found to be directly related to system or policy variables, and the remainder to environmental variables (Root and Ahmed, (1978)). Although the survey was primarly concerned with their locational choice, the ESP paradigm is no less relevant in explaining differences in the ownership advantages of MNEs of different nationality and the modalities by which these advantages may be used.

Let me recap my thesis up to this point. MNEs possess many of the characteristics of multiplant domestic firms and of firms engaged in international trade. The fact that a corporation locates part of its income generating activities ouside its national boundaries i.e. engages in

international production, does not really affect the nature of the beast. It must still possess certain advantages over firms which might seek to serve the same market; it must also be worthwhile to use these itself, rather than lease them to other firms; (i.e. the net benefits from internalisation — which may include risk reduction — are expected to exceed those offered by the market) and it must be profitable to produce at least part of its output in a foreign, rather than a domestic location. What primarily distinguishes *international* from *domestic* corporations is the configuration of the ESP variables facing two groups of firms and the way in which this impinges on the OLI (ownership, location, internalisation) advantages just described. The form and structure of these OLI advantages then determine the extent of multiplant operations. This suggests that any explanatory model of international production must take account of new variables, and particularly those to do with location specific systems and policies, (which do not usually vary between regions *within* a country e.g. those to do with operating in different political, currency and tax regimes); while others, which also influence the siting of domestic economic activity, e.g. communication and labour costs etc. take on different values.

III

Using this kind of approach, let me now turn to examine some aspects of the interaction between MNEs and the countries in which they operate in the last 25 years or so. We can identify three fairly distinct stages in this interaction. While the precise timing of each stage may differ between companies and countries, by and large, the first lasted from the early 1950s to the mid 70s; the second from the mid 60s to the mid 70s and the third from the mid 70s to date. For reasons which will become apparent, I shall call them respectively the honeymoon, the confrontation and the reconciliation phases.

a) *The Honeymoon Phase*

Any partnership, and particularly one which is intended to be a lasting one, starts off with each partner having a great expectancy of what the other can offer; although this is sometimes more a matter of faith than anything else. And certainly, if love is not blind, mutual attraction does tend to wear rose coloured spectacles, which magnify the

good and overlook the less desirable features about one's partner. So it was with the early post-war interface between MNEs — or foreign direct investors as they were then known — and the countries in which they operated. From the viewpoint of both newly emerging developing nations and war ravaged Europe, the capital, technology, managerial skills and entrepreneurship of US firms were sorely needed; but, due to a shortage of dollars and an inadequate international market for these assets, they could only be obtained via equity investment, i.e. they remained internalised within the transferring firm. During these years, US economic hegemony was at its peak, and American corporations dominated international production just as UK firms had dominated world trade a century and a half before. At the same time, US manufacturers were looking for new markets for their products, (particularly in the late 1950s, when some of the steam had gone out of the domestic economy) and new sources of materials to supplement indigenous supplies.

On the face of it, it seemed a perfect partnership; although in some cases, it was Hobson's choice to host countries, as, at the time, only MNEs possessed many of the assets or markets they needed. And it was this very monopoly which gave rise to the first signs of discontent in the relationship. But in the 50s and early 60s at least, all (or most) was sweetness and light, and with the international economic climate, fashioned at Bretton Woods and Havana in the mid 40s and ensuring exchange rate stability and a well ordered trading regime, the scenario for international business was more promising than at any time since before the first World War.

One other thing is worth mentioning. Most MNEs in those days were quite small, and involved in many fewer countries than they are today. Most manufacturing affiliates, too, were set up as import substituting ventures, and were truncated replicas of their parent companies acting independently of each other, and closely identified with the interests of the host country. Only in the primary goods sectors had foreign corporations evolved anything approaching a global product or marketing mandate, or was there in much intra-firm trading. The main impact of such corporations, in these years was, then, in the assets they provided, rather than the way in which these, and local resources, were allocated.[7]

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[7] I.e. their ownership advantages were of the first and second, rather than the third kind identified on page 353.

b) *The Confrontation Stage*

As a marriage passes out of its honeymoon stage and becomes more firmly established, the partners are better able to assess how far each is, *in fact*, able to satisfy the other's aspirations. Sometimes this learning process affects the attitudes and behaviour of one or both partners; sometimes the character of the relationship changes; sometimes the balance of influence shifts. But one thing is certain, after a time, each partner becomes aware of the weaknesses as well as the strengths of each other, and the costs as well as the benefits of the relationship.

