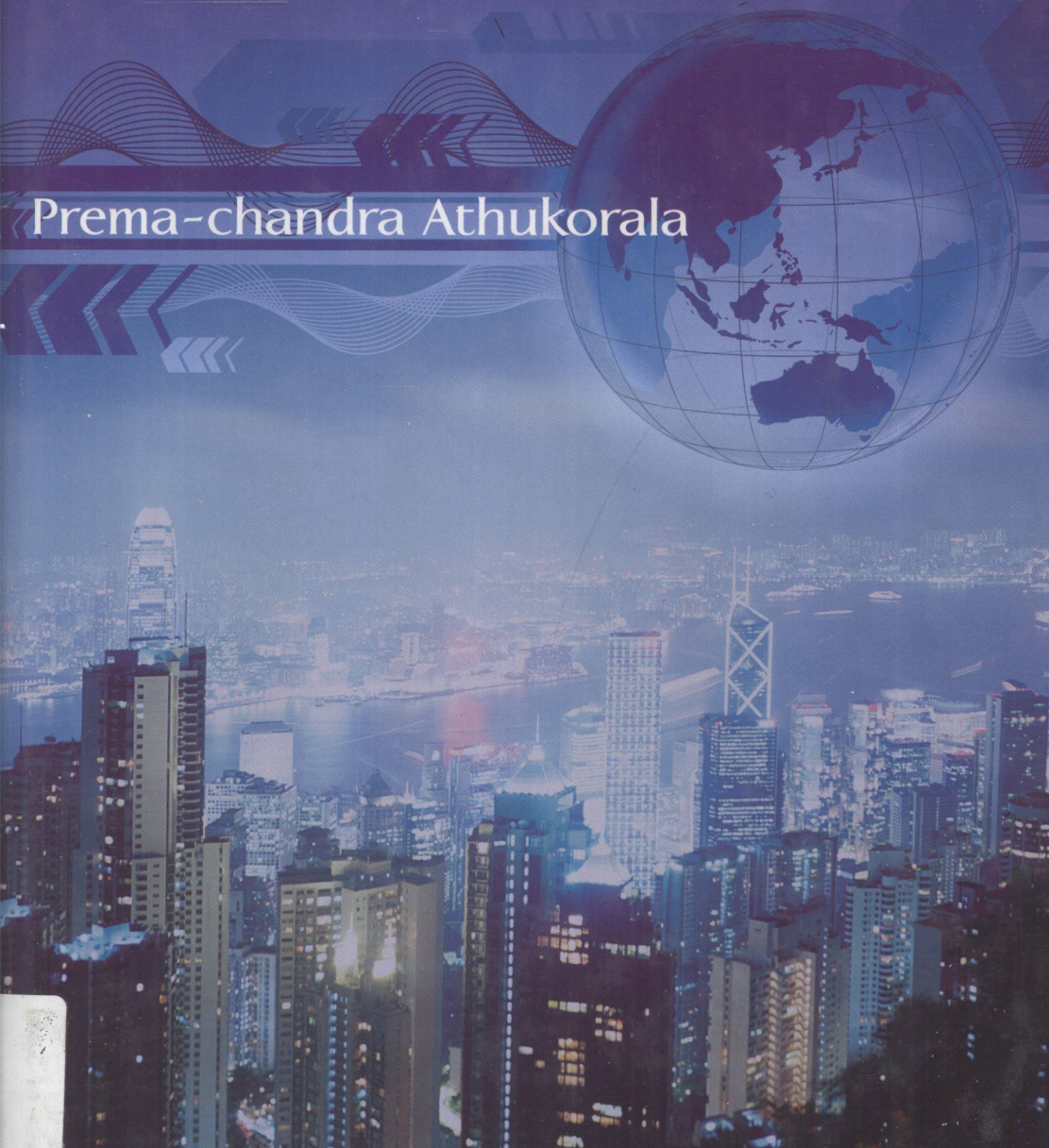




Multinational Enterprises in Asian Development

Prema-chandra Athukorala



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*For my great mentor,
Max Corden*

Preface

Both scholarly and policy interest in the role of multinational enterprises (MNEs) in the contemporary world economy has burgeoned in recent years against a backdrop of growing economic integration of national economies into the global economic system. The data chronicling their global operations have become far more extensive, and the scientific literature, both theoretical and empirical, dissecting their activities has grown much richer. However, the implications of the operations of MNEs for economic development in host developing countries remain elusive. There are many unresolved issues relating to designing policies to regulate and monitor the entry and operations of MNEs as part of the overall national development endeavour. This book aims to fill this gap in the literature by examining some issues central to this policy debate in the light of the experiences of developing countries in Asia. Developing Asia provides a valuable laboratory for the study of these issues, given the long-standing presence of MNEs in many of these countries and the diversity among countries in terms of the stage of development and the timing of policy transition towards greater receptivity to MNE involvement in the national economies.

The book begins with an overview chapter which traces the evolution of post-war thinking and paradigm shifts relating to the role of MNEs and foreign direct investment in economic development and describes the structure and contents of the ensuing chapters. The next chapter gives a broad-brush picture of policy reforms and the investment climate in developing Asian economies and examines, from a comparative regional and global perspective, their experiences as hosts to MNEs as reflected in foreign direct investment inflows over the past three decades. The rest of the book is structured thematically, with each chapter providing a self-contained treatment of a selected theme of the contemporary debate on harnessing MNE participation in national development. The issues covered in the chapters include the role of MNEs in manufacturing export expansion; the ongoing process of international product fragmentation and its implications for trade patterns and global integration of developing countries; global research and development activities of MNEs; the relative stability of foreign direct investment compared with other forms of capital flows in the context of international financial crises, and the implications of the

operations of multinational enterprises for the recovery process; the implications of MNE presence for productivity growth in manufacturing, and the role of host country trade policy in conditioning the outcome; and the role of foreign direct investment in economic transition in former centrally planned economies (based on the experience of Vietnam). The core (thematic) chapters follow a common structure encompassing the state of the debate, relevant theory, methodology and data sources, and policy implications of the results, with extensive referencing to the related literature for those desiring to pursue the individual topics further. Two key concerns that guide the empirical analysis throughout are the interconnection between theory and practice and the choice of analytical procedures and tools with a view to getting the maximum out of the available (limited) data.

I believe that the book will be of interest to a broad audience, consisting of students, professional economists and policy makers. The economics of MNEs is a popular subject in advanced undergraduate (college) and graduate curricula, in its own right or as a major component of courses in international economics, development economics and international business. While there are a number of excellent textbooks on the subject, there is a dearth of empirical evidence and case study material to supplement the analytics. This book aims to fill the gap. Apart from this pedagogical value, the book will also serve as a valuable reference source for professional economists, and policy makers in developing countries and international development agencies in broadening their understanding of the role of MNEs as an integral part of the international dimensions of development policy. The reader will find this book to be unique amongst the few available policy-oriented books in this area, not only in terms of the subject coverage but also in terms of the effort made to draw upon a variety of hitherto unexploited data sources in studying the issues at hand.

Chapters 4, 5, 6, 7 and 9 draw upon my sole or joint contributions to the following journals: *Asian Economic Papers* (MIT Press); the *Australian Economic History Review* (Blackwell); *The World Economy* (Blackwell); *Transnational Corporations* (United Nations); and the *Oxford Bulletin of Economics and Statistics* (Blackwell). I thank the publishers for granting copyright clearance. The published material is incorporated in the book with considerable modification, rewriting and expansion in order to avoid overlap as well as to update the data and the literature coverage.

It is a pleasure to thank everyone who helped me in this endeavour. Most importantly, I am grateful to my co-authors, Sarath Rajapatirana, Satish Chand and Sisira Jayasuriya, both for fruitful research collaboration over the years and for permission to make use of material from our joint papers in Chapters 6, 7 and 9 respectively. I would also like to express profound gratitude to Peter Drysdale, Chris Findley, Ross Garnaut, Hal Hill, Vijay

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Finally, my family – Soma, Chintana and Chaturica – deserve my warmest thanks for love, forbearance and unwavering support without which this task would never have been completed. Chintana and Chaturica also deserve thanks for help with preparing the manuscript.

Chandra Athukorala
Australian National University
June 2006

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1. Multinational enterprises and developing countries: background and preview

Multinational enterprises (MNEs)¹ are a major force in the evolving process of economic globalization which is encapsulating and reconfiguring the nature of global economic space. By the early 1970s, many US-based enterprises had already gone some way toward creating a global network, when European and Japanese firms began to take their place alongside the US firms. The global spread of companies from relatively high-income developing countries, in particular the East Asian newly industrializing countries, was an even more recent phenomenon, dating from about the mid-1970s. Today, the world is blanketed with affiliates of firms head-quartered in many different countries. Activities of MNEs have expanded from mining and petroleum industries, the traditional mainstay of their global operations, to manufacturing and services. They have established a strong and ever increasing presence in almost every country, including the former centrally planned economies in Asia and Central and Eastern Europe, linking factor and product markets across the globe. Global operations of MNEs are therefore a key factor that impinges on the designing of national development policy in the context of a rapidly globalizing world economy.

Foreign direct investment (FDI)² – the only ubiquitous quantitative indicator of the scale of MNE activity – grew dramatically from an average annual level of US\$59 billion during 1980–84 to US\$844 billion during 2000–04, recording an annual compound growth rate of about 5 per cent (compared with a 3.8 per cent rate of growth in world merchandise trade).³ The share of FDI in total private capital flows increased from 22 per cent to 32 per cent between these time points. The bulk of total world FDI inflows is absorbed by developed countries, with the share of developing countries (including transition economies) hovering around an average annual level of 28 per cent during 1980–2004. However, FDI inflows account for a much larger and increasing share of gross domestic fixed capital formation in developing countries compared with developed countries (8.5 per cent and 4.4 per cent respectively during 1980–2004).

Moreover, from about the late 1980s, FDI has continued to be the largest single source of total external finance (private capital inflows + official development assistance (ODA)) for developing countries. During 2000–04, FDI accounted for more than half of total external resource flows to these countries and was considerably larger than ODA.⁴

The scale of MNE activity is obviously better gauged by *direct* indicators of their performance, such as production, sales or employment, rather than by looking just at FDI.⁵ However, such performance indicators are unavailable for about half or more of the affiliates of MNEs, because most countries do not collect information on what their firms do outside their national boundaries (Lipsey 2004). According to available rough estimates (made by extrapolating the available data to the global level), production in foreign affiliates of MNEs (that is, production in enterprises located outside the country of residence of their parent companies) increased persistently from about 4 per cent of world output (GDP) in 1982 to about 10 per cent in 2004, and their share in world merchandise trade rose from 32 per cent to 39 per cent. Total employment in foreign affiliates recorded a three-fold increase (from 19.6 million to 57.4 million) between 1982 and 2003 (UNCTAD 2005, Table 1.3).

Data on FDI (or direct performance indicators) tell only part of the story of the impact of multinational firms on host economies. This is because ‘the modern multinational company is primarily a vehicle for the transfer of entrepreneurial talent rather than financial resources’ (Dunning 1992, p. 321). The decision of a firm to set up an affiliate in a given country is underpinned by the desire to reap benefits from its specific advantages (in the form of technology, managerial expertise, marketing know-how and so on), which cannot be effectively leased or sold through ‘arm’s-length’ market dealings with unrelated firms. Thus multinational affiliates bring along with them some firm-specific knowledge in the form of technology and managerial expertise that cannot be effectively leased or purchased on the market by the host country. As part of the parent company’s global network, they also have marketing channels in place and possess experience and expertise in product development and international marketing. Given these firm-specific advantages, MNE affiliates have the potential to contribute directly to the economic growth of the host country through improvement in productivity. In addition to this direct effect, the presence of foreign firms can also impact on the overall growth performance of the host economy through ‘spillover effects’ (positive or negative) on local firms. On the positive side, foreign firms can act as conduits of new technology, managerial practices and marketing know-how for local firms, either through pure demonstration effect or as an integral part of their local operations through employee training and direct dealing with local firms in