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DIRECT INVESTMENT TRENDS



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DIRECT INVESTMENT TRENDS**

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## FOREWORD

1. In June 1976, at the meeting of the OECD Council at Ministerial level, the Ministers, acting on behalf of their governments, adopted a Declaration on International Investment and Multinational Enterprises.<sup>(1)</sup> In this Declaration the governments of OECD Member countries stated, inter alia, that "international investment has assumed increased importance in the world economy and has considerably contributed to the development of their countries"; that "multinational enterprises play an important role in this investment process"; and that "co-operation by Member countries can improve the foreign investment climate, encourage the positive contribution which multinational enterprises can make to economic and social progress, and minimise and resolve difficulties which may arise from their various operations". The aim of the Declaration was to promote strengthening of co-operation among Member countries in the area of international investment and multinational enterprises through interrelated instruments.

2. At the June 1979 meeting of the OECD Council at Ministerial level, the Ministers, acting on behalf of their governments, agreed to the suggestions included in the Review Report of the 1976 Declaration and Decisions proposed by the Committee on International Investment and Multinational Enterprises (hereinafter called the CIME) which is the body in OECD responsible for carrying out, inter alia, the tasks assigned to it in the Declarations and Decisions.<sup>(2)</sup> The Review Report, inter alia, recommended that the CIME include in its medium-term work programme periodical analytical studies of recent trends in international direct investment flows.

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- 1) International Investments and Multinational Enterprises, Revised Edition 1979, OECD.  
2) Review of the 1976 Declarations and Decisions on Guidelines for Multinational Enterprises, OECD, 1979.

3. At its October 1979 meeting the CIME therefore undertook an analysis of recent international investment trends. The present report is the result of this work. It has benefited from discussions that have taken place in the CIME, from contributions by delegations and from suggestions by BIAC(1) and TUAC.(2) It has been approved by the CIME.

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1) Business and Industry Advisory Committee to the OECD.  
2) Trade Union Advisory Committee to the OECD.



## INTRODUCTION

4. The present report identifies the main trends in the growth of international direct investment in recent years both as regards the total volume and the direction of the major flows. Also addressed are changes in methods used for investing abroad. However, the present report does not intend to cover many areas of interest of the CIME, and in particular the effects of international direct investments on home and host countries economies, or trends in governmental policies with respect to international direct investment or multinational enterprises.

The report notes that the slower growth of direct investment flows in the aggregate conceals some dynamic sectors of growth and some significant geographical swings. Thus industrial projects in the developed countries have been buoyant as regards European and Japanese investment in the United States. A few newly-industrialised countries outside the OECD area have also figured as major recipients of direct investment from abroad. Direct investment in services as distinct from industrial or raw material production has emerged as an important component of the total. The means used for implementing direct investment projects have become more diversified as investors have adapted to changed investment conditions and to policy requirements of host countries. In sum, the present day world scene as regards direct investment is much more diversified than twenty or even ten years ago. More countries are involved as home and host countries, there are many more firms who are investing significantly abroad and ways of doing business have become more diversified.

5. Part I of the report gives a brief synopsis of developments during the period of 1960s and early 1970s in order to better situate more recent trends. Part II focuses on those trends that have attained significance in recent years and which seem likely to be of greatest relevance for the future. Part III pulls together the information available on major changes underway in the methods, actors and forms of direct investment.

6. A caveat is necessary as regards the coverage, comparability and reliability of published sources of data concerning international direct investment. Balance-of-payments sources provide for the most consistent data available but are incomplete.<sup>(1)</sup> Consequently, the report uses other sources of data in addition to those derived from balance-of-payments figures, where such sources seem to furnish valid pointers to recent trends. The reader who wishes to secure more detailed information regarding the availability of data in direct investment flows and of the problems in using such information is referred to the statistical annexes at the end.

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1) Work is at present underway in OECD designed to improve the quality, quantity and comparability of statistics on direct investment.

## Part I

### SALIENT FACTS OF INTERNATIONAL DIRECT INVESTMENT TRENDS FROM THE EARLY SIXTIES TO THE MID-SEVENTIES

7. Looking first at the historical background, foreign investments have played an important role in the international economy since the latter part of the XIXth century. The majority of the earlier investments were in the form of portfolio investments in fix-interest loans and securities. The United Kingdom was the most important creditor nation, investing abroad up to 7 per cent of its GNP in the years preceding World War I. However, a few companies undertook direct investment and thereby established foreign productive operations during that period. The 1920s witnessed an increasing role of the United States as a source of foreign investment; and, in parallel, the rate of direct investment expanded to account for 25 per cent of total overseas lending. In the 1930s direct investment, especially from the United States to Europe, continued to grow but only slowly, while portfolio investment suffered the most from the severely depressed levels of economic activity. The economic climate for international investment improved dramatically after the Second World War and produced an upsurge of private investment, the majority of which was direct rather than portfolio capital. This was in particular the case for United States direct investment in Europe, as United States firms gradually moved in, in order to retain the markets they had established through trade in the immediate post-war period. International direct investment continued to expand in the 1950s, but the flows involved were not as important as those which were to develop in the 1960s, for in the earlier decade foreign investment activities were still hampered by remaining barriers to capital flows, including the non-convertibility of major currencies, which during the latter years of the 1950s were gradually reduced, particularly among the OECD Member countries.

A. THE EMERGENCE OF INTERNATIONAL DIRECT INVESTMENT  
AS A MAJOR PHENOMENON

8. The period ranging from the early sixties to the mid-seventies witnessed a rapid development of international direct investment both in absolute terms and relative to the growth of other economic aggregates such as visible trade, domestic investment and GNP. The United States remained the dominant country of origin, although some European countries began to be more active as exporters of direct investment. International direct investment was heavily oriented towards developing sources of primary products and oil at the outset of the period. Later, an upsurge of direct investment in manufacturing developed in the OECD area due to a number of factors, including, in particular, the need for large firms to protect their markets developed through international trade but threatened, inter alia, by tariff cuts among members of custom unions and the growth of domestic firms in these markets.

9. Over the 1960-73 period the average annual growth rate of total outward international direct investment flows,(1) in current dollars, as measured by the total for 13 OECD investing countries,(2) was close to

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- 1) The international direct investment flows considered here and in paragraphs 20-23 below are those published in the balance-of-payments accounts under the heading of direct investment. They capture international direct investment when it gives rise to international capital flows. Their evolution is of independent interest as they measure properly, for instance, efforts made by countries to invest abroad. However, these flows do not include other important sources of finance for the growth of assets under foreign control such as reinvested earnings (which are available in the balance-of-payments figures for Australia, Canada, the United Kingdom and the United States, and more recently the Netherlands and Germany under various headings, and are sometimes included in direct investment flows), depreciation provisions of foreign affiliates, local borrowing and borrowing in third countries. The absolute amounts of direct investment indicated by these flows do, therefore, significantly underestimate the growth of assets under foreign control. It nevertheless seems possible to assume that trends in direct investment flows as measured from balance-of-payments data are a sufficiently reliable proxy for trends in the total growth of foreign-controlled assets (see also paragraphs 51-53 below and the technical notes to Annex I).
- 2) Australia, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Norway, Spain, Sweden, United Kingdom, United States (see Table 3 and Graph 1). Reinvested earnings have been excluded from these data for those countries for which they are available in order to achieve comparability. Reinvested earnings are included in the more heterogeneous stock data presented in Table 2. Unofficial data for Switzerland are presented in that table. It can also be seen that the stock of foreign direct investment by other countries was small and grew slowly until 1973.

12 per cent a year. This figure was approximately one-and-a-half times the average growth rate of OECD GDP in current dollars and practically the same as the growth rate of international trade (14 per cent). This period also witnessed the rapid growth of a number of very large industrial groups with extensive international ramifications. While most of the largest multinational enterprises had been in existence for a good number of years, in this period they grew rapidly, both in the size and in the international scope of their operations, and a growing number of formerly national firms joined their ranks.

10. Looking at some further indications of the growing economic importance of multinational enterprise activities, the order of magnitude of international production by United States-based multinationals, i.e. the production by branches and subsidiaries abroad, was roughly estimated to be some three times the value of United States exports in 1960; and by 1971 this ratio had increased to four times United States exports. In 1960 the same ratio of international production to exports was at a low level for both Germany and Japan but subsequently rose rapidly, reaching a value of approximately 2.5 by 1971.(1)

11. The volume of intra-company trade which passed national frontiers also rose notably. There are few reliable figures on this, but as regards the United States it was estimated that, by the mid-1970s, imports by United States-based multinationals from their majority-owned foreign affiliates were close to 30 per cent of total United States imports.(2) An analysis of the importance of intra-group trade in total international trade concluded that the percentages of the total due to intra-group trade were 22 per cent in 1966 and 25 per cent in 1970, excluding trade with centrally-planned economies.(3)

12. If one looks at the activities of multinational enterprises from the side of the host countries, by the mid-to-late 1970s they occupied a significant share of total industrial activity. Thus, the share of foreign-controlled local enterprises in employment was reported to be above

- 1) Multinational Corporations and World Development, United Nations, 1973. Production by branches and subsidiaries abroad was estimated as a fixed ratio of the book value of net assets. This renders international comparisons unreliable, but comparisons of the situation of a country at different points in time remain valid in low-inflation periods such as the 1960s.
- 2) Transnational Corporations in World Development, A Re-examination, United Nations, 1978. These figures include imports of raw materials. It should be noted that intra-company trade is generally valued at transactions prices, which may differ from market prices.
- 3) Implications of Multinational Firms for World Trade and Investment and for United States Trade and Labour, United States Tariff Commission for the United States Senate Finance Committee, 1973.

15 per cent in the Federal Republic of Germany, Australia, Austria, Canada, France and Italy, while their share in manufacturing sales exceeded 20 per cent and sometimes even 30 per cent in many OECD countries.(1) The relative weight of multinational enterprise affiliates was considerably greater than these averages in some sectors such as oil, electronics, chemicals and the automotive industries.(2)

## B. GEOGRAPHICAL AND SECTORAL TRENDS

13. During the sixties and early seventies, international direct investment, which was still practically all organised by private firms, concerned for the most part two kinds of firms:(3)

- those with a significant multinational dimension already in the pre-war period and engaged in primary sectors of production in less-developed countries and a few OECD countries or in such sectors as food and agricultural machinery the latter being less numerous than the former;
- companies that switched from export to direct investment to protect or to expand their share of sales in foreign markets when confronted with more dynamic local competition or with trade barriers. As was pointed out by R. Vernon and other researchers,(4) such companies tended to be found in oligopolistic sectors, where markets are dominated by a small number of large firms and where barriers to effective entry by new competitors are frequently related to the possession of a superior capacity to innovate based on large R & D budgets. Such advantages tend to be short-lived but can be a powerful influence in the competitive struggle. Chemicals, electronics, automobiles, and household durable goods

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1) See Table 1 in Annex I below.

2) See Penetration of Multinational Enterprises in Manufacturing Industry in Member Countries, OECD derestricted document, 1977 and Addendum in 1979. An updating of this information is underway in the Industry Committee of the OECD.

3) Equities and other bilateral assets represent only a small proportion of Official Development Assistance or Other Official flows (generally less than 5 per cent of the sum of these flows) and not more than 10 per cent of direct investment flows from DAC countries accruing to developing countries (see for instance the annual Development Co-operation, published by OECD and which contained such data). As direct foreign investment in OECD countries by public enterprises is generally included in private direct investment data and as public direct investment emphasizes developing countries, it represents an even smaller proportion of global direct investment flows.

4) R. Vernon, Sovereignty at Bay, New York, Basic Books, 1971.

were the main sectors concerned and not surprisingly they were the major growth sectors in OECD countries during the period. Companies investing in such activities originated frequently from countries having a comparative overall advantage in R & D activities. As they had to rely on the export of capital from their home country to finance expansion abroad, at least at the beginning, such companies were thus placed at an advantage if the parent company was situated in countries with strong currencies and few balance-of-payments problems. The link between foreign direct investment and R & D comparative advantage helps to explain why such companies preferred to expand through wholly-owned new plants rather than joint-ventures or acquisitions.

14. The above technological and financial considerations go a long way to explain why the United States and, to a lesser extent, the United Kingdom were still the major exporters of direct investment capital during the 1960s:

- American companies engaged in primary production already had a strong multinational content and a number of dynamic American companies in growing R & D intensive sectors switched their approach to international markets from export to direct investment. United States' direct investment abroad was close to one-half of OECD originated international investment during the post-war period and up to the early 1970s. This dominant position was bound to be challenged when firms in other countries caught up in a number of technology sectors.
- British firms were traditionally more heavily engaged in primary production and rather less in R & D intensive sectors. France, Sweden and small countries, such as the Netherlands were also involved in the former sectors. However, in all of these countries a number of R & D intensive firms continued to develop and further internationalise their activities. In addition, relatively high labour costs and, in particular for smaller countries, the low elasticity of their labour supplies had for a long time constituted further inducements to invest abroad.
- It was only in the early seventies that German and Japanese outward flows of investment started to grow very rapidly, once rebuilding of their domestic capabilities had been completed. The substantial balance-of-payments surpluses of these two countries and the appreciation of their currencies relative to the United States dollar worked in the same direction. The shares of Germany and Japan in the flows of international direct investment were

close to 7 and 2.5 per cent respectively from 1961 to 1967. But they rose to 12.5 and 7 per cent from 1968 to 1973.(1)

15. The counterpart of the above trends was that European countries, and especially the EEC countries, which later included the United Kingdom, substantially increased their share as host countries for international direct investment flows. Western European countries' share of the United States' stock of direct investment abroad was close to 15 per cent in 1950, 21 per cent in 1961 and 32 per cent in 1968. Simultaneously the share of non-OECD countries tended to decrease from 53 per cent in 1950 to 40 per cent in 1961, and 33 per cent in 1968, this decline continuing in fact until 1974.(2)

16. This orientation of international direct investment towards European countries was related to the fact that the European market was growing very fast and demand was becoming more diversified and sophisticated for high-technology products. The creation of the EEC offered improved prospects for economies of large-scale production to firms setting up in one of the member countries of the Common Market. As international direct investment in primary sectors, and especially in mining, tended to grow less rapidly after the high peak in world demand reached during the Korean war, there was a deceleration of the growth of investment in developing countries despite a growing stream of international direct investment in manufacturing which was to become a major feature of the international investment scene in the subsequent period.

17. Although the mid-1970s have been taken here as the cut-off point for the phase of direct investment which began in the early 1960s, a number of newer trends related to changes in growth sectors and in markets and to diversification of the standard wholly-owned foreign branch or subsidiary pattern began to appear earlier. But they did not begin to have a significant influence on the overall picture until the late 1970s.

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1) See Table 3 in Annex I below.

2) See Table 2.



## Part II

### MAJOR NEW TRENDS IN DIRECT INVESTMENT FLOWS

18. The period since the mid-seventies stands in quite sharp contrast with the period which preceded it in a number of important respects. At the overall level, the previously rapid and steady rise in direct investment flows has given way to a more moderate rate of growth. A search for the causal factors behind this break in the earlier trend is a major purpose of the paragraphs which follow. At one and the same time a cause and a result of this break, the geographical and sectoral distributions of direct investment flows have changed. Technological and market factors and, to some extent also, home and, especially, host country policies have also contributed to this result.

#### A. NEW OVERALL TRENDS AND THEIR SIGNIFICANCE

##### The Statistical Record

19. Since the mid-seventies, whilst aggregate international direct investment has been expanding less fast, the flows between Europe and the United States have become more balanced and some developing countries have managed to attract substantial amounts of international direct investment.

20. A slowdown of the real growth of direct investment flows has taken place. The average annual growth rate of outward direct investment from 13 OECD countries(1) - using capital flows only as the common measure - in current dollar terms in the 1974-79 period, was slightly less than

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1) See footnote (1) to paragraph 9. It should also be noted that according to Table 2, the 13 countries considered here seem to account for a smaller share of worldwide international direct investment in the most recent period, as other countries (including Switzerland) share in the stocks of foreign direct investment has risen from 8.7 per cent in 1973 to 12.3 per cent in 1976.