The most far reaching changes in the international economic climate of the 1960s and early 70s stemmed directly from the growing political independence of many developing countries, a better identification of their economic goals and a more realistic perception of their capacity to achieve these goals.

This national self awareness, coupled with a Keynesian approach to economic management, and the setting up of new economic systems and policies, was occurring at a time when MNEs were gaining a substantial foothold in many host countries. As more emphasis began to be given to such developmental goals as satisfying basic needs, advancing self reliance, improving the balance of payments, and raising the level of technological capacity, so foreign direct investment became evaluated in these terms, and not surprising, in one direction or another, was found wanting. Gradually, it dawned on Governments that the kind of contribution which MNEs might make to development was not always or necessarily that which they most needed. To be sure, foreign firms provided technology, but was it always the appropriate kind, or at the right price? True, their affiliates might help to save imports, but did they always buy as much from local producers as was socially desirable? Admittedly, they might export part of their output, but was not this restricted to markets designated by their parent company? Agreed that they created employment, but were not their production methods more capital intensive than those of indigenous firms, and did they always recruit or train local management as well they might?

On top of this, MNEs were perceived to transmit a way of life which was not always welcomed, and, through advertising and other promotional means, adversely influence social and cultural values. By their presence and behaviour, they could drive out, or preclude the entry of, indigenous competitors; while, in refusing to transfer high value added activities from their home countries, and/or by internalis-

ing technology transfers, they could lessen the chances of a host country achieving even a modest technological viability. Finally, because of their monopoly power, they were able to earn high economic rents, and so the local net output created by them might be minimal and indeed, in some cases, negative.

These were years too, when the management style and organisational strategy of some of the larger MNEs was changing. As the activities and geographical spread of their foreign affiliates increased, so did the tendency of corporations to adopt a more centralised and multidivisional control structure, while decisions about capital investment, product range, sourcing and markets, were more likely to be taken from a regional or global perspective. The trend too towards the international standardisation of some products, and specialisation of processes and markets, placed an increasing premium on quality control, the continuity of output, the protection of proprietary rights, and transaction cost economising, all of which encouraged a more integrated organisational structure of MNEs and conferred upon them ownership advantages of the third kind described on page 353.

In the later 1960s, fixed exchange rates held good, world economic growth continued apace and inflation was generally under control. But the system was under great strain, particularly when the US balance of payments position turned sour and the US dollar lost some of its appeal as a reserve currency. Two events in the early 1970s — the devaluation of the dollar and the huge price rise of oil by OPEC — heralded a watershed in post-war international economic relations. These events, added to the growing frustration of many developing countries with the inability of the existing economic order to reduce the income gap between themselves and the developed nations, sparked off a period of intensive North/South confrontation. Though much of the debate was rhetorical, it did create an uncongenial climate for international business. In the first half of the 1970s MNEs came under increasing scrutiny and attack. Not only were they criticised on the grounds of their unacceptable behaviour,[8] and uneven contribution to economic development, but as an expression of a no longer acceptable international economic system; if the system could not be changed, *inter alia* because of the inadequate bargaining strength of developing countries, then, at least, some redress might be taken against one of its institutions viz. the MNE.

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[8] The most blatant example being the ITT intervention in Chilean politics.

This flexing of muscles by many countries, including some developed countries, e.g. Canada and Australia, was both understandable and inevitable, even though the actions taken was often imprudent and counter-productive.

The early 1970s were the 'high noon' of confrontation between several nation states and MNEs. The measures taken by Governments are well known and already part of history;[9] they ranged from outright expropriation of foreign assets of MNEs, through restricting the level and direction of new investment, to laying down strict performance criteria for foreign affiliates and controlling dividend and capital repatriation, to aiding indigenous firms to compete more effectively against foreign affiliates.

