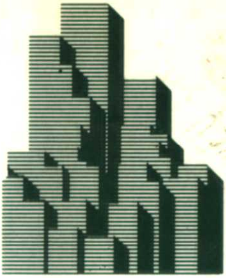

Multinational Enterprise *and* World Competition.

A comparative study of the USA, Japan, *the* UK, Sweden, *and* West Germany.

JEREMY CLEGG

Foreword by John H. Dunning

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MULTINATIONAL ENTERPRISE AND WORLD COMPETITION
A Comparative Study of the USA, Japan, the UK, Sweden and West Germany

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Foreword

This book represents a revised version of the author's PhD thesis. When Dr Clegg began his graduate studies at the University of Reading in 1976, most of the empirical research on the determinants of international production, i.e. production financed by foreign direct investment and undertaken by multinational enterprises (MNEs), was of three main kinds. The first consisted of cross-sectional or time-series studies which focused largely on the geographical distribution, i.e. the *where* of foreign direct investment; the second were bi-national inter-sectoral studies which sought to identify *why* the share of the domestic output of one country, accounted for by foreign affiliates of another country's MNEs, was greater in some sectors than others; while the third centred on trying to explain the form of involvement by MNEs in foreign countries, e.g. whether by equity investment or contractual arrangement.

The particular merit of Dr Clegg's approach is that it is multi-faceted. Indeed, it is ambitiously so, since the author not only attempts to explain the industrial distribution of the different forms of foreign involvement in, or by, five countries; it also does so for three years over a ten-year period for both inward and outward investment. The data, carefully assembled, rigorously analysed and sensibly interpreted, enable the author to make one of the first cross-country, cross-industry, cross-form of involvement and cross-time studies ever undertaken.

It is a thorough and original piece of work and deserves the widespread and careful attention of scholars. It provides many insights into the importance of country and industry characteristics in explaining the extent and pattern of foreign direct investment, exports and non-equity resource transfers; the institutional modes by which goods and services are transacted across national boundaries, and how these have changed over time. The comparisons between the inward and outward capital stake patterns of the USA and Germany, and those of the UK and Japan, are particularly instructive; while the changes which have taken place in the character and form of Japanese outward economic involvement between 1965 and 1975 suggest that the belief by some Japanese scholars that a different theory is necessary to explain the activities of Japanese, compared with US MNEs, may be misguided.

One major conclusion of this book, which includes a comprehensive review of the major theoretical and empirical research on MNEs, is that any worthwhile theory of international production must be part and parcel of a more general paradigm which also explains the possible alternatives to such production. This involves answering questions relating to both the location and ownership of economic activities, and hence drawing upon different strands of economic theory, notably the theory of international trade and the theory of the firm. Dr Clegg also reveals that students of international production must cross traditional disciplinary boundaries, and that, depending on the precise question to be answered, the researcher on MNEs is required to embrace an amalgam of concepts, methodologies and analytical tools.

In the 1980s, many of the issues dealt with by Dr Clegg in this book are the subject of detailed research. But this does not detract from the pioneering contribution of the author in taking a holistic view of the activities of MNEs. The thesis well deserved the joint first prize for the best doctoral dissertation in international business awarded by the Academy of International Business in 1985.

University of Reading JOHN H. DUNNING

Preface and Acknowledgements

The modern theory of the multinational enterprise is far more than a review of the mysteries of large international firms. While it begins with the most fundamental question of all – 'why do they exist?' – it considers in great detail the interrelationships between the ways in which firms compete in the international economy.

The multinational enterprise is at the centre of international competition, and indeed international economics. As the statistics in this book show, the pervasiveness of multinational firms' operations is continually increasing, to the extent that direct foreign investment has grown faster than any other form of competition. What is more, multinationals are involved not only in direct foreign investment, but in trade and many other international transactions – it is easy to underestimate their importance.

The approach taken here is to assess the lessons that a comparative study of five major international economies, the USA, Japan, UK, Sweden and the Federal Republic of Germany, can teach us about the causes and methods of international competition.

This study arises from my PhD at Reading University, in the course of which research I have become greatly indebted to many individuals and institutions. I should like to thank the many economists and government statisticians with whom I have corresponded, unfortunately too numerous to mention by name. In particular I should like to thank the officers and heads of sections of the following institutions: the US Department of Commerce, Bureau of Economic Analysis, the Swedish Statistiska Centralbyran and the Deutsche Bundesbank, all of whom readily provided invaluable material and guidance on statistics.

I should also like to thank Joji Kobayashi of the Japan Securities Research Institute, Professor Mark Casson for most helpful advice and comments, and Panos Michael of the University of Liverpool for his most invaluable counselling on my empirical work.

I am particularly grateful to Mrs Jill Turner, Mrs Meg Wells and Mrs Pat Elgar for the preparation of the typescript, despite the unreasonable demands put upon them by the time available.

I should like to express my deepest gratitude to Professor John H. Dunning, my PhD supervisor at Reading, for his continued academic encouragement, indispensable advice and unswerving support for my endeavours in this most challenging area of research.

JEREMY CLEGG

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1 Introduction and Summary

1.1 WHY THIS BOOK IS NEEDED

There is now a coherent body of theoretical work on the economics of the multinational enterprise (MNE). Empirical work, however, has been severely hampered by the lack of information, particularly of a statistical kind, on the nature and extent of multinational operations. As theory has progressed this deficiency has only become more apparent.

Modern theory emphasises that the economic activities of MNEs must be appraised within the context of the full range of international economic competitive routes, by which firms may contend for international markets. As a direct result the data requirements for the critical investigation of theory have become increasingly demanding.

Furthermore, a number of predictions have been made on the nature of anticipated significant differences between countries in respect of their roles both as sources of, and hosts to, MNEs. This logically implies that a comparative study be made between countries. To date there has been none.

That these projections should be subjected to formal testing cannot be stressed too much, when it is appreciated that this area of research constitutes the economic basis of important policy issues. There exists, therefore, a pressing need for empirical analysis consistent with the modern theoretical perspective. It is the aim of this book to make a contribution towards the satisfaction of this need.

1.2 THE SCOPE OF THE STUDY

Theoretical Approach

While it may be true that there is no single universally agreed theory of international competition, there is a focal point in the literature which provides a clear analytical framework for the elements that a general theory should contain. The approach used in this study uses the analysis of the eclectic theory (Dunning, 1977) and the internalisation approach (Buckley and Casson, 1976). A further advantage of the line of reasoning of this approach is that, in principle, all earlier theoretical approaches relevant to any one or other of the methods by which firms compete internationally, can be better expressed within this framework.

This need for an integrated approach is now generally recognised. In a large number of previous empirical works, typically before the late 1970s, the generality of the conclusions that could be drawn was severely limited. For example, an enquiry based on the industrial organisation approach, e.g. for the USA, could produce results at the forefront of the literature in the early 1970s, but would nevertheless beg the question of whether a truly generally applicable model had been found. Worse than this, the implications of the then-popular industrial organisation approach were that any model obtained should be the same for all countries. The most marked reaction to this doctrine came from Japan (Kojima, 1973), vehemently refuting both the theory and the welfare implications in the case of Japanese investment. Unfortunately, none of these exchanges brought economists any nearer to a general understanding of the factors which explain all forms of international involvement.

It is now possible to look again at these heterogeneous contributions and draw out some which can be fitted into an integrated theory. More recent empirical works have done this for various source countries and hosts, and particularly notable here has been research by economists associated with what can be usefully called the Reading School, and in addition, notably, Swedenborg (1979) and Lall (1980). The distinguishing feature of these studies is that they analyse both trade and production generated by direct foreign investment (DFI), and explicitly recognise the country-specific aspects of their results.

Empirical Approach

The present study takes the need for an integrated framework as its starting point, and extends the analysis for the first time to international licensing, in a manner analogous to the treatment of trade. Also, as modern theory requires, explicit tests are made for international differences in the models obtained for a selection of five major developed countries, using comparable data. Furthermore, the analysis is applied to data on both outward and inward involvement. The principal method of investigation used is regression analysis.

The five developed countries selected for this enquiry are the United States, Japan, the UK, Sweden and the Federal Republic of Germany. In 1975 these together accounted for 73.9 per cent of the estimated world stock of direct foreign investment (Dunning, 1979a). The period covered by the present study is 1965–75. There are several advantages to the choice of a standard time period, and to this one in particular. Comparative statistical investigation requires a close correspondence between the data to be analysed in terms of quality and measurement. The time dimension is one important aspect of measurement. Given this, more trustworthy inferences about the real nature of differences between countries can be made which might not be possible if they were being studied at different times in their development.

The period chosen is particularly appropriate, both because many modern patterns of competition are well developed and because the quality of comparative data is particularly high. This is true to the extent that a similar comparison for a later set of years could not be attempted for as compelling a selection of countries. As it is the analysis is restricted to manufacturing industry. However, this does occupy a central place of interest in the study of the MNE. The information used in this enquiry has been gathered from many national and international sources.

1.3 THE CONCEPT OF INTERNATIONAL PRODUCTION

Here the term 'international production' is used in a wider sense than in some other works, for example Dunning (1981a). The reason for this is simply to standardise on the concept of production for international markets, and to clarify the distinctions among its constituent parts. To this extent the present usage resembles that of Parry (1975), though with the addition of licensing.

Defining international production as production for international markets, therefore, includes the operations of both MNEs and of non-MNEs, where the latter group may only be involved in trade or licensing. The definition of the MNE adopted here is in many ways the simplest, being the threshold definition which states that the MNE is a firm which owns and controls income-generating assets in more than one country (Dunning, 1973).

International production is, therefore, a very broad concept and includes all the business linkages which can occur in the international economy. This will cover all international transactions in goods, services and assets. The business relationship within which these transactions take place is of central interest here. Aside from direct exporting, there is considerable interest in novel forms of international industrial co-operation, which contrast with the full ownership and control of foreign subsidiaries. Such new forms include joint ventures, contractual arrangements for transfers of technology and skills, and services via management contracts (Buckley and Casson, 1985).

In practice, there are three forms of international production with which economists and economic theory are most concerned, although these do represent stylisations of actual behaviour. However, they are the three dominant forms of international competition by value, and this study will make the assumption that they are exhaustive of the value of international production.

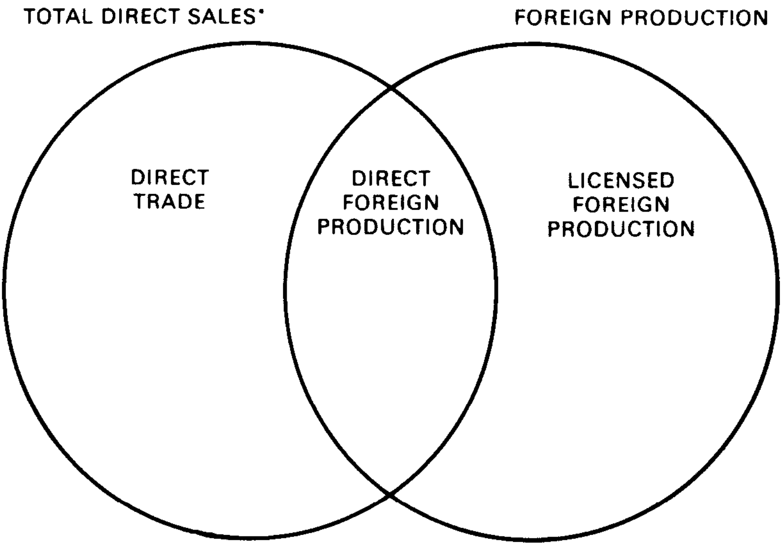
The routes which are considered here are trade, direct foreign production (DFP) and licensed foreign production (LFP). DFP is the value of output generated by direct foreign investment (DFI), and LFP is analogous, being the output generated by licensing. Throughout this study the terms 'DFI' and 'DFP' are used interchangeably, except where the distinction is crucial; their relationship to one another is discussed in Chapter 3. The concept of DFI as a measure of foreign involvement is inferior to that of DFP, therefore; despite this DFI is only referred to here because of its currency in the literature. The definition and measurement of DFI is both more complicated and less instructive than that of DFP, and this is also discussed in Chapter 3.

The relationships of the three routes of international production can be readily appreciated when represented in Figure 1.1.

Unless otherwise stated, the licensing referred to in this study is non-affiliate licensing as opposed to affiliate licensing. Non-affiliate licensing is defined as that between otherwise independent transactors, not related by ownership.

Valuation of Transactions

There will be few other avenues for non-affiliate licensing transactions, other than those recorded in the non-affiliate licensing statistics, so these may be taken as the total, although undervaluation of the



* production owned by the source country firm.

FIGURE 1.1 *International production*

data itself can be a problem. The published trade statistics do not differentiate between non-affiliate and affiliate trade, and the only justification for using their sum as representative of total non-affiliate trade is that internalised trade is believed to have been less important over the period studied. This is not an indefensible assumption unless the level of disaggregation used is particularly high, when affiliate trade may well reach significant proportions of total direct trade.

While international markets external to firms may not exist for various types of transactions in goods, assets and particularly services, this is not necessarily true of markets internal to firms. Here, transactions may not be classified accurately according to the actual subject matter concerned. However, some limited data do exist on affiliate transactions. In such transactions, as with all transactions internal to the firm, statistics or nominal values may not be an accurate measure of the value of, for example, services or technology transferred internationally within the firm. No reasonably objective value is available as it is for non-affiliate licensing; indeed, many internal transactions remain unpriced.

It is therefore impossible, in practice, to build up a composite