

Has Financial Internationalization Turned into Financial Globalization?

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Preface

In the study of economic globalization, one of the most interesting and important debates focuses on the comparison of the international economy at the end of the nineteenth and the twentieth centuries. Some political scientists and economic historians argue that the level of internationalization in the period between 1870 and 1914 is at least as high as that found in the last quarter of the twentieth century. Accordingly, they prefer to speak less of "globalization" and more of "internationalization." Others argue that this analysis is flawed because it does not take sufficient account of the greater extensiveness of the international economy at the end of the twentieth century and of the deeper integration of world financial markets. They prefer to distinguish these changes by describing the current world economy as a "globalized" one rather than an "internationalized" one. The debate is also important because it has given rise to questions about how best to "measure" economic globalization, particularly when most statistics are still gathered by nation-states and are organized around the framework of relations between nation-state economies rather than a global economy.

Finally, the issues at the heart of the debate are crucial ones. Understanding well the economic processes of the current global economy is important for public policy. For those seeking a more economically just global economy, it is important to understand well what states can do on their own and where their actions will require cooperation with other states to be effective. Those who emphasize the continuity between the late nineteenth century world economy and that found in the late twentieth and early twenty-first century see greater possibilities for autonomous state action. In contrast, those who argue that important structural changes distinguish the current economy from its historical antecedent stress the importance of greater cooperation among states and perhaps a strengthening of international economic institutions in order to pursue successful and more just economic reform.

In this paper, Professor Samir Saul reflects upon these debates through the marshalling of important evidence that permits a stronger comparison between the two periods than is found elsewhere. One of the difficulties in resolving the debate has been the construction of data in ways that permit a systematic comparison of the two periods. Professor Saul has gone to considerable length in preparing data for such a systematic comparison, making this paper an important contribution to the overall debate. His analysis suggests that there are important continuities between the situation of the world economy in 1870 to 1914 and the present period. He also suggests that new elements are beginning to emerge in current global economy that point to longer-term more profound changes, that he terms "globalization."

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Overview of the Paper

Money-capital has crossed state borders in increasing amounts since the nineteenth century. Understood as internationalization, this phenomenon has been a feature of the world economy for some time. Globalization is more complex and encompassing. It posits an intensification, a deepening and a multiplication of forward and backward links between units of a global economy. Financial globalization "is an aggregate concept that refers to increasing global linkages created through cross-border financial flows" (Prasad et al. 2003, 2). It includes uniformity of practices and liberalization — in this instance, the removal of legal barriers and regulatory restrictions to international financial flows. It assumes integration of markets, mobility of actors, interconnectedness, and multilateral relations. Historically, financial internationalization has meant largely unidirectional movement of capital from relatively capital-rich to relatively capital-poor countries. Financial globalization implies multidirectional mobility, cross-investments, as well as reciprocal back-and-forth movement of capital between investor and recipient economies.

Does the movement of capital in the past quarter century indicate a transition from an era of financial internationalization to one of financial globalization? The distinction between internationalization and globalization is important. It is an easily verifiable fact that vast amounts of capital move about in the world. Interpreting that fact represents a challenge. Volume per se does not necessarily mean a qualitatively new reality. If present-day capital movements are similar in nature to those of the past, the idea that the world is globalized would not apply, at least not in the financial sector. If, on the other hand, capital flows have acquired a global character, then the notion of globalization would be shown to have materialized in a key economic activity. Evidence would be provided of the arrival of a new era.

This paper seeks to determine whether the surge in financial internationalization during the last thirty years represents an intensification of an old process or a qualitative leap sufficient to be described as globalization. The methodology is historical; it is based primarily on an empirical investigation of the statistical data. Capital flows and capital stocks accumulated abroad are quantified, their geographic distribution delineated and their sectoral composition presented over the time frame beginning in 1870 and ending in the present day. The enquiry leads to the conclusion that the process is still closer to internationalization than to globalization, notwithstanding enormous increases in the amounts of capital circulating in the world and the greater presence of features associated with globality.

Successive eras of international capital flows are compared. Each era is defined by the prevailing regime of capital movement: open from 1870 to 1914, controlled from 1918 to 1940, managed from 1945 to the early 1970s, deregulated from the early 1970s to the present. Specifically, the contemporary era, beginning around 1975, is compared to the pre-contemporary. Standard practice breaks down capital transfers in two streams: portfolio flows (equity and debt securities bearing fixed interest, such as bonds and certificates of deposit, acquired with a view to earning income rather than obtaining control) and foreign direct investments, or FDI, (stock purchased in order to participate in management and gain control of a company). Both streams imply internationalization and lead to encounters between separate economies. FDI, however, has greater globalization potential because it is carried out by firms, usually with a view to coordinating or integrating production on an international scale. Its intensification is a useful index of the depth of globalization.

The first part of the paper looks at the pre-contemporary era, starting in 1870 and ending in the early 1970s. This era is divided into three periods: 1870-1914, 1914-1945, and 1945-1975. The second

section describes the surge in the internationalization of capital which occurred after 1975. The third and fourth sections consider the main components of international transfers of capital, namely portfolio flows and bank loans, on the one hand, and FDI, on the other. Each section begins with an succinct overview of the general characteristics of the period. A detailed portrait is then drawn of the origins, volumes, and direction of capital flows. It is completed by a survey of the geographic distribution of capital stocks, region by region. The fifth and final section focuses on the notion of an "integrated international production system," one of the possible consequences of FDI and an operative criterion of globalization. The paper concludes that globalization is not yet a universal fact and that internationalization is a more accurate description of the present. It closes with reflections on the perplexing problem of asserting autonomy in the face of advancing globalization.

The Pre-contemporary Era

The pre-contemporary era can be divided into three relatively distinct periods. Between 1870 and 1914, the fixed exchange rate system, relative absence of regulatory restrictions, abundance of capital in industrialized Western Europe, and strong demand outside Western Europe greatly accelerated the internationalization of capital. From 1914 to 1945, internationalization receded. The First World War (WWI) led to a breakdown of international economic relations, inflation, floating exchange rates, devaluations, and deficits in public finances. Depression provoked autarkic reactions, placing great strain on international financial relations and reducing capital flows sharply, even before the Second World War (WWII) undid what remained of the international economy. The third period, commencing after WWII, saw the reconstruction of national economies and of the framework of international economic relations. Growth, restoration of international commercial relations, and stable currency arrangements by means of fixed exchange rates were the order of the day, under the aegis of the International Monetary Fund (IMF) created at Bretton Woods in 1944. Lasting a quarter century, the structure disintegrated in the late 1960s under the pressure of productivity slowdowns, mounting deficits, runaway inflation, and increasingly unrealistic fixed exchange rates. The downturn ushered in the present phase in the early 1970s.

The 1870-1914 era represents a "benchmark of international integration" (UNCTAD 1994, 120) because international commercial and financial relations reached levels and amounts never previously attained. The international economy was Europe-centered. Investment flows were unidirectional, emanating from Western Europe and radiating to the outside. Except for the United States, a sharp divide separated creditor and debtor nations, and investors and recipients of foreign investments. The bulk of investments tended to move from capital-rich/slowly-growing to capital-poor/rapidly-growing areas, usually on a rate-of-return basis (higher marginal profit or interest-rate differentials). Their origin was almost entirely private.¹ Their destination was infrastructure, often export-related (railroads, ports), social overhead expenditure (transportation, public utilities, public works, real estate, urban development), natural resource extraction, or financing of current government expenditures. Loans to foreign governments were prominent, but the proportion of holdings in debentures and equity of companies was on the rise.

The exact mix between portfolio and FDI has undergone revision recently. A common estimate had been that about nine-tenths of investments took a portfolio form. But much investment originally considered as portfolio was under the management or control of non-residents who owned a majority or a substantial minority equity stake. One reclassification according to the present-day portfolio-direct distinction resulted in a scaling down of portfolio to about one-half in what would later be called the Third World or developing countries, where two-fifths of accumulated foreign private investment were located in 1914 (Svedberg 1978, 753, 768). Direct investment represented about 35

percent of the estimated total long-term international assets in 1914, a ratio higher in relation to the national income of the capital-exporting countries than at any time before or since (Dunning 1983, 85).

An original form of investment, specific to the pre-1914 period, was the "free-standing company" or "société articulée." This was a business incorporated in a capital-exporting country but operating exclusively abroad. As in the modern transnational firm, ownership and management were located in the home country. Shareholders were mostly individuals. Like the modern transnational corporation (TNC), it might possess technological advantages and integrated management structures. Unlike the modern TNC, its strategy was not multinational. It functioned in a single foreign country. Moreover, it remained a single-purpose concern providing one product or service. Halfway between the national and the foreign firm, this type of company grew out of the need to conduct business activity abroad while controlling operations from head office, close to capital markets and shareholders.

Commercial, industrial, and financial pre-eminence had made Britain the hub of the international economy since the beginning of the nineteenth century. Wealth generated by industrialization and revenue from sales of manufactured goods abroad accumulated into a mass of capital available for export to other countries. By the 1850s, holdings of foreign securities in Britain were in the range of \$950 to \$1,144 million (see Table 1).²

Table 1: Stock of Foreign Publicly Issued Securities Held in Britain in 1854

US	£50-60 million
French, Belgian, Dutch and Russian government securities	£45-55 million
Spain and Portugal	£35-45 million
Latin America	£35-40 million
French railways	£25-30 million
Belgian railways	£5 million
Total	£195-235 million

Source: (Jenks 1927, 413)

Between 1860 and 1879, £320 million (\$1,558 million) were raised on the London capital market for foreign government loan issues and £160 million (\$779 million) for colonial and Indian loans, while £232 million (\$1,130 million) were paid up on shares and debentures of foreign and colonial firms, three-fifths going to railway-building companies (Jenks 1927, 280, 425, 426).

Annual outflows from Britain in current value swelled from £40 million (\$195 million) in the 1860s, to £75-80 million in the 1890s, £130 million in 1900-1904, £145 million in 1905-1909, and £175 million (\$852 million) in 1910-1914 (Davis and Huttenback 1986, 37).³ At its peak, net capital outflow from Great Britain reached 9 percent of gross national product (GNP) (Eichengreen and Mussa 1998, 31). According to method of calculation, the stock of outstanding long-term publicly issued foreign investment accumulated by the British in 1913 – the country's net creditor position – was set at £3,714 million (\$18.1 billion) (*The Statist*, 14 February 1914); £3,763 million (\$18.3 billion)⁴ (Feis 1930/1964, 23); then at £3,990 million (\$19.4 billion) (Imlah 1958, 28). From 1865 to 1914, £4,082

million (\$19.9 billion) were raised in London through the issue of foreign securities (Cottrell 1975, 27). Overseas assets in 1913 were equivalent to 1.5 times gross domestic product (GDP) (Maddison 2001, 105). They amounted to 30 percent of national wealth (Edelstein 1982, 25) and produced 9 percent of national income (Feis 1930/1964, xix).

Approximately 60 percent of British capital went to independent countries and less than 40 percent to the Empire. Outside Europe, 68 percent flowed to temperate regions of recent settlement (independent countries and self-governing colonies),⁵ 27 percent to the tropics, and 5 percent to non-tropical Asia (Simon 1968, 24-5). Put differently, less than 10 percent went to the dependent Empire — of which three-quarters went to Asia and one-sixth to Africa (Davis and Huttenback 1986, 72). In 1913, British overseas investment in quoted securities was employed for social overhead purposes, taking the form of loans to governments and municipalities (30 percent) and holdings in railway securities (40 percent). Resource extraction, mainly mining (10 percent), public utilities (5 percent), and manufacturing (4 percent) were the other leading sectors (Feis 1930/1964, 27; Simon 1968, 23).