The response of the MNEs — which has not been so well documented — was predictable. Where their subsidiaries were already fully integrated into the local economy (as in the case of many older import-substituting ventures) but were still earning an economic rent, they absorbed the costs of intervention — but thought twice before investing any new capital. But in other cases, their options were wider; these ranged from restricting the transfer of technology or the introduction of new products, to circumventing controls on income flows through transfer pricing manipulation, to switching — or threatening to switch — production to a more congenial environment, to trying to persuade their home governments to use their economic or political leverage against offending host governments.

In the main, this kind of reaction enraged host countries even more, especially where, in order to compete for the same foreign investment, they were forced up to pay even higher economic rents. So harmonised regional action as, for example, taken by the Andean Pact countries and EEC, and an international consensus in the form of the Commission on Transnational Corporations [10] (TNCs), and other UN bodies, was urged to strengthen the negotiating and bargaining power of host nations; and also to provide more information about MNEs and their role in the development process. Some of us involved in these early discussions saw the Commission on TNCs, in particular, as a kind of marriage guidance counsellor, which might provide a forum for a

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[9] See, for example, the various reports of the U.N. Centre on Transnational Corporations, especially UNCTC (1978a and b) (BOARMAN and SCHOLLHAMMER (1975) and LALL and STREETEN (1977)).

[10] The UN's preferred nomenclature for MNEs.

dialogue between MNEs and governments, so that each might be better informed of what the other expected, and had to offer; and be more appreciative of the interaction between their policies and strategies.

c) *Reconciliation*

As often happens, just as one is beginning to find a solution to a particular problem, the problem becomes less pressing or ceases to exist. The latter 1970s saw Governments learning from the experiences of the previous decade, refining, modifying and extending policy instruments to better harness the contribution of foreign direct investment — witness the very sophisticated machinery now used by some Latin American and East Asian countries in their dealings with non-resident companies; while, at an international level, attention has centred on drawing up codes of conduct or guidelines of behaviour for MNEs, and improving the flow of information about their activities. There are now encouraging signs that Governments have made progress in their understanding not only of the costs and benefits of different types of MNEs and foreign direct investment; but of those of obtaining resources through alternative routes. If the 1960s and early 1970s were a period of disillusionment about the net benefits of international business, the later 1970s brought with it no less disenchantment about the gains offered by unbundling the package of resources provided by MNEs. But the result of a sometimes costly learning process has been a more enlightened appraisal of the alternative forms of resource importation, and a more positive and selective set of policies towards MNEs. At the same time, MNEs have become more cognisant of the ways in which their operations might not always work in the best social interests of the countries in which they operate. A new and better trained breed of managers and civil servants has emerged, and the focus of bargaining has moved to promoting a more harmonious and mutually beneficial relationship between the parties, from that of extracting the most economic rent out of each other.

These shifts in attitudes have been sparked off and shaped by changes in the ESP configuration of countries and the OLI configuration of firms. I would simply emphasise three such changes. First, and most important, there has been a widening of the sources of many of the assets which, in the 1960s, were largely monopolised by US and some

European MNEs. The markets for many kinds of technology, management skills and capital have become less imperfect, and hence the incentive to internalise their sale has lessened. Second, and allied to the first, an increasing number of countries are themselves engaging in foreign direct investment — South Korea, Brazil, Hong Kong and Singapore are among some recent examples[11] — and, as a result, we see movements in disembodied intangible assets beginning to resemble those of goods embodying these assets, with intra-industry international production developing along the lines of intra-industry trade (Dunning (1981b)). But third, while we observe a substantial growth of all types of non-equity or contractual resource exchanges, we also see more integration between the activities of some MNEs, which has occurred in spite of the volatility of exhange rates and an unstable monetary environment of the latter 70s. This has led some countries to ask themselves how far do they want to be locked into a kind of international economic order that the division of labour imposed by MNEs seems to require; for the dilemma is that, the more unique the contributions of MNEs to development, the less amenable they are to Government control.

There.is, of course, a political dimension to what has happened in the last decade. With a few exceptions — the French elections being a noticeable example — Governments have moved to the right, and with this, policies have been modified and more emphasis has been placed on the market as an allocative mechanism.[12] Moreover, countries which have grown the fastest in the past decade are generally those which are favourably disposed towards inward direct investment, and accept the need to be economically interdependent with the rest of the world. But Governments come and go, and policies, and even systems, come and go with them. The scholar evaluating the ESP paradigm from a longer term perspective, has to try and discern broad trends, and, with the usual caveats, I would argue that the happenings of the last decade, viewed in this context, do allow us to make certain observations about the likely course of international business.

d) *Towards a Mature Relationship*

The last few years have seen signs of a more mature and balanced relationship emerging between MNEs and Governments. Each now

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[11] For an examination of MNEs from developing countries see KUMAR and MACLEOD (1982).

[12] Though often within the framework of a well defined and articulated economic and industrial economic strategy e.g. as in the case of Japan.

knows the conditions under which either may, or may not, be expected to contribute to its well being. But because the economic and social goals, the ability to achieve these goals, and the bargaining power of countries differ, it follows that one might expect a wide divergence of policies towards the involvement of MNEs. Moreover, there is nothing permanent about an ESP configuration of a particular country; the opening up of some Eastern European countries and China to international business is testimony to this. Similarly, MNEs vary in size and strategy and the OLI values affecting their behaviour will change over time.

One of the lacunae in the literature on international business is a dynamic approach to its role in economic development. What I believe is needed, is a re-interpretation of W.W. Rostow's model of the economic growth process — first presented in the late 1950s, (Rostow (1959)) — and an extension of Hollis Chenery's analysis of transitional growth and world industrialisation (Chenery (1977, 1979)), to explicitly incorporate the various modalities of international economic involvement. In formulating such an approach I would like to think that some use could be made of the ESP/OLI paradigm; and that, although, the value of the explanatory variables may fluctuate wildly both between countries and over time, some useful hypotheses might be made about the interaction of international business and the stage and direction of economic development.

In the last two years I have been exploring the concept of an international direct investment development cycle.[13] Put in its simplest terms, it comes down to this. In the initial stage of economic development, there is only a very limited role for foreign business, however rich a country may be in natural resources, basically because of the inadequacy of its commercial, technological or educational infrastructure, and/or insufficient domestic markets. In the second stage of development (when gross national product per head in 1980 values reaches around the $ 400 mark) — but occasionally well before, e.g. India — foreign business may be attracted by the prospects of larger domestic markets and better production capabilities; import substituting investment may be aided by local Governments imposing import controls, and by foreign firms anxious to gain a presence before their competitors. On the other hand, in the case of countries whose

[13] See Chapter 5 of DUNNING (1981a).

prosperity relies more on the export of primary products, then *ceteris paribus*, improved infra-structure facilities — particularly roads and docks — may be sufficient to lower the costs of production and marketing to an economic level. However, as with import substitution investment, firms may wish to internalise the technology transferred, not only to maintain product quality and protect property rights, but also to exploit the gains of integrating new activities into the existing operations, e.g. to guarantee supplies. At this stage of development, information markets are likely to be extremely imperfect, and consequently, the transaction costs of contractual resource flows will be high. Finally, depending on the availability of cheap and well motivated labour, in some larger industrialising economies MNEs may begin assembling and processing of goods for export to industrialised countries.

It is at this point that most explanations on the determinants of international production seem to stop; indeed their interest is largely confined to discrete acts of investment, rather than the process by which the pattern of foreign involvement is built up. But let us take our argument a step further. When one looks at the role of MNEs in developed countries, one observes similar types of import substitution and export oriented investment taking place, although the sectors in which MNEs dominate may be different. But one also sees a different type of investment which, like intra-industry trade, is primarily a phenomenon of the advanced industrialised countries; this is rationalised investment — of the Philips Eindhoven type — which is geared to exploiting the advantages of product or process specialisation, scale economies and the economies of synergy. Unlike import substituting investment, rationalised investment requires to be centrally coordinated, and the resulting pattern of resource allocation may not always be consistent with individual host country goals.

The link between the role of MNEs in developing and developed countries lies in the interface between MNEs and the development process via the ESP variables. Ignoring the role of Government for the moment, factors like size of country, pattern of resources and economic distance from the main centres of technology and markets play a crucial role in influencing the OLI configuration of both foreign and domestic firms. But I would expect that as a country moves along its development path, its indigenous firms would begin to generate their own ownership advantages in those sectors which required the type of resources in which it has, or is developing, a comparative advantage. At the same

time, expanding markets and changing costs of its endowments might increase the demand for new products which required the kind of resources which foreign firms were best able to provide, either by trade or foreign production. On balance, I would expect that, as it approaches economic maturity, a country would become *more* rather than less involved in international production, though its *balance* as a net inward or outward direct investor would very much depend on the structure of its resource endowments *vis à vis* the rest of the world: cf. the case of Canada with that of Japan.

What is perhaps more dificult to predict is the form in which the changing advantages of international business will be exploited. The choice between trade and foreign production is not the real issue, although, in passing, one might suggest that as countries develop, the case for international production based on differential factor endowments weakens; instead the options rest increasingly on differences in technology and consumer tastes between countries, and the opportunity for scale economies.

I earlier argued that the growth of MNEs — especially in the late 50s and early 60s — rested on advances in the technology and organisation of intra-firm information flows over space, and on the continued imperfections of markets. The relative decline in the MNE as a resource or rights transferor (i.e. its acting as an arbitrager in shifting resources from where they earn less to where they earn more) over the past 15-20 years may then be put down either to its reduced efficiency as an organisational unit or to an improvement of the external market for the allocators. The evidence strongly supports the latter hypothesis; indeed, advances in intra-firm communication and information technology have continued to favour multinational hierarchies. But the widening of alternative sources of technology, the decline in the transaction costs of intermediate products, especially some primary products and nature or standardised technology, have all combined to make licensing agreements, management contracts, turnkey operation and other non-equity resource flows more viable than once they were.

However, this tendency has not occurred in all countries or in all sectors of activity; indeed in those sectors at the vanguard of technological progress, e.g. fibre optics, micro-chips and bio-technology, the markets for new technology remain as imperfect as ever, and MNEs continue to dominate; moreover, as we have seen, as firms grow, they tend to generate the kind of ownership advantages which are not readily marketable. Since production and trade in both kinds of products is

mainly between developed countries, it is not surprising that the 100% owned affiliate still flourishes in these areas. It also remains the main mode of involvement in sectors in which the advantages of internalisation are strong (e.g. Japanese trading companies are 100% owned, even if their manufacturing associates are not, as are most export-platform affiliates).

From this viewpoint, the future of international business — like its past — rests on the extent, pattern and geographical distribution of technological and organisational advances. Recent innovations in data retrieval, storage and dissemination systems — particularly trans-border information flows — suggest that the boundaries of large firms will be pushed further out and that hierarchies will be even easier to manage. However, the human factor — e.g. the huge costs associated with human error and disruptions in large organisations — and Government intervention, e.g. in breaking up or controlling conglomerates, may have the opposite effect. Innovations of new products and processes will continue, but their direction and rate — as opposed to the dissemination of *existing* technology — may well condition the extent to which contractual resource flows will replace direct investment as the main vehicle of resource transference. At the same time, the likely spread of ownership advantages among firms of different nationalities, and the growth of intra-industry production, suggests that a lot of international sub-contracting will be internalised as firms wish to exploit non-marketable advantages.

What, now, of the role of Governments in the development process? More than anything, Governments have influenced the modality of resource transference across boundaries, although sometimes (and Japan and Korea are classic cases) — through their technological and industrial policies — the ownership advantages of their own firms as well. Governments also affect international business by the economic systems they operate and the particular policies they pursue. We have seen that these change with the political complexion of Governments, and there is only a faint suggestion that S and P variables vary with economic development, with industrial maturity being associated with less rather than more State intervention in trade and investment.

More important, perhaps, is the extent to which countries wish to be independent or interdependent of each other. With so many uncertainties (e.g. economic and political stability and the future of non-renewable resources), but with the growing internationalisation of ideas, customs and technology, most countries pursue a schizophrenic

course; they want the benefits of interdependence but not the costs. Most noticeably, they wish to maintain their economic and political sovereignty. The trade-offs vary too according to the relative bargaining powers of MNEs and host countries, and the way in which the advantages and disavantages of interdependence change over time. Thus regional integration is a recognition of the benefits of large markets: while a self-sufficient energy or science and technology policy suggests that countries particularly value their economic autonomy.

After a century of unparalleled economic expansion and the acceptance of the benefits of interdependence, the inter-war years saw most countries adopting a much more insulated stance, with Governments seeking more control over their own destinies. The post World War II period up to 1971 tried to capture some of the spirit of the 19th century by emulating the conditions which made for its prosperity; but these too had their costs, and it was these which countries were seeking to minimise in the 70s as they moved towards a new mercantilism, with economic stability tending to give way to self reliance as the main driving force in many parts of the developing world.

But underlying these changes in the international economic climate, there do seem to be a number of irreversible trends. Governments are much more active in the areas of social programmes, defence and environmental protection, and in spite of political swings, are likely to continue to be so. In the international arena, a policy of controlled geocentricism seems the most probable future scenario, with nations seeking to benefit from economic co-operation with the rest of a shrinking world, yet, either separately or through sympathetic sectoral or regional groupings, to influence supranational decisions and minimise the adjustment costs of industrial restructuring. Except for very large countries, I believe a policy of economic isolationism will be increasingly more difficult to sustain. All this, of course, places an enormous burden on existing regional and international organisations — which are likely to take on board more co-ordinative responsibilities, e.g. in the energy and environmental fields.

In summary then, I believe that the response to international business by countries and international organisations will increasingly parallel that towards trade; and that, in due course, similar mechanisms will be devised to provide an orderly framework for international production and resource transference, as GATT provides for trade in goods. For the foreseeable future, however, control will continue to be

exerted through unilateral policies of Governments — aided by more intensive monitoring of company behaviour — codes and guidelines, the goodwill of companies, the actions of organised labour, and, not least, by competition.

Within this kind of scenario, I would expect international business to flourish, but that its character will change and its structure will become a lot more diversified. The integrated MNE should remain a dominant force in technology and information intensive industries, but probably will not be the typical foreign investor of the future. With the advent of telematics, the opportunities for smaller firms to internationalise their operations will increase. At the same time, there might be an extension of functional internalisation based on either equity participation, e.g. as exists in import and export merchanting, or through contracts, e.g. as exists in the hotel industry.[14] There might be, too, a growth of time-limited equity arrangements, particularly in the less technology intensive import substituting sectors, with MNEs from Japan and the more advanced developing countries playing an active tutorial role (Kojima (1978)); while developed countries will probably display a greater propensity towards joint-ventures, particularly where non US and European firms are involved. At the same time, as mergers and rationalisations are part of domestic economic life — particularly in times of structural change — and, as long as imperfections remain in international capital anf foreign exchange markets, I would foresee an increase both in the exit and entry of MNEs and of transborder acquisitions, with one type of MNE, viz. the multinational conglomerate, behaving more like an institutional than a direct investor. Finally, I would envisage a greater role of Governments as initiators, and the international capital market as financiers, of projects in which foreign firms will act more as contractors or sub-contractors than as entrepreneurs. Gone are the days when foreign companies *own* country-specific natural resources which are the basis of that country's comparative trading advantage with the rest of the world. This indigenisation of assets will become more widespread in some manufacturing and service sectors — with the role of the foreign direct investor being increasingly that of a catalyst for self-development, rather than that of an economic imperialist.

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[14] Which route is chosen depends on how far the benefits of internalisation can be captured in an contractual agreement.

More generally, in many ways, the international economic climate of the last quarter of the 20th century will be very different from that of the third quarter. Then the emphasis was on technological innovations and productivity improvements — spurred on by the need to cope with rising living standards and manpower shortages; this generated ownership specific advantages of a capital or technology intensive kind. In the foreseeable future, in an industrialised world of limited growth and substantial unemployment, environmental concern and the depletion of non-renewable resources; and in a developing world, increasingly conscious of its need to satisfy basic needs, the innovatory emphasis may well be on materials and energy saving and increasing agricultural output.

If this diagnosis is correct, it may be that the kind of technological advances of the 80s and 90s will require a different kind of organisational form to exploit them. As some countries move towards a post-industrial stage of development, more innovations will occur in the service sector (already this has happened in the sphere of project management, consultancy and data provision and interpretation). It is by no means certain that the resource endowments needed for these innovations and their development will be those which generated their predecessors; nor that the hierarchial structure of firms evolved during the 60s and 70s will be suitable for the remaining years of the 20th century.

All this suggests a constantly shifting role of MNEs in the world economy and the form of their involvement. But this is no less true of the domestic business sector in many countries; very few firms supply the same product or markets that they did 50 years ago. Yet whatever the problems of size and diversification, for every firm that cannot manage to cope efficiently, another can — spurred on by some new technology or organisational advance, which it can accommodate in its hierarchy. That to my mind is the test; the rate of growth of new innovations, institutions and ideas on the one hand, and the willingness of countries to be economically interdependent on the other.

Twenty years ago, I would have argued that a world without multinationals could only have been achieved at a very real cost to economic welfare. Today, I am not so sure. Due to the increasing speed at which technology is disseminated, it may be that some retrenchment of the multiplant phenomena and the ownership of foreign assets is on the cards. Add to this the possibility that the technologies of the future will require a different form of governance for their commercialisation,

then it is at least possible that some of the giant MNEs of today will be the dinosaurs of tomorrow. This does not necessarily auger a decline in international business, but rather that the MNE as a packager and a transmitter of resources may no longer be as unique or appropriate an organisational form as it has been in the past; and that the future will see the ingredients of growth differently bundled, and channelled through the market and by contract between independent firms as well as by foreign direct investment.[15] Certainly, the dominance of the kind of MNEs of the 60s — particularly US based MNEs — is unlikely to return again.

May I conclude by observing one particularly disturbing feature of the world economy in the early 1980s, which, to a large extent, is a response to the events of the past decade. This is the drift to protectionism by the industrialised developed countries.[16] This drift does not primarily take the form of restrictions or traditional non-tariff barriers, but of domestic interventionist policies by governments which affect the kind of and standard of goods and services produced, means of procurement and the terms on which they are traded.

Such protectionism is reminiscent of the beggar-my-neighbour trade policies of the inter-war years but goes well beyond it. In the 1930s, non-resident companies tried to overcome trade obstacles by setting up local producing facilities. This may again occur in the 1980s particularly with respect to Japanese penetration of European and North American markets. But, unlike in the inter-war years, governments today are a major — and in some cases the only — purchaser of goods and services, particularly those supplied by MNEs in high technology industries.

Now, while GATT rules generally forbid member governments to impose discriminatory import duties, and the OECD guidelines for MNEs endorse the principle of equitable treatment between national and foreign owned firms; it is not difficult to find ways round their rules and guidelines particularly where sensitive areas of national security are involved. And it is worth observing that the impact of many of the new technologies, e.g. telematics, microchips and biotechnology, straddles both the private and the public domain; and that commercial and social interests are becoming more difficult to disentangle. My concern is lest governments, in their desire to advance short term

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[15] The increasing relevance of the non-equity forms of resource transference is now being explored by OECD Development Centre. See e.g. OMAN (1980).

[16] Described, for example, in a special issue of *Economic Impact* (1982).

national goals will introduce policies which might jeopardise the fabric of international production built up by MNEs in the last two decades. Indeed, whereas in the 1960s and 1970s the main battleground of the MNEs was in the developing world, in the 1980s it could well shift to Europe, United States and Japan. Dare one hope that the combined wisdom of individual governments, international agencies and MNEs may be deployed to avoid such a conflict?

Reading

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