The world's second capital exporter before 1914 was France. Even before industrialization, Paris' financial market ranked next to London's as a normal venue for foreign borrowers. Its resources were drawn from the savings of a large number of small investors. Accurate amounts are more difficult to establish than for Great Britain. The rhythm of outflows is similar, slow in the 1870s and 1880s, then gradually accelerating in the 1880s and 1890s, and reaching a peak on the eve of the war. From next to nothing in the early 1880s, average yearly long-term foreign investment stood at 1.2-1.3 billion francs (\$228-247 million) in 1909-1913 (Thomas 1972, 39).⁶ In 1872, stocks of foreign securities amounted to 12 billion francs (\$2.3 billion), or one-quarter of the country's portfolio. Even when flows slowed down, stock rose steadily to 40-42 billion francs (\$7.6-8 billion), or 38 percent of total holdings of securities in 1912, and around 45 billion francs (\$8.6 billion) in 1914, or one-sixth of national wealth (Arbulu and Vaslin 2000, 31; Feis 1930/1964, xx, 47). From 1880 to 1913, one-third to one-half of French savings was channeled abroad (White 1933, 269).

Government bonds made up one-half of foreign securities negotiated on the Paris stock exchange; the balance was split evenly between equity and debentures issued by companies (Arbulu and Vaslin 2000, 31). In 1914, over 60 percent of French long-term investments were in European countries; Russia alone accounted for 25 percent. Latin America had 13 percent; French colonies 9 percent; Egypt 7 percent; Asia 5 percent; and the United States, Canada, and Australia 5 percent (Feis 1930/1964, 51). Sectoral breakdown resembled Great Britain's.

Germany arrived late to foreign investment. Its stock increased from 5 billion marks (\$1.2 billion) in 1883 to 22-25 billion (\$5.3-6.0 billion) in 1914 (Maddison 1989, 157).⁷ But less than one-tenth of savings went abroad from 1900 to 1914. Over half of Germany's long-term foreign investment was in Europe, especially Central and Eastern Europe (Feis 1930/1964, 61, 71, 74). Throughout the nineteenth century, the United States was a borrower, mainly in Britain. In 1914, British investors held about \$3.7 billion (par value) of American shares and bonds, or five-eighths of the foreign-owned total (Lewis 1938, 119). At the end of the nineteenth century, the United States became an international lender, even while it remained a net debtor. From 1897 to 1914, foreign assets held by Americans rose from \$0.7 billion to \$3.5 billion. Liabilities also increased from \$2.7 billion to \$7.2 billion. A particularity of US investment was its concentration in FDI, most likely for the sake of proximity to foreign markets after introducing mass-produced consumer items. Mass production and transnationalization went hand in hand, and the United States rapidly gained prominence in both. In 1914, three-quarters of its accumulated assets overseas were in FDI (*ibid.*, 445).

It is estimated that, at the outbreak of World War I, total stock of long-term foreign investments was about \$44 billion. Britain held assets worth \$18 billion (41 percent); France \$9 billion (20 percent); Germany \$5.8 billion (13 percent); Belgium, the Netherlands, and Switzerland \$5.5 billion (13 percent); and the United States \$3.5 billion (8 percent). The destination of these sums were Europe (\$12 billion, or 27 percent), Latin America (\$8.5 billion, or 19 percent), the United States (\$6.8 billion, or 16 percent), Asia (\$6 billion, or 14 percent), Africa (\$4.7 billion, or 11 percent), Canada (\$3.7 billion, or 8 percent), and Oceania (\$2.3 billion, or 5 percent) (United Nations 1949, 2). A more recent estimate is presented in Table 2 below.

Table 2: Nominal Value of Capital Invested Abroad in 1914 (Millions of Current Dollars)

	Europe	European-Peopled Countries	Latin America	Asia	Africa	TOTAL
UK	1 129	8 254	3 682	2 873	2 373	18 311
France	5 250	386	1 158	830	1 023	8 647
Germany	2 979	1 000	905	238	476	5 598
Other Countries	3 377	632	996	1 913	779	7 700
US	709	900	1 649	246	13	3 514
TOTAL	13 444	11 173	8 390	6 100	4 664	43 770

Source: (Maddison 2001,106) ⁸

War conditions radically transformed the international financial environment. The net position of most belligerent countries was weakened. Creditors had to liquidate assets overseas to prosecute the war. In addition, repudiation by debtors meant severe outright losses. Britain sold securities worth about \$4 billion, two-thirds of which were debentures issued by American railway companies, and wrote down another \$600 million to depreciation. The aggregate amount and the proportion of loss were higher for France due mainly to writedowns or writeoffs of the Russian, Balkan and Austro-Hungarian portfolios. Total loss ranged between 28 billion and 33 billion francs (\$5.3 and \$6.3 billion), or 62 to 73 percent of foreign assets. Unlike Britain's but like France's, Germany's prewar investments were mainly in Europe and suffered the same fate. German overseas investments were liquidated or relinquished (United Nations 1949, 5; Milward 1977, 301-2).

Disinvestment had reduced the US assets of Europeans from over \$6 billion in 1914 to about \$2.8 billion in 1919 (BRI 1940-41, 121). Whereas continental Europe became a net debtor,⁹ the US position changed from that of a debtor to that of a creditor country, in fact the prime source of capital flows in the world. In 1919, its assets abroad amounted to \$6.5 billion, nearly double the 1914 level, excluding the \$10 billion it had granted as official loans to its wartime allies (United Nations 1949, 6; Dunning 1970, 19). It insisted on repayment of the debt owed, a persistent postwar problem compounded by reparations payments demanded from Germany.

The interwar period contrasted with the so-called "golden age" of the previous forty years. Alongside reconstruction, stabilization plans and debt relief were the order of the day. Inflation, budget shortfalls, external balance of payments deficits, unstable exchange rates, exchange controls, transfer difficulties and defaults exemplified the financial disequilibria which made long-term decisions and investments risky or impossible. Short-term capital flows increased and became more volatile in

response to currency fluctuations. International financial relations were in a state of turmoil but they did not grind to a halt. Although there was a reflux in the flows of long-term capital, references to complete financial disintegration or breakdown are exaggerated (Flandreau and Rivi re 1999).

Britain recovered her position as a source of capital during the 1920s. Although the United States had accumulated considerable resources, partly from trade surpluses, the City of London benefited from greater know-how in exporting capital, more international connections, and a banking system better adapted to recycling capital abroad. International flows resumed slowly in the interwar period, reached a plateau at the end of the 1920s, then fell off sharply. The pattern is unmistakable even with data framed in current prices (see Table 3).

Table 3: Foreign Issues (Annual Averages in Millions of Current \$)

	1919-23	1924-28	1929-31	1932-38
US	531	1 142	595	28
UK	416	587	399	143

Source: (United Nations 1949, 28).¹⁰

A feature was the importance of FDI in the accumulated stock of the two leading exporters of capital. The proportion of investment by companies in overseas subsidiaries and branches increased. In 1929, it was on the same level as portfolio investments (see Table 4).

Table 4: Stock of Foreign Securities in 1929 (Millions of \$)

	United Kingdom	United States
Portfolio Investments (par value)	8 900	7 100
FDI	7 900	7 500

Source: (United Nations 1949, 33)

The United States had over \$3 billion of FDI in Latin America and \$2 billion in Canada. For the United Kingdom, the Commonwealth share was \$3 billion, with Latin America taking \$2.7 billion. Targeted sectors were railways, utilities, financial institutions, mines, smelting plants, oil extraction, and plantations. One-fifth of US and less than one-tenth of UK FDI went to manufacturing, mainly in developed or partly developed countries (United Nations 1949, 35-37). Company financing tended to take the form of FDI. Meanwhile, both the United States and the United Kingdom were sources of government funds. Almost three-quarters of American and British portfolio investment went to governments and public agencies, as opposed to private companies (Fishlow 1985, 418-19). FDI was a feature of the interwar era. It was probably stimulated by a dominant feature of the 1920s — exchange uncertainties. In the following decade, import restrictions, tariff barriers, quotas, and prohibitions threatened access to foreign customers, forcing exporters to open subsidiaries within the newly-protected markets. It was relatively unhurt by the Depression.

The Wall Street crash of 1929 and Depression led to wholesale defaults and selloffs of depreciating assets. Exchange controls replaced free convertibility. The decade witnessed erratic capital

movements. Large amounts of "floating capital" traveled nervously to and fro in reaction to economic, monetary, or political anxiety. Flight was followed by repatriation, then return to the same haven or a new one. The United States became the leading recipient of refugee capital in search of security (i.e., avoidance of loss rather than quest of gain). Its balance of payments was positive throughout the 1930s. Devaluation of the dollar in 1934 stimulated the influx. In 1939, it reached a summit of nearly \$2 billion, bringing the total non-resident claim to \$9.5 billion, only \$1.9 billion less than overseas investments by the United States (BRI 1939-40, 99; 1940-41, 121). War reversed the trend as trade surpluses and credits improved the United States' creditor position.

The interwar period did not lead to an increase in the stock of assets cumulated abroad. The trend set since the middle of the nineteenth century of rising levels of long-term lending and investments was broken (see Table 5).

Table 5: Nominal Value of Capital Invested Abroad in 1938 (Millions of Current \$)

	Europe	European-Peopled Countries	Latin America	Asia	Africa	Total
UK	1 139	6 562	3 888	3 169	1 848	17 335
France	1 035	582	292	906	1 044	3 859
Germany	274	130	132	140	—	676
Netherlands	1 643	1 016	145	1 998	16	4 818
Other Countries	1 803	1 143	820	101	646	4 579
US	2 386	4 454	3 496	997	158	11 491
Japan	53	48	1	1 128	—	1 230
TOTAL	8 331	13 935	8 774	8 439	3 712	43 988

Source: (Maddison 2001, 106).¹¹

Following WWII, governments gave priority to reconstitution of the fabric of international economic relations torn by the two world wars and the Depression. The Bretton Woods system was primarily a means of establishing a stable currency framework in order to promote trade while permitting the pursuit of domestic macro-economic objectives, such as promotion of employment and income redistribution. Its architects, John Maynard Keynes and Harry Dexter White, did not favour the international mobility of capital or the integration of financial markets (Kenen 1976). The crash of 1929 had left a legacy of mistrust of financial markets, domestic and international. The Bretton Woods system laid emphasis on regulation and safeguarding national economies from instability originating abroad. Fixed exchange pegs were an incentive to maintain or reinforce statutory barriers to cross-border movement of capital.

The resumption of the process of internationalization of capital had to be a gradual process. The postwar era was as US-centered as the pre-1914 period had been Europe-centered. Along with a reinforced industrial base and three-quarters of the world's gold reserves, the United States was to all intents and purposes the only available source of capital. Its banking system and financial sector had gained scope and experience in the transfer of funds internationally. With limited convertibility of currencies, controls on exchange and restrictions on capital issues in force practically everywhere — the United States and Switzerland being notable exceptions — most capital transfers were officially

arranged at first. In fact, government loans and other investments changed the United States' capital account position from that of a debtor in 1939 to that of a creditor as of 1946. Net private flows from the capital exporting countries intensified in the 1950s (see Table 6 and Table 7).

Table 6: International Investment Position of the US (Billions of Current \$)

	1939	1946	1947
US Investments Abroad			
Private Long-Term			
Direct	7.3	8.5	9.4
Portfolio	4.1	5.8	5.7
Private Short-Term	1.1	1.3	1.6
Total Private Investments	12.5	15.6	16.7
US Government Investments	—	5.1	12.1
TOTAL	12.5	20.7	28.8
Foreign Investments in the US			
Private Long-Term			
Direct	2.9	2.6	2.6
Portfolio	5.8	5.1	4.8
Private Short-Term	3.8	5.2	5.2
Total Private Investments	12.5	12.9	12.6
US Government Investments	0.3	3.5	3.9
TOTAL	12.8	16.4	16.5
Net Position of the US	-0.3	4.3	12.3

Source: (BIS 1948-49, 31)

Table 7: Net Long-Term Private Flows

	Annual Average (Millions of Current \$)		Share (Percentage)	
	1946-50	1951-59	1946-50	1951-59
US	1 085	2 011	59	70
UK	600	530	33	18
Switzerland	77	197	4	7
Belgium-Luxembourg	67	89	4	3
Federal Republic of Germany	—	49	—	2
Sweden	—	2	—	—
Total	1 829	2 878	100	100

Source: (United Nations 1963, 42)

Postwar private investment had a number of distinctive features, including the predominance of FDI over portfolio investments, the greater proportion of reinvested profits of branches and subsidiaries

relative to injections of fresh imported capital, and flows toward the industrial rather than developing countries. FDI accounted for three-quarters of private outflows from the United States and the United Kingdom, the two leading exporters representing 90 percent of the total (United Nations 1963, 62). Reasons for the rise of FDI are numerous but one possible explanation lies in the technological advances which WWII induced to a much greater extent than WWI.

While portfolio capital will normally move to those sectors within the recipient economy which, as revealed by their profitability, have a comparative advantage over their counterparts in the investing country, in the case of much direct investment, capital will flow to those industries in which the investing country (initially) has the comparative advantage but in which it is possible for the recipient country to gain. ... A company will invest abroad by extending its own operations (FDI), rather than investing in a foreign company (portfolio), as long as expected income is greater. This will occur whenever the investing company possesses some advantages over its foreign competitor which are not readily available to it and are sufficient to compensate for the disadvantages of operating a subsidiary at a distance [i.e., superior tech, patents, access to markets, entrepreneurial expertise, economies of integration, and so on]. ... The more significant the advantages, the greater the likelihood of monopoly profits being earned, and the more a firm is encouraged to engage in direct rather than portfolio investment (Dunning 1970, 12, 16-7).

In 1947, 70 percent of net outflow of private long-term capital from the United States was in the form of direct investments in the petroleum industry of Latin America and the Middle East (BIS 1948-49, 9). Geographic and sectoral reorientation then occurred. Private capital gave way to official transfers in the developing world and went mainly to industrial countries. From 1951 to 1959, private long-term capital outflows from the United States amounted to \$18 billion, official grants \$17 billion, and official and private loans \$4 billion, for a total of \$39 billion, or 72 percent of net international flows of \$54 billion (United Nations 1961, 2).¹² US FDI went mainly to Canada until 1958, when the establishment of the Common Market drew capital to Western Europe during the 1960s. British overseas investments continued to head mainly for sterling zone countries, but Australia took precedence over India, Pakistan, and South Africa. Whereas FDI in developed countries went into manufacturing; most FDI in the developing world flowed to resource extraction, mainly oil. The periphery continued to be viewed in terms of natural resources, not yet as potential industrial capacity.

The pattern of FDI emanating from the United States illustrates the shift to developed countries and to industry. Although its share diminished during the 1970s, the United States continued to be the main source of FDI in the world (see Table 8 and Table 9).

Table 8: Stock of FDI Originating from the United States (Billions of Current \$)

	1929	1946	1957	1967
Geographic Destination				
Canada	2.0	2.5	8.6	18.0
Latin America	3.5	3.1	8.1	10.2
Europe	1.4	1.0	4.1	17.9
Other Countries	0.6	0.6	4.4	13.2
Total	7.5	7.2	25.2	59.3
Sectoral Distribution				

Industry	1.8	2.4	8.0	24.1
Petroleum	1.1	1.4	9.0	17.4
Mining and Metallurgy	1.2	0.8	2.4	4.8
Other sectors	3.4	2.6	5.8	13.0
Total	7.5	7.2	25.2	59.3

Source: (Turner 1971, 16) ¹³

Table 9: Accumulated Stock of FDI by Country of Origin (Billions of Current \$ and Percentage)

	1914		1938		1960		1971		1978	
	\$	%	\$	%	\$	%	\$	%	\$	%
United States	2.7	18.5	7.3	27.7	32.8	49.2	82.8	48.1	162.7	41.4
Canada	0.2	1.0	0.7	2.7	2.5	3.8	6.5	3.8	13.6	3.5
UK	6.5	45.5	10.5	39.8	10.8	16.2	23.7	13.8	50.7	12.9
Germany	1.5	10.5	0.4	1.3	0.8	1.2	7.3	4.2	28.6	7.3
France	1.8	12.2	2.5	9.5	4.1	6.1	7.3	4.2	14.9	3.8
Belgium	—	—	—	—	1.3	1.9	2.4	1.4	5.4	1.4
Netherlands	—	—	—	—	7.0	10.5	13.8	8.0	28.4	7.2
Switzerland	—	—	—	—	2.0	3.0	9.5	5.5	27.8	7.1
Japan	—	—	0.8	2.8	0.5	0.7	4.4	2.6	26.8	6.8
ALL COUNTRIES	14.3		26.4		66.7		172.1		392.8	

Source: (Dunning 1983, 87)

Since 1975: Surge in the Internationalization of Capital

In the past three decades, capital crossed borders as never before, certainly since 1914. If a transition did occur from internationalization to globalization in the financial system, it is in the post-1975 era that it happened. Close scrutiny of this period is necessary if light is to be shed on the issue raised in this paper. The two basic categories of capital movements remain portfolio flows and bank capital, on the one hand, and FDI, on the other.

Two processes set the overall framework of the post-1975 phase of the internationalization of capital. In the developed, mainly Western, countries, the exhaustion of the post-WWII economic boom became manifest by the end of the 1960s. For three decades, high levels of investment, aimed at mass production and encouraged by the prospects of continuing growth and profits, had met high levels of demand sustained by near-full employment, rising real income, state-run distributive mechanisms, and demand by the public sector. Then falling productivity, slower market growth, and stagnant profits upset the Fordist-Keynesian nexus. In the developing economies of the "Third World" and the centrally-planned economies of the "Eastern Bloc," the model of import-substituting industrialization (ISI) had reached an impasse and was beginning to break down (Waterbury 1999).

In the developed countries, stagnation set the stage for the dismantling by employers and state authorities of the macro-economic foundations of the postwar era and the dissolution of the "social contract." Heightened competition for diminishing opportunities led to reconfiguration of internal productive and distributive arrangements, resulting in greater regulation by market forces, stagnation of real wages, rising unemployment or quasi-employment, reorientation of state intervention from support of demand to facilitation of immediate short-term profitability, more reliance on cost-cutting profit-enhancing technology, and a greater urge to expand abroad as a way of offsetting sluggish internal growth.

The attainment by Western Europe and Japan of the capacity to compete with the United States in several sectors, and their eventual slipping into stagnation as the postwar model of growth became less capable of generating rising or even stable levels of profits, added further impetus to the search for new areas of expansion in their competitor's home territory. As difficulties accumulated domestically, developed countries looked to the developing and Eastern European economies. Combining with their inner shortcomings, pressure from outside was more intensely exerted to bring about the reorientation or downfall of the latter countries' regimes and economic structures, and make previously inhospitable regions receptive to foreign capital. Although expectations were too sanguine or premature in that respect, the stage was set for a formidable outburst of cross-border capital movements. Both investor and recipient economies experienced an acceleration of the pace of their externalization.

Linked to gold (1 ounce = \$35) by the Bretton Woods system, the US dollar was in all but name a reserve currency, the easiest to send abroad. To cover US civilian and military spending, especially the war in Indochina, the US Treasury expanded the money supply by issuing dollars in great quantities during the 1950s and 1960s. In the meantime, dollar-denominated deposits at commercial banks in Europe had expanded rapidly. Soon there were more dollars outside the United States — so-called Eurodollars (Clendenning 1970; Prochnow 1970; Chalmers 1969) — than gold in the United States to back them. In 1971, the US balance of trade became negative for the first time since 1893. The value of the dollar could no longer be sustained relative to gold. Convertibility was suspended in 1971.

The order of fixed exchange rates established at Bretton Woods unraveled between 1971 and 1973 when currencies were left to float in relation to each other, without reference to gold. It was the prelude to a gradual return to the unfettered movement of capital in the 1980s. Floating exchange rates became the norm and were followed by the removal of exchange controls. The current account imbalances, especially those of the United States, which unhinged the Bretton Woods system continued to swell during the 1980s, requiring mounting flows of capital to cover deficits.

During the 1980s, restrictions on cross-border capital flows were gradually relaxed in the major industrial countries. Great Britain set a trend by lifting exchange controls in October 1979. Other countries followed suit: Japan (1980); the Federal Republic of Germany (1981); Australia (1983); New Zealand (1984); the Netherlands (1986); Denmark (1988); France (1989); Austria, Finland, Norway, and Sweden (1989-1990); Belgium, Ireland, and Luxembourg (1990); Portugal and Spain (1993); Greece (1994); and Iceland (1995) (Eichengreen and Mussa 1998, 35-6; IMF 1992, 6-7). At the end of 1986, the United Kingdom permitted foreign financial firms to enter the domestic securities market; other countries did likewise. Regulatory burdens were lightened; fees and charges reduced. Financial markets were increasingly liberalized, deregulated, and integrated in a worldwide network. Financial institutions were allowed an expanded range of activities. Simultaneously, distinctions between banks and non-banks faded. Moreover, the multiplication of financial instruments provided new means of

conducting transactions and moving capital. Substantial pooled savings and other financial resources in the hands of institutional investors found new outlets.

Practically all types of previously-known capital flows pursue an active existence in this period. Official aid, bank loans, portfolio investment, and FDI coexist in changing proportions and in a variety of combinations. It is almost impossible to determine any overarching reason or across-the-board rule for preference being given to one form of capital over another. As in all aspects of capital movements, the inclination or usual practice of the purveyors has to be squared with the general conditions pertaining to international capital movements and the specific conditions of the targeted recipients. The period is characterized by the multiplication of the ways and means of transferring capital around the world (see Table 10 and Table 11).

Table 10: Global Capital Flows

(Billions of Current \$, Cumulative)						
	1971-75	1976-80	1981-85	1986-90	1991-95	1995-2000
TOTAL INFLOWS	339	1 513	1 895	4 316	5 541	16 503
FDI	67	168	282	770	1 105	4 623
Portfolio Investment Liabilities	69	186	393	1 274	2 633	6 680
Other Investment Liabilities	203	1 159	1 219	2 273	1 803	5 199
%						
FDI	19.7	11.1	14.9	17.8	19.9	28.0
Portfolio Investment Liabilities	20.5	12.3	20.7	29.5	47.5	40.5
Other Investment Liabilities	59.9	76.6	64.4	52.7	32.5	31.5

Source: (Wong and Adams 2002, 19) ¹⁴

Table 11: Composition of Private Long-Term Flows (Percentage)

	1975-79	1980-84	1985-89	1990-94	1995-98
FDI	18	19	49	48	55
Portfolio	5	4	11	38	29
Loans	63	62	17	7	15
Other	14	15	23	7	0

Source: (Mody and Murshid 2002, 5) ¹⁵

Total volume of inflows and outflows rose sharply, both in absolute terms and relative to basic economic indices. In current values, gross flows from the main industrial countries in the form of bonds, equities, and other negotiable instruments went from about \$100 billion in the first half of the 1980s to an average of \$500 billion during 1985-1993, to about \$850 billion in 1993 (Claessens 1995, 1).¹⁶ Table 10 and Table 11 show the steepness of the rise since the 1970s.

Aggregate amounts grew tenfold in the two decades spanning the 1980s and 1990s. The combined external assets of the United States, United Kingdom, Japan, and Germany increased in current value from \$6,497 billion in 1989 to \$14,214 billion in 1998, their liabilities from \$5,901 billion to \$14,708 billion (Maddison 2001, 145).¹⁷ Relative to their GDP,¹⁸ the stock of external assets and liabilities of the fourteen leading industrial countries nearly tripled from 1983 to 2001; equity, plus FDI assets and liabilities, taken alone, quadrupled (Lane and Milesi-Ferretti 2003, 7, 25, 26). Global capital inflows to the United States, Canada, Japan, the United Kingdom and "emerging markets" (developing and "transition" economies), as measured by the four components of the capital account of the balance of payments — namely, portfolio investment; direct investment; other capital (transactions of domestic banks, the private non-bank sector and resident official entities); and official reserve assets (IMF 1992, 2-3) — amounted to \$310 billion in 1991 and \$1,149 billion in 2002. Outflows were recorded at \$212 billion in 1991 and \$875 billion in 2002 (IMF March 2003, 118-9; September 2003, 140-1).

International capital movements dwarfed international trade. By 1989, daily global foreign exchange trading, estimated at \$650 billion, was almost forty times the average daily value of world trade (Turner 1991, 9-10). Five years later, the multiple was fifty, with gross foreign exchange transactions estimated at \$5 trillion a day, against a total of \$4 trillion a year for the exchange of goods and services (*The European*, 13-19 May 1994). From 1986 to 1995, the turnover of daily foreign exchange transactions in the world jumped from \$188 billion to \$1,190 billion — that is, from 7.4 percent to 19.1 percent of yearly global exports of goods and services (Bairoch 2000, 203). Even more than on the domestic level, the financial dimension of the economy appeared to have been detached from the productive economy and to have taken on a life of its own (Chesnais 1997; Alworth and Turner 1991). Long viewed as flows compensating disequilibria in the real economy, such as balance of trade or current account deficits, the financial sphere is now largely autonomous.

Major providers of capital changed little. The "Triad" (North America, European Union, and Japan) remained the main importer and exporter of capital. Its members were simultaneously the main investors and recipients of each others' capital (see Table 12). Three-quarters to four-fifths of total flows occurred between developed countries. Capital moved basically from east to west, and from west to east, in the northern hemisphere. A trickle went from north to south and it concentrated on selected spots. Salient features of the period were the increasing role of European countries and Japan in imports and exports (exports only for Japan) of capital relative to the United States, the transformation of the United States into a net importer of capital, the concentration of inward flows in a handful of countries in Eastern and Southeast Asia, as well as Latin America, and the relative abandonment of the great majority of developing countries.

Table 12: Composition of Gross Capital Flows (Billions of Current \$, Annual Averages)

	Industrial Countries					
	Gross Outflows			Gross Inflows		
	1973-78	1979-82	1983-88	1973-78	1979-82	1983-88
FDI	26.3	45.9	94.2	15.1	36.0	69.0
Portfolio	11.0 e	29.6	142.6	9.5 e	35.8	128.9
Long-Term Bank Flows	12.3	32.3	17.8	4.9	5.4	13.6
Official	8.4	14.1	16.2	11.3	12.3	7.2
Other	17.4	40.8	46.7	20.4	37.7	37.6

Total	75.4	162.7	317.5	61.2	127.2	256.3
<i>Memo: Short-Term Bank Flows</i>	49.9	181.6	251.8	52.2	203.5	326.3
	Developing Countries					
	Gross Outflows			Gross Inflows		
	1973-78	1979-82	1983-88	1973-78	1979-82	1983-88
FDI	0.4	1.1	1.5	5.7	14.9	15.0
Portfolio	4.3	18.5	- 4.0	—	3.9	3.6
Long-Term Bank Flows	0.2	0.4	0.4	19.7	20.6	29.2
Official	7.0	31.2	35.1	13.3	28.3	35.9
Other	4.8	20.5	5.5	12.5	31.2	- 5.9
Total	16.7	71.7	38.5	51.2	98.9	77.8
<i>Memo: Short-Term Bank Flows</i>	6.0	22.4	28.2	7.9	24.4	18.4

Source: (Alworth and Turner 1991, 126)¹⁹

The two main forms of capital movements in the post-1975 period are examined in the next sections.

Portfolio Flows and Bank Loans since the 1970s

The volume of portfolio investment (equities and bonds) rose from one-fifth of total outflows in the late 1970s to nearly one-half in the 1980s. In current values, the amount of cross-border equity transactions exceeded \$1,500 billion in 1989, compared to \$73 billion a decade earlier (IMF 1992, 8). By the early 1990s, it had overtaken FDI and the syndicated commercial bank lending prevalent in the 1970s. The latter was curtailed in the aftermath of the Latin American debt crisis of August 1982. Long-term bank flows were "securitized," or converted into securities or portfolio liabilities possibly intermediated by banks but held by non-bank entities, mainly securities houses and institutional investors, such as pension funds, mutual funds, hedge funds, investment trusts, insurance companies, endowments, and foundations. Institutions entrusted with colossal assets "went global" in their desire to buoy up investment returns (*Wall Street Journal* 19 January 1994; 26 July 1996; 19 June 2000).²⁰ Investments by US pension funds in "emerging" markets went from less than \$10 billion in 1992 to over \$35 billion in 1995 (Maxfield 1998, 90). High real interest rates made bonds more desirable than equities.

The US market became highly attractive during the 1980s and 1990s as military spending swelled the public debt, while control of inflation protected the value of investments and stagnation of real wages shored up profits. A massive influx of Japanese funds went into US bonds,²¹ while equities drew investors from the UK and Japan, the stock market crash of October 1987 leaving no lasting effect. In 1984, the net international position of the United States (assets minus liabilities) became negative. By 1998, the deficit on current account was equivalent to more than 20 percent of GDP (Maddison 2001, 144-5). The exit of Japanese capital in the 1990s was more than made up by European flows.

As in 1914, the United States was again the world's leading debtor nation (the largest negative net international investment position), saddled with a mounting trade imbalance and living beyond its means thanks to outside financial assistance. The world covered the deficit of its balance of

payments and contributed to the long phase of expansion of its economy during the 1990s. Foreign resources became a substitute, rather than a supplement, to domestic saving. By 2000, foreigners owned about 35 percent of the US Treasury market, nearly 20 percent of American corporate bonds and 7 percent of the stock market (*International Herald Tribune*, 7-8 April 2001).

Huge and recurring US government deficits drained world savings. Foreign, especially East Asian, central banks accumulated enormous dollar reserves by purchasing US Treasury bills and bonds in order to uphold the dollar and prevent appreciation of their currencies. By feeding a constant flow of financial resources to the United States, foreign economies supported the US currency and maintained the purchasing power of the US market, thus safeguarding their exporters and their own assets. According to William Poole (2004, 3), president of the Federal Reserve Bank of St. Louis, at the end of 2002 foreigners owned more than \$9 trillion of US assets, based on market values, while US assets abroad fell short of \$6.5 trillion, leaving a negative net international investment position equivalent to a quarter of GDP.

None of these facts should detract attention from a residual form of capital movement, to wit short-term bank flows, mainly offsetting interbank transactions. An important stream, it is usually only estimated because of its fleeting character, with operations lasting no more than one day. Averaging \$11.5 billion per annum from 1975 to 1979 for fourteen major industrial countries, they amounted to \$28.1 billion from 1980 to 1984, and \$78.1 billion from 1985 to 1989 (Turner 1991, 75). (See Table 13, Table 14 and Table 15 for background and comparison.)

Table 13: Global Holdings of Equities and Bonds (Billions of Current \$)

	1983	1985	1988	1989
a. Global Portfolios				
Equities	3 284	4 667	9 297	10 926
Bonds	4 318	6 049	10 067	10 622
b. Non-Resident Holdings				
Equities	233	341	619	728
Bonds	345	589	1 148	1 357
% b/a				
Equities	7.1	7.3	6.7	6.7
Bonds	8.0	9.7	11.4	12.8

Source: (Turner 1991, 52) ²²

Table 14: Equities Investment Flows (Billions of Current \$, Annual Averages)

	1975-79	1980-84	1985-89
Aggregate Inflows (14 Industrial Countries)	3.6	10.8	23.1
US	1.5	3.4	8.6
Japan	0.6	3.5	- 9.1
9 Major European Countries	1.5	2.0	18.8
Aggregate Outflows (14 Industrial Countries)	1.2	8.7	36.6

US	0.2	1.7	4.1
Japan	0.1	0.2	9.2
9 Major European Countries	0.8	5.9	19.9

Source: (Turner 1991, 56) ²³

Table 15: Bond Investment Flows (Billions of Current \$, Annual Averages)

	1975-79	1980-84	1985-89
Aggregate Inflows (14 Industrial Countries)	8.8	17.1	102.4
US	0.6	4.1	30.3
Japan	2.3	4.2	37.2
9 Major European Countries	3.9	5.9	29.3
Aggregate Outflows (14 Industrial Countries)	16.7	40.1	147.3
US	5.6	4.0	5.3
Japan	2.5	13.7	80.8
9 Major European Countries	8.6	21.7	59.6

Source: (Turner 1991, 59) ²⁴

Because it is based on the decisions of numerous agents and is, in principle, not aimed at control, portfolio investment normally attracts less attention than unit-"lumpy" (large amounts of capital per transaction) and sometimes spectacular (involving major or symbolic companies). Its visibility increases markedly when turbulence, instability, or crises occur. Such capital is relatively liquid, thus more mobile ("volatile") or footloose ("hot capital"), more subject to the "bandwagon" effect (or more easily "spooked"), and more rate-of-return-sensitive than FDI which typically has a longer time horizon. Stocks, bonds, and debentures can be acquired or unloaded more quickly than production facilities. "Surges" in inflows have prompted calls for restrictions, controls, and "sterilization" ("... narrowly defined as the exchange of bonds, instead of money, for foreign exchange") (IMF 1984, 27; Schadler et al. 1993; Fieleke 1993; Lee 1997; Hernandez, Mellado, and Valdès 2001; Lipschitz, Lane, and Mourmouras 2002).

Liberalization and greater interconnectedness of capital markets have increased the scale, velocity, and global impact of local crises. The intensity of crises has been heightened and their propagation accelerated. "Herd behaviour" by inadequately informed "risk-averse" portfolio investors tended to become "contagious," spreading "shocks" and panic selling ("capital flight" or "hemorrhaging") of securities of countries rightly or wrongly perceived to have the same creditworthiness as the source of the scare ("spillover" or "neighbourhood effect"). Overnight capital flows were reversed and economies whose "fundamentals" appeared sound plunged into recession coupled with inflation. Outflows deepened current account deficits which suddenly turned to monetary crises as holders, fearful of devaluation, dumped the local currency, while runs on banks dried up deposits. Economies became highly vulnerable to externally triggered crises (Isard, Razin, and Rose 1999; Johnson 2002).

Until the late 1960s international private capital tended to shun developing countries. Capital received

by the "Third World" consisted largely of concessional lending, development assistance, and other official bilateral and multilateral aid (mainly by the World Bank and the IMF). Private financial flows to developing countries, in the form of FDI, were largely directed toward resource extraction. In the form of bank loans, they began in earnest in 1969. The process was fuelled by the booming Eurodollar market. Creation of money by the United States was already rapid in the 1960s. It accelerated with the removal of the link to gold in 1971. As domestic inflation and international commodity prices skyrocketed, developing countries became interesting potential borrowers (Payer 1991, 61-2; Norel and Saint-Alary 1988, 42-4). Expectations of returns were high. After 1974, bank loans received a new impetus from deposits made by oil-exporting countries which underwent recycling into syndicated commercial bank loans, mostly to official borrowers such as governments and public-sector companies (Holley 1987; Lomax 1986). Bank intermediation — and liabilities — replaced bond finance. Governments of the South took to relying on foreign loans as the way of financing their development programs. After a hiatus of several decades, private capital was returning to the Third World where it had gone in appreciable amounts until the Depression sent commodity prices on a free fall. Such flows were in keeping with established historical patterns of internationalization (see Table 16).

Table 16: Aggregate Net Long-Term Resource Flows to Developing Countries (Billions of Current \$)

	1970	1973	1978	1979	1980	1981	1982	1983	1984	1985
Official	9.5	15.3	32.7	36.9	45.6	33.7	34.6	34.8	33.6	39.7
Grants	8.2	12.7	27.4	31.1	37.8	11.4	10.9	10.4	12.6	15.6
Loans	1.3	2.6	5.3	5.8	7.8	22.3	23.7	24.4	21.0	24.1
Private Loans	3.3	10.3	44.3	40.6	27.9	53.3	45.1	30.7	27.4	20.6
Banks	3.0	9.7	39.9	35.9	22.0	44.0	32.9	23.4	23.0	7.8
Bonds	0.3	0.6	0.2	0	1.6	1.3	4.2	1.6	-0.1	5.6
Other	0	0	4.2	4.7	4.3	8.0	8.0	5.7	4.5	7.2
FDI	3.4	4.7	11.7	13.5	11.2	12.9	11.4	8.6	9.4	11.3
Portfolio Equity	0	0	0	0	0	0	0	0	0.2	0.1
TOTAL	16.2	30.3	88.7	91.0	84.7	99.9	91.1	74.0	70.5	71.6
	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Official	43.9	43.9	40.8	41.1	56.3	65.6	55.4	55.0	45.7	53.0
Grants	16.0	16.7	18.3	19.0	29.2	37.3	31.6	29.3	32.4	32.6
Loans	27.9	27.2	22.5	22.1	27.1	28.3	23.9	25.7	13.2	20.4
Private Loans	9.3	8.6	11.0	10.1	16.6	16.2	35.9	44.9	44.9	56.6
Banks	1.8	1.1	7.9	3.9	3.0	2.8	12.5	-0.3	11.0	26.5
Bonds	0.8	1.0	2.9	4.2	2.3	10.1	9.9	35.9	29.3	28.5
Other	6.7	6.5	0.2	2.0	11.3	3.3	13.5	9.2	4.6	1.7
FDI	10.1	14.5	21.2	24.7	24.5	33.5	43.6	67.2	83.7	95.5
Portfolio Equity	0.6	0.8	1.1	3.5	3.2	7.2	11.0	45.0	32.7	32.1
TOTAL	63.8	67.7	74.0	79.3	100.6	122.5	146.0	212.0	207.0	237.2

Source: Table compiled from data found in (OECD 1983; 1986; 1987; 1988; McCulloch and Petri 1998, 162)

Borrowing by non-oil developing countries from private sources and residual flows — primarily unrecorded private capital flows — increased from 26 percent of total reserve accumulations and current account imbalances in 1973 to 48 percent in 1981. Their international bank credits and, marginally, bond issues rose from \$58 billion in 1975 to \$191 billion in 1981 (IMF 1982, 70-71).

By 1981 private capital flows to the developing countries — two-thirds of which consisted of bank credits — were more than twice foreign aid. When the United States raised interest rates in order to bring inflation under control, the cost of servicing their external debt became prohibitive for the developing countries. As the dollar's exchange rate rose and the industrialized world experienced the worst recession in fifty years, export markets weakened and commodity prices fell. Caught in the cyclical downswing, developing countries saw export earnings plummet. In August 1982, Mexico, one of the largest borrowers, suspended payments on its debt, sending shock waves through the banking world. Many major institutions in the developed countries had lent to Mexico and were highly exposed. By the end of 1983, over thirty countries were in arrears.

Commercial bank credits dried up and private capital flows to most developing countries ebbed during the 1980s. There was a virtual cessation of lending as debt overhang set in. What credits were extended went to rescheduling, rolling over, or refunding previous loans. Stabilization and Structural Adjustment Programs under the aegis of the IMF and the World Bank were the order of the day. The level of aggregate resource inflows declined by 24 percent in real terms between 1980 and 1990 (Woodward 2001, 29). Nevertheless, the increase in the external liabilities of less developed countries continued unabated, the total amount in current values rising from \$751 billion in 1981 to \$1,351 trillion in 1991 (*Bulletin Financier BBL*, January-February 1993; Easterly 2002). Two-thirds of the debt was owed to American, European, and Japanese commercial banks, one-third to government banks and multilateral lending agencies. With private markets closing, the relative importance of development aid increased.

Private international financing of developing countries resumed in 1987 and increased by more than 150 percent between 1990 and 1996, nearly double its 1980 level in real terms (Woodward 2001, 29). Developing countries' share of global FDI flows rose from 12 percent in 1990 to 38 percent in 1995 (World Bank 1997, 104). The structure of international flows toward the South had changed. First, the private share of total aggregate flows, which had fallen from nearly one-half in 1970 to one-third in 1987, stood at four-fifths by 1994 (Lensink and White 1998, 1223).²⁵ Second, the share of bank lending had fallen considerably, while FDI and portfolio (equity and bonds) flows made up nine-tenths of the intake of foreign private capital (*ibid.*). Third, portfolio flows, barely noticeable until 1987, grew in real terms from \$0.01 billion in 1970 to \$82 billion in 1996, and more than sevenfold from 1989 to 1993 (Schmukler 2004, 41; Claessens 1995, 3). Accounting for more than one-third of total inflows, they nearly overtook FDI. Fourth, in the portfolio portion of total private flows, equity was more important than bonds (Fernandez-Arias and Montiel 1996). Fifth, equity (FDI and portfolio) weighed more than debt (bank and portfolio). From 1990 to 1996, inflows of FDI and equity investment increased by 440 percent; they were more than twenty times their 1980 level in real terms (Woodward 2001, 29). There was a shift from debt instruments to equity instruments. Debt receded from four-fifths of the total in 1978-1981 to one-third after 1990 (Fernandez-Arias and Montiel 1996, 53-54; Lensink and White 1998, 1224). Sixth, the public sector gave way to the private sector as the main recipient of foreign capital. The latter's share increased from two-fifths of the total before 1989 to four-fifths after (Fernandez-Arias and Montiel 1996, 54). Seventh, flows increasingly took place

through capital market channels. Accumulated stock of foreign capital in developing countries in 1998 was six times what it had been a quarter century earlier and twice its value relative to their GDP.

Table 17: Gross Amount of Stock of Foreign Capital in Developing Countries (Billions of \$ and Percentage)

	1870	1914	1950	1973	1998
Total in current prices	4.1	19.2	11.9	172.0	3 590.2
Total in 1990 prices	40.1	235.4	63.2	495.2	3 030.7
% Stock/GDP of developing countries	8.6	32.4	4.4	10.9	21.7

Source: (Maddison 2001, 136)

Latin America and Asia, both major recipients of FDI, had also become destinations for increasing amounts of portfolio capital in the early 1990s. In the 1960s and 1970s, foreign capital came into Latin America in the form of official flows from the World Bank, the IMF, and the Inter American Development Bank. During the oil boom of the 1970s, the continent was a favorite destination of foreign banks in search of borrowers. Flush with Eurodollars resulting from liberal US monetary policy, then with deposits from the OPEC countries, they were drawn to resource-rich countries of Latin America. With their revenues rising along with the international price levels of raw materials, they looked like customers able to bear the burden of interest payments. Loans were pressed on them and their foreign debt swelled prodigiously. Mexico, an oil exporter, saw its public and private foreign debt liabilities more than triple to \$88 billion between 1976 and 1982. They soared by \$47 billion in the three years from 1980 to 1982 (*Wall Street Journal*, 15 May 1984; 8 April 1986; *The New Republic*, 14 April 1986; Brown 1987; Rojas-Suarez 1991; Pastor 1990; Eggerstedt, Brideau Hall, and Wijnbergen 1995).²⁶

Interest rates were tied to the US prime rate or the London interbank rate for dollars. When the US Federal Reserve drove the prime over 20 percent in early 1980 in order to combat domestic inflation, the cost of servicing foreign debt rose substantially. As worldwide recession induced by high interest rates set in, GDP dropped, export earnings collapsed and borrowers were brought to the brink of default. Mexico — or more precisely, highly exposed foreign banks — had to be rescued in August 1982 by a US-initiated emergency relief plan intended to prevent suspension of payments. Lending more money to clear off arrears, reschedule loans and sustain interest payments averted default but increased the already towering external debt. By 1985, Latin America owed \$360 billion (*Wall Street Journal*, 12 June 1985). From 1983 to 1989, it experienced an average yearly net capital outflow of \$16.6 billion, contrasting with the average yearly net inflow of \$26.3 billion of the 1977-1982 period (Cartapanis 1997, 170).²⁷ Although foreign banks disengaged from Latin American loans through sales on the secondary market, debt-for-equity swaps and some writedowns throughout the decade, the continent's foreign debt rose to \$400 billion by 1988 (*Wall Street Journal*, 22 July 1988). For debtors, lower US interest rates in the early 1990s finally lightened the burden and lifted the debt overhang.

Table 18: Net Foreign Flows to APEC Developing Countries (Billions of Current \$)

	FDI				Portfolio			
	Asia	Mexico	Chile	Total	Asia	Mexico	Chile	Total

				APEC Developin g Countries				APEC Developin g Countries
1982	3.6	1.7	0.4	5.6	1.1	0.9	—	2.0
1983	3.8	0.5	0.1	4.4	0.7	-0.7	—	0.1
1984	4.1	0.4	0.1	4.5	-0.3	-0.8	—	-1.0
1985	3.6	0.5	0.1	4.2	6.9	-1.0	—	6.0
1986	4.8	1.2	0.1	6.0	1.7	-0.8	0.2	1.1
1987	6.1	1.8	0.2	8.2	1.2	-0.4	0.7	1.5
1988	6.9	0.6	1.0	8.5	-1.6	-0.9	-0.1	-2.5
1989	4.5	2.6	1.3	8.4	0.3	0.4	0.1	0.8
1990	8.9	2.5	0.6	12.1	-1.7	1.8	0.4	0.5
1991	14.0	4.8	0.4	19.1	2.3	9.1	—	11.5
1992	18.7	4.4	0.3	23.4	6.1	13.4	0.3	19.9
1993	34.1	4.9	0.4	39.5	19.1	17.2	0.7	37.1

Source: (Khan and Reinhardt 1995, 59-60) ²⁸

The restoration of investment flows to developing countries (see Table 18) came at a price. Banks, the IMF, and the World Bank rescued several debtor countries but applied pressure on them to restructure their economies, espouse liberalization, and adopt market-based policies. This was the gist of the plan proposed in March 1989 by US Secretary of the Treasury, Nicholas Brady. High interest rates, tight fiscal and monetary policy, austerity, cuts in social spending, reduction of subsidies, abolition of price controls, selling off of state-owned enterprises, opening markets to free trade and removal of barriers to foreign investment were urged on reeling Latin American (and other) countries. With the return to full-scale borrowing from banks excluded, attracting investment in the private sector appeared as the only way out of deepening impoverishment. In 1989 Mexico allowed 100 percent foreign ownership of many large companies. Gradually the whole region followed suit while foreign capital, deprived of high returns elsewhere, returned to Latin America (Turner 1995). Net portfolio investment was in the order of \$26 billion per annum between 1990 and 1994, as compared to (-\$1.2) billion from 1983 to 1989 (Cartapanis 1997, 170).

Portfolio investment in Mexico exploded from \$500 million in 1989 to \$17 billion in 1993 (Trigueros 1998, 214). When the influx upset the Mexican balance of payments, foreign reserves were depleted and the exchange rate of the national currency came under downward pressure. The devaluation of the peso by 15 percent on 20 December 1994 spread panic among foreign investors and caused the stock market to plunge. A massive sell-off forced the central bank to float the peso. Between December 1994 and February 1995, it lost 40 percent of its dollar value. Regarded as a feature of globalization, a high proportion of inflows was made up of hot money searching interest rate differentials or foreign exchange market inefficiencies, and prone to quick reversals. "Foreign capital has been likened to an umbrella that opens in the sunshine and closes in the storm: it flows abundantly only when least needed" (*Financial Times*, 29 March 1993). The Mexican crisis of 1994 was viewed as the harbinger of crises to come in the era of globalizing finance, with foreign capital and the host country's private sector playing the major role. A period of recovery then set the stage for the surge of FDI of the late 1990s.

Held up in the early 1990s as a model of open, foreign capital-driven, export-oriented growth, Asia became in its turn a storm centre of crisis at the end of the 1990s (Ito 1999; 2000). Capital poured into Thailand during the 1990s, predominantly due to borrowing by banks and financial institutions. Bank credit soared. Inflows averaged over 10 percent of GDP (13 percent in 1995), pushing up the real effective exchange rate of the baht by more than 25 percent between 1990 and 1997. Over the same period, Indonesia's rupiah also appreciated by 25 percent while the Korean won gained 12 percent (Chauvet and Dong 2004, 27, 29). Asian currencies, pegged to the dollar, became overvalued, reducing to a standstill the exports on which the economy came to depend. Excess capacity plagued the export industries. Slower growth burst a real estate bubble that had resulted from an overbuilding of offices. Declining property values weakened banks and finance companies holding "nonperforming" loans.

The baht came under speculative attack in February, March, and May 1997. When currency speculators resumed pressure in July, authorities let the baht float — in effect, devalued it. But the process got out of control and the exchange rate fell precipitously as panic selling continued. Since credits to financial institutions were denominated in foreign currencies, currency depreciation turned into a banking crisis as foreign investors withdrew in panic. The Thai shock spread to neighbouring countries. Anticipating turmoil, foreign capital poured out of the region in June 1997. Speculation hit the Philippine peso, the Korean won, the Malaysian ringgit, and the Indonesian rupiah — also overvalued as a result of capital inflows. Each currency went into a free fall. By June 1998, the rupiah was worth no more than 20 percent of its June 1997 dollar value (*Wall Street Journal*, 9 June 1998; OECD 2000). The IMF was drawn in with the largest bailout scheme in its history. The Asian path extolled as a "miracle" turned into a nightmare as capital flight and crisis set in, bringing in their wake mass layoffs, skyrocketing prices, a drop in the standard of living and political instability.²⁹

A similar process was unleashed the following year. The epicenters of the crisis shifted to Russia in August 1998,³⁰ then Brazil. Both had economies characterized by overvalued currencies and budget deficits. The ruble crumbled and the real was devalued in January 1999. Again foreign capital exited massively one month before each collapse (*Wall Street Journal*, 7 July 1998; Hausmann and Hiemenz 2000). Ecuador's turn came in 2000, then Turkey and Argentina in 2001, and Uruguay in 2002. Nor should debacles on the expanding financial derivatives market be forgotten: Metallgesellschaft and Orange County in 1994, Baring in 1995, Sumitomo in 1996, and Long Term Capital Management in 1998.

Financial crises were not unknown in the past; there were forty-four in developed countries and ninety-five in developing countries from 1973 to 1997 alone (Schmukler 2004, 53). Until the 1930s, when crises hit non-Western economies, fresh capital stopped coming from developed economies. Now capital rushes out in panic. A typical old-style crisis would be due to a drop in commodity prices, reducing governments' ability to service their debt and forcing companies to cut dividends and stop paying interest on debentures. Now the onrush of foreign capital wreaks havoc with the exchange rate of currencies in receiving economies. Vast amounts of inflows make possible and sustain, often through the local banking system, the multiple strands of indebtedness knitting "emerging" economies tightly. The original intake produces the economic fillip that entices more capital to pour in. Overcapitalization ensues and soon enough the bubble bursts. The tremors of a shock spread with great speed as the failure of one actor impacts on another and companies go under in succession. Suspicion surrounds identical economies and they, in turn, break down. The model of development based on outside capital requires openness of economies, leaving them vulnerable to quick internal collapse, caused by uncontrolled influxes and sudden withdrawals of foreign capital.

Openness or absence of regulations is a condition for globalization and for internationalization. The mechanism of crisis can be valid in both paradigms or contexts. What is certain is that "emerging" economies are at risk when placed at the disposal of colossal amounts of capital searching for opportunities.

Foreign Direct Investment

Although it is not novel, FDI deserves special attention because it lies at the heart of the internationalization of production, often pointed to as the embodiment of globalization. "International production — or the production of goods and services in countries that is controlled and managed by firms headquartered in other countries — is at the core of the process of globalization" (UNCTAD 1999, xvii). Carried out by TNCs, FDI is considered to be the driver of international production and the building block of transnationalization. It is the lever by which they internationalize production. FDI is more common than non-equity means of controlling productive assets in more than one country. "Exercising control and having a voice in the management of an enterprise located abroad ("foreign affiliate") — whether through capital investment or through contractual arrangement leads to international production" (ibid., 3).

While the flows of portfolio investment increased at approximately the same rate in the past quarter century, the potential FDI represents as an integrating force of the world economy has given added significance to its soaring volume and widening geographic scope. The agents of internationalization and globalization are advancing side by side. This section of the paper examines the overall growth of FDI, the methodology of analyzing FDI, the distribution of flows and stocks by geographic region, and the origin and sectoral activity of TNCs.

Expectations of economic growth in different parts of the world spurred the movement of FDI outward in search of positional advantage. Technological advances assisted. Along with miniaturization and computer-aided design and manufacturing, the combination of information processing and communications technologies reduced or abolished the barriers of distance and time, allowing more direct management of far-off businesses and greater presence in far-away markets. The enhancement of the technological component as a competitive asset meant escalating costs of research and development, shorter product life spans ("product cycles") and consequent need for wider markets to ensure adequate turnover. Favourable institutional arrangements, specifically market-oriented policies, were a third contributing factor. Markets were deregulated, allowing banks to enter business such as securities transactions and asset management, and nonbank financial institutions to engage in banking activities. Deregulation of the securities markets, liberalization of FDI regulatory regimes and privatization of firms in the public sector became the order of the day, the latter being opened to private foreign capital.

Some sixty-three thousand parent TNCs — a sixfold increase in thirty years — and their 690 000 foreign affiliates managed one-quarter of the world's output (gross domestic product) of about \$32 trillion in 1997. GDP of foreign affiliates alone, that part of output which can be associated with international production, tripled between 1982 and 1994. By 1997, it represented 10 percent of global GDP, up from 5 percent in 1982 and destined to reach 11 percent in 2001 (UNCTAD 1997, xv; 2000, 3-4; 2002, 14). Its growth rates were consistently higher than those of world GDP and gross fixed capital formation (GFCF).

Table 19: Annual Growth Rates (Percentage)

	1986-90	1991-95	1996-2000	2001	2002
GDP of foreign affiliates	17.3	6.7	7.9	14.7	6.7
Global GDP	10.8	5.6	1.3	-0.5	3.4
GFCF	13.4	4.2	1.0	-3.9	1.3

Source: (UNCTAD 2003, 3)

With assets in their foreign affiliates rising from \$1.4 trillion in 1997 to \$2.9 trillion in 2001, the share of the largest one hundred non-financial TNCs, ranked by foreign assets, rose from one-third to two-fifths of global FDI stock. They accounted for one-third of the outward stock of FDI of their countries of origin (UNCTAD 1994, 5; 1996a, 29; 2003, 187-8). The United States held more stock abroad than any other country and half of it belonged to twenty-five US-based TNCs, a share unchanged in four decades (UNCTAD 1997, xvii). The largest fifty TNCs in the world were at the origin of over half the FDI outflows of their countries (UNCTAD 2000, 71).

Since 1987, global sales by foreign affiliates grew by a factor of 1.2 to 1.3 relative to exports of goods and services. Considered to be synonymous with international production, their sales outweighed exports as the dominant mode of servicing foreign markets. From \$3 trillion in 1980, they attained \$14 trillion in 1999, almost twice as high as global exports of goods and services (UNCTAD 1997, xv; 2000, xv; 2001, 9). Trade within TNCs and arm's-length (by way of the market) trade by TNCs amounted to two-thirds of world trade. One-half of TNC trade was between parent firms and their affiliates abroad, or among affiliates, and one-third of world trade was intra-firm (internal to each TNC) (UNCTAD 1994, xxi; 1999, xix; 2000, 17). Nearly 80 percent of global research and development was done in TNCs, and 80 percent of international payments for royalties and fees (a measure of technology transfer) were intra-firm (UNCTAD 1994, xxi-xxii; 2000, 17).

A massive and ever-expanding literature has developed around FDI, TNCs, and the effects (see for example de Mello 1997; Aitken and Harrison 1999; Chuang and Lin 1999). From the 1980s onwards, systematic opposition was less widespread or more muted than in the 1960s and 1970s. Criticism of FDI and TNCs highlighted their tendency to reinforce unevenness and dualism; to introduce inappropriate technology and consumption patterns; to induce misallocation of local resources by financing ("gearing") themselves locally; to benefit from tax holidays, subsidies, and other incentives; to stifle indigenous enterprise by superior know-how and management; and to cause political friction based on suspicion that foreign interests control assets and jobs (Streeten 1973; Lall 1974).³¹ It was also felt that FDI was detrimental to growth if it acted as a substitute for domestic saving.

In the 1980s governments were consistently urged, and most made it their policy, to open their financial systems to the operations of international intermediaries (Haggard and Maxfield 1996) and to render their countries attractive to TNCs. The aim was to draw them and benefit *inter alia* from fresh capital, improved productivity, new technology, the creation of employment, access to foreign markets, and a boost to exports. Traditional proponents of transnational direct investment became natural advocates of liberal globalization, while critics continued to show concern mixed with perplexity in the face of a complex phenomenon.

Data collecting about FDI and TNCs improved markedly since the 1960s. It has become universal and comprehensive, thanks mainly to the United Nations Conference on Trade and Development (UNCTAD), the IMF, the World Bank, the Organisation for Economic Co-operation and Development

(OECD) and General Agreement on Tariffs and Trade (GATT)-World Trade Organization (WTO). Covering every country in the world, UNCTAD statistics are the most complete, but those of the OECD concern the industrial countries, the principal actors in FDI. Information is now less uneven because it is no longer limited to certain countries.

As with other statistical series, FDI tables must be approached with caution. Information is obtained from national sources using dissimilar methodologies. In some countries, such as the United States and Japan, a cross-border holding of 10 percent or more of ordinary shares or voting power in a firm is deemed to be sufficient to exercise control and to qualify as FDI.³² In others, especially in Europe, the equity threshold must be higher for an investment to be treated as FDI. Flows considered to be FDI in one country may be classified as portfolio elsewhere.³³ The result is discrepancies between the aggregate world totals of incoming and outgoing capital. Even for developed countries, data is not the same in UNCTAD and in OECD sources.

Another contributing factor is the recording of reinvested earnings, one of the three components of FDI, along with equity and inter-company debt transactions. Major investor countries compute reinvested earnings as outflows but many host countries do not count them as inflows. In the 1990s, equity capital was estimated to account for 72 percent of global inflows, reinvested earnings 8 percent (UNCTAD 2000, 15).³⁴ Finally, most countries evaluate FDI stocks at book value, which usually understates market value. Some estimate market value. The United States, France, and Sweden compile both sums.

Beyond statistical disparities, a more complicated problem remains unresolved. The tendency to view FDI as synonymous with TNCs and international production may be misleading. Foreign affiliates of TNCs often raise funds locally, a practice which lowers the proportion of FDI in their equity and makes the value of their assets greater than FDI. An investment recorded as FDI may be, at most, marginally foreign. Affiliates also seek equity or loans on international markets. Investment in foreign affiliates, amounting to \$1.4 trillion in 1996, was four times the value of FDI inflows. Assets of foreign affiliates in the world are estimated to be three to four times the amount of FDI stock (UNCTAD 1997, xvi; 2002, 14-15). Moreover, some FDI may be capital belonging to nationals which leaves the country temporarily, only to return in the garb of foreign capital eligible for various advantages; it may be an inflow in name only. "Round-tripping" Chinese capital is a case in point. Whereas paucity of information used to be a daunting challenge, reliability is now the main goal in the endeavour to accurately measure FDI.

FDI is a cyclical phenomenon; it accelerates in periods of rapid growth in developed countries, the main participants, and slows down when their growth is sluggish. The cycle in developing countries plays a lesser role. Rates of growth or decline of FDI are correlated with those of world GDP, and the latter is weighted toward the developed countries. A succession of distinct periods can be discerned, year-to-year rates within each not being the same (UNCTAD 2003, 16; 2002, 4). Generally upward movement of rates of change in FDI inflows occurred from 1970 to 1974, 1977 to 1981, 1984 to 1990 (spurts of 45 percent in 1986 and 60 percent in 1987), 1993 to 2000 (spikes of over 40 percent in 1998 and nearly 60 percent in 1999). Sharp downturns were felt in 1975-1976 (-21%), 1982-1983 (-14%), 1991 (-24%) and from 2001 (-31% in 2001, -21% in 2002). The rate of growth of GDP fell from 3 percent in 1980 to 1 percent in 1982. By 1984, it rose to over 4 percent and stayed near that level until 1988, when it declined every year, falling below 2 percent in 1991. It climbed back to around 2 percent in 1992 and 1993, and hovered at or above 4 percent from 1994 to 2000. By 2001, it was no more than 2 percent, rising to 3 percent in 2002.

Whatever the extent of the bulges and troughs, levels of FDI maintained a consistently upward direction. Both cyclical booms and busts occurred at levels of FDI flows higher than in the previous period of growth or recession. The long-term trend was upward. From 1970 to 1974, each of the inward and outward yearly flows were within the range of \$10 to \$30 billion a year. During the recession of 1975-1976, the levels were about \$20 billion. They rose to about \$55 billion by 1981 and stayed near the \$50 billion mark during the recession of 1982-1983. They edged over \$200 billion in 1990, falling back in the ensuing downswing to levels comparable to those of the 1980s upswing. The boom of the 1990s raised levels steeply; by 1999, each flow crossed the \$1 trillion mark. In the downward cycle that began in 2001, levels of inflows and outflows declined but were still in the upper-range years of the previous boom (UNCTAD 1997, 10; Appendix 1).

In nominal values (i.e., at current prices), inward and outward flows of FDI in the world tripled during the 1980s, doubled between 1993 and 1997, then more than doubled between 1997 and 2000. By 2001, inflows were ten times the yearly average of the 1980s, but the recession reduced the pace to 4.6 in 2002. On average, levels of inflows and outflows rose by over two-fifths per annum in the late 1980s, one-fifth in the early 1990s and one-third in the late 1990s (see Appendix 1). Lest sight be lost of relative volumes, it must be remembered that inflows represented no more than 0.4 percent of world GDP in 1980 and 1985, 0.9 percent in 1990, 1.1 percent in 1995 and 4.4 percent in 2000. However, relative to world exports, FDI went from 2.7 percent in 1980 to 3 percent in 1985, 6 percent in 1990, 6.4 percent in 1995 and 23 percent in 2000.³⁵ Combined global exports and imports of goods and services were in the range of 35 to 45 percent of GDP (UNCTAD 1998, 7; OECD 1995, 19; Maddison 2001, 280, 380). Nor should it be forgotten that portfolio outflows were greater than FDI outflows every year between 1989 and 2001, a period which includes the peak years of FDI flows in the latter part of the 1990s (see Appendix 2).

A yardstick of transnationalization is provided by the ratio of flows of FDI relative to gross fixed capital formation or productive capacity. Appendix 3 shows that their role has risen significantly in the 1980s and 1990s, even if a reversal set in with the 2001 recession. FDI stocks can be a measure of the investment underpinning international production. Assets accumulated under the governance of TNCs tripled during the 1980s and tripled again in the 1990s (see Appendix 4). Relative to global GDP, their importance grew by a factor of 1.6 in the fifteen years from 1980 to 1995, but by 2.2 in the subsequent seven years (see Appendix 5).

Notwithstanding the apparently triumphal march to international production, caution is in order. Transnationalization is an index of ownership; it implies greater integration but not necessarily increased production. In contrast to the 1950s and 1960s when "greenfield" investment — the creation of new start-up operations — was the norm, cross-border mergers and acquisitions (cbMAs) became the preferred means of carrying out FDI, especially in developed countries where nine out of ten acquisitions take place. Outlays for acquisitions were from 1.5 (1982) to 8.3 (1990) times greater than for new establishments in the United States in the 1980s (Graham and Krugman 1991).³⁶ In all the developed countries, transactions were mostly acquisitions, rarely mergers. They took the standard forms: horizontal (firms in the same business), vertical (client-supplier or buyer-seller relationships), or conglomerate (unrelated businesses). In the developing and East European countries, cbMAs were conducted in the course of privatizations of state-owned companies.

The flurry of cbMAs of the late 1980s and early 1990s turned into a tide in the late 1990s. Encouraged by means of financing developed in the 1980s, such as "leveraged buyouts" (LBOs), or borrowing to buy, it centered on telecommunications, "new economy-high tech" industries, and media. The number of "mega" operations, their proportion of total value of cbMAs and the amounts

involved increasing markedly as the decade drew to a close.

Table 20: Cross-border Mergers and Acquisitions with Values of over US\$1 billion

	Number of deals	Percentage of total	Value (billion \$)	Percentage of total
1987	14	1.6	30.0	40.3
1988	22	1.5	49.6	42.9
1989	26	1.2	59.5	42.4
1990	33	1.3	60.9	40.4
1991	7	0.2	20.4	25.2
1992	10	0.4	21.3	26.8
1993	14	0.5	23.5	28.3
1994	24	0.7	50.9	40.1
1995	36	0.8	80.4	43.1
1996	43	0.9	94.0	41.4
1997	64	1.3	129.2	42.4
1998	86	1.5	329.7	62.0
1999	114	1.6	522.0	68.1
2000	175	2.2	866.2	75.7
2001	113	1.9	378.1	63.7
2002	81	1.8	213.9	58.1

Source: (UNCTAD 2003, 17)

Despite the fact that the aggregate value of cbMAs never represented more than 3.5 percent (in 2000) of GDP or 3.7 percent (in 2000) of the market capitalization of world stock exchange markets, it constituted about 60 percent of FDI inflows from 1987 to 1990, and 40 percent from 1991 to 1995 (UNCTAD 2001, 53; 2003, 16). Except for the recession years of the early 1990s, there was a close relationship between the upward and downward swings of FDI inflows and cbMAs (UNCTAD 1998, 19). Both are cyclical, responding positively to high economic growth and the prospect of rapidly expanding markets; both are curtailed in downturns. However, an element of uncertainty surrounds the determination of the exact share of cbMAs in FDI inflows because they can in part be financed locally or through portfolio investments of less than 10 percent made on the local or international markets.

While cbMAs brought about further concentration, a turnover of ownership and management, as well as the possibility of fresh capital, technical know-how, organizational skills, entrepreneurial capabilities, and internationalization, it has not been established that they indeed contributed to an increase in fixed capital formation, expanded production, greater productivity, or better performance. They could have been counterproductive if the deals were "fire sales" or if they "crowded out" local capital (Uthoff and Titelman 1998). Some may have involved a change in ownership but no relocation of production activities. Takeovers may even have led to a scaling down or a dismantling ("hollowing out") of existing facilities. Corporate "raiding" was a feature of the US domestic scene in the 1980s. Most deals produced poor results, but cbMAs were less a response to the need for immediate gain than a positional strategy in response to competitive oligopolistic pressures, whereby new assets were sought and restructuring done in order to remain competitive,³⁷ gain quick access to a market,

defend and develop market shares, keep up with competitors, or grow quickly to avoid becoming the target of an acquisition. Foreign affiliates in the United States were less profitable than domestic companies. But the main object of FDI in the United States was to obtain a footing in a large and growing market, and get exposure to the stimulus of the technological environment (UNCTAD 1999, 4, 12; 2000, xix-xxi, 33, 97). Therefore, although the discussion of FDI has so far highlighted significant change, the full situation is not without contradictions and uncertainties.

Examination of the evolution of flows reveals more stability than movement in the proportional distribution of FDI around the world (see Appendix 6). Some change is occurring, but none foretells a major redistribution or reorientation of FDI and none seems irreversible. For example, the share of developing countries in world FDI outward flows rose from 1.5 percent in 1982-87 to 6.6 percent in 2002, mainly due to Southeast Asian investments. But developed countries continued to dominate in all respects during the past two decades, despite fluctuations. Roughly three-quarters of FDI flowed into developed countries (mainly the "Triad" of the United States, European Union, and Japan) and over nine-tenths of exiting FDI originated from there. The five largest home countries — the United States, the United Kingdom, Japan, Germany, and France — were responsible for two-thirds of outflows; the ten largest for four-fifths. The developing countries had a larger portion of the rest than Central and Eastern European countries ("transition economies"). Among the developing countries, the forty-nine least developed received minuscule inflows. A distinguishing feature of FDI was its geographic concentration. The top thirty host countries accounted for 93 percent of inflows and 90 percent of inward stocks; the top thirty home countries for 99 percent of outflows and 99 percent of outward stocks (UNCTAD 2001, 121).

Within the developed world, the boom in Japanese outflows came to an end in the 1990s as the country was mired in a prolonged recession. Luxembourg, the continental platform for many holding companies operating in Europe, was at the heart of an important two-way movement of FDI. In 2002, the Grand Duchy was the world's leading destination and initiator of FDI. An increasing, if still secondary, role was played by previously minor actors in FDI, such as Spain, Ireland, Italy, Finland, Sweden, Denmark, and Austria. Membership in the European Union and formation of the Single Market were decisive in contributing to capital flows. Regional integration was the operative factor. In 1958, fifteen years before joining the European Union, Ireland opted for an outward-looking approach to development and terminated the policy of import substitution instituted in 1932 (Long 1976). During the 1990s it became home to an influx of US, European, and Asian manufacturing companies, especially information-technology affiliates, seeking a point of entry into Europe (*Wall Street Journal*, 20 September 1991; 6 March 2001).

In the 1970s, Western Europe supplanted the United States as the home of the largest flows of outgoing FDI. Outward expansion by the United States was strong from the 1950s to the late 1970s. It was then scaled down. FDI into the United States took off in the 1970s after the end of the Bretton Woods fixed exchange rates confirmed the devaluation of the dollar. The lower the exchange rate of the dollar, the more attractive US assets became. During the 1980s, nearly two-thirds of FDI originated in Western Europe, while the share of the United States receded from one-fifth to one-tenth, mirroring the diminution of its GDP relative to the world's. In the phase opening in the 1990s, US exports of FDI were back at one-fifth but Western Europe still accounted for two-thirds. Western Europe became a more important venue for foreign capital than the United States at the end of the 1980s and widened its lead during the 1990s, even during the boom of the late 1990s and even if the United States was generally the principal recipient and home country.³⁸

There were exceptions. In the 1980s, the UK was the largest outward investor; its participation in

cbMAs in the United States contributed to making the United States the largest recipient country. Coming near in 1999, the United Kingdom was again the world's leading exporter of capital in 2000, due to the acquisition in 1999 by Vodafone of AirTouch Communications, a US company, for \$60.3 billion, then in 2000 of Mannesmann, a German mobile phone operator, for \$202.8 billion. The first deal was the largest of the late 1990s; the second the largest ever in current prices, representing almost all of the unusually large influx of capital into Germany, and 6 percent of the combined GDP of the United Kingdom and Germany (*Wall Street Journal*, 4 February 2000; 19 July 2000).³⁹ Acquisitions by France Telecom of Orange PLC from Mannesmann for \$46 billion and by Vivendi of Seagram for \$40.4 billion made France the world's second country of origin of FDI in 2000.

As expected, FDI turned to Central and Eastern Europe in response to improvement in fundamentals (Garibaldi et al. 2002). Magnitudes increased as the privatization of state enterprises got underway⁴⁰ and became the prime force in FDI inflows. The proportion of FDI Central and Eastern Europe received was not considerable and it went mainly to four countries — the Czech Republic, Hungary, Poland, and Russia.

Rapidly rising amounts of FDI, as well as foreign portfolio investment, flowed into developing countries in the 1990s. An important characteristic of those inflows was their concentration in a few countries located in Latin America and East and Southeast Asia. The five largest host countries — Mexico, Brazil, China, Malaysia, and Argentina — received in excess of three-fifths of FDI inflows;⁴¹ the ten largest more than three-quarters. Less than a score drew 95 percent of net private flows to developing countries. Less than 1 percent went to the hundred smallest recipients. The proportion of inflows to and outflows from the developing world experienced ups and downs relative to aggregate global flows.

Relative amounts of inflows into Africa reached a peak in 1988, then declined precipitously overall. Petroleum exploration in Angola,⁴² Namibia, Equatorial Guinea, Nigeria, and Egypt attracted most of the stream of FDI (see Appendix 1).

Table 21: FDI Inflows to Africa (Billions of Current \$, Annual Average)

	1981-85	1986-1990	1991-93
To the African continent	1.7	2.8	2.8
To African oil-exporting countries	1.4	2.0	2

Source: (UNCTAD 1995, 101, 105) ⁴³

At the same time FDI were transferred in the continent, revenues were transferred out in the form of repatriated profits, resulting in a net negative annual balance of \$1.5 billion in 1981-85 and a net positive annual balance of only \$0.7 billion in 1986-1990, and \$1 billion in 1991-93 (-\$1.2 billion, \$0.7 billion, \$0.8 billion for the oil-exporting countries) (UNCTAD 1995, 101, 105). Africa constantly took a distant third place behind Asia and Latin America (see Table 22).

Table 22: FDI Inflows Relative to GDP (Dollars per \$1000 of GDP)

	Africa	East and Southeast Asia	Latin America and the Caribbean
1970	5.2	2.6	7.4

1975	3.2	3.9	10.7
1980	1.0	3.7	8.3
1990	6.7	12.8	8.1
1991	8.5	12.4	13.1
1993	9.6	23.1	13.2

Source: (Ibid., 80)

The Latin American and the Caribbean share of inflows and outflows was not radically different in 2002 from what it was twenty years earlier. The low intake of the 1980s, stemming from the debt crisis, was more than made up in the 1990s. FDI amounted to three-fifths of total foreign capital inflows of \$107 billion in 1997 (OECD 2001, 14, 19, 26).⁴⁴ Argentina experienced ups and downs, as did — not unexpectedly — tax havens, such as Bermuda and the Cayman and Virgin Islands. The other key Latin American recipients, Brazil and Mexico, were somewhat less affected by short-term swings.

South and Southeast Asia's involvement in FDI increased notably. To all intents and purposes, the half dozen "tigers" garnered the bulk of Asia's FDI. China, the largest host country in the developing world, received the lion's share of inward FDI — almost half of South and Southeast Asia's total from the late 1990s⁴⁵ — and Hong Kong was the main source of outward FDI (Li and Lui 1999; Tseng and Zebregs 2002). Noteworthy was the number of countries of the region involved in international capital flows. Indonesia, Malaysia, Thailand, and Vietnam (Freeman 2002; Brimble 2002) joined more established participants like the Republic of Korea, Singapore, and Taiwan as major regional importers and exporters of capital. India's attitude toward FDI was ambivalent and its part in capital flows relatively small. Constraints on foreign investment were eased in 1984 and 1991, running counter to statist policies followed since independence. But administrative hurdles and public suspicion, fuelled by accidents such as the gas leak at the Union Carbide plant at Bhopal which killed thousands, remained.⁴⁶ As in Europe, regional integration stimulated capital flows and increased the number of countries active in FDI.

Japanese outflows returned to South, East and Southeast Asia. Historically geared to securing natural resources and low-cost labour, mainly in Asia, they had been redirected to developed countries out of concern about mounting protectionism. Sizeable investments were made during the 1970s⁴⁷ and 1980s (*Wall Street Journal*, 16 January, 24 February, 2 March 1989; *Financial Times*, 13 January 1990)⁴⁸ in the United States. In the 1990s, against the background of a slowdown of the Japanese economy and of Japanese foreign investments abroad, they were disposed of, as affiliates were sold off and the proceeds shifted to closer and more promising markets (*Wall Street Journal*, 27 January 1993; *Financial Times*, 24 May 1994).⁴⁹ In East and Southeast Asia, "rapid economic growth — driven by some of the world's highest savings and capital-formation rates — offers better returns than more mature markets in America, Europe or even Japan" (*Wall Street Journal*, 10 August 1993).⁵⁰

In the early 1990s, nearly seven-tenths of the FDI flows out of East and Southeast Asia were intraregional, about a quarter went to North America, the balance to the European Union. Postwar links with the United States, as well as its unified market, made it more attractive than the fragmented and differentiated markets of Europe (UNCTAD 1996b, xiv, xv, 50; *Wall Street Journal* 26 October 1994). The pattern was similar in other developing countries: the main recipients of what outflows they generated were other developing countries. Insufficient experience of internationalization and

lack of means to confront stiff competition from the firms of developed economies gave precedence to more familiar markets where "transaction costs" (knowledge of local conditions, internal transportation and communications costs, regulations, and standards) were lower. Developed countries, especially in Europe, were not yet viewed as "a potential site for global sourcing in an integrated production strategy, but only, or mainly, as a market to be tapped by setting up a local production presence" (UNCTAD 1996b, 48). As with the rise of the EU, servicing an entire region in the process of integration led to rationalization of production or distribution and choice of specific countries as gateways to the area. FDI inflows had a regional focus. Investment in the auto industry in Brazil was aided by MERCOSUR. FDI in the Southeast Asian countries owed much to the Association of South East Asian Nations (Indonesia, Malaysia, the Philippines, and Thailand).

The list of leading recipient and source countries in the 1990s throws additional light on the distribution of flows of FDI in the world (see Appendix 7). The picture is complex, with some changes emerging against a background of continuity. Eight or nine developed countries were simultaneously the leading exporters and importers, maintaining trends set in the 1970s. Multilateral flows are an indicator of multilateral integration and a feature of globalization, but they are not new. Ever since the United States lost its overwhelming predominance in FDI vis-à-vis Western Europe and Japan, integration ceased to be a unilateral US-driven process. A novelty is the presence of Spain among the dozen leaders for inflows and outflows; the circle of globalizers is widening.

China, Brazil, Mexico, and Argentina were the primary destinations for FDI. As is traditionally the case, developing countries take in capital and send out comparatively little, resulting in one-way integration and large positive balances of flows. This is internationalization, albeit by means of FDI, and it has a long past. Reversing the import-substituting strategy of the Mao era, China embraced the "export-led development" path of capitalism on which other East and Southeast Asian economies (the "tigers") had preceded it. Imports of substantial amounts of foreign capital concentrated in some urban areas sustain basic industries and assembly plants, with the risk of a repeat of the Asian crisis of 1997 hovering over the experiment.

Equally unsurprising are the negative balances of developed countries traditionally active in international capital movements. They are evidence of the fact that those countries do not just exchange capital with each other in a zero sum operation. Some of their outflows go outside the group of developed countries. The former transactions can be considered as part of globalization; the latter are in line with internationalization.

Two new realities with globalizing attributes can be noted. Several South Asian countries ("newly industrializing economies") are participating in inflows and outflows of FDI, indicating at least two-way integration. The second reality concerns the United States. It is in the historically original position of a large developed country that draws in more FDI than it pumps out. In fact, its positive balance ranks second in the world. This is an unusual phenomenon, its causes ranging from the necessity perceived by TNCs to be on a market as large as the United States (high turnover, fear of restrictions to entry, need to face the test of competition), to geopolitical primacy which makes the United States the potential headquarters of all large TNCs, to the achievement by the United States of a rentier status based on enjoyment of geopolitical advantages. It has to be qualified by the fact that the United States still possesses the most FDI assets abroad, although its share has diminished from 38 percent of the world's total in 1980 to 22 percent in 2002, not much higher than the United Kingdom's (15 percent).

The predominance of developed countries in FDI stocks was just as pronounced as for flows (see

Appendix 8). In fact, the relative size of the portfolio of FDI assets located in the developed world grew during the past two decades. About three-fifths of inward FDI stock was in the developed countries and nearly nine-tenths of outward stock in the world was owned by companies based in those countries. FDI is mostly a two-way rich-rich affair, aimed at spreading risk in asset distribution ("diversification finance"). Capital is not flowing to the same extent to capital-poor countries ("development finance") where the marginal rate of return is theoretically higher. This phenomenon is in marked contrast to the pre-1914 era when investment flows were mostly unidirectional, from rich to poor countries. Nevertheless, although developing countries are relatively neglected by capital flows at the present time, they bear the brunt of financial crises (Obstfeld and Taylor 2004, 231, 241, 249).

The accumulation of assets in European hands proceeded steadily; Western Europe as a whole and its largest recipients and investors increased their share of an expanding global stock. This was done at the expense of the United States and Japan. Western Europe increased its share of outward stock from two-fifths to over one-half of the world's total as the American portion shrank from two-fifths to one-fifth. The United States retained the largest foreign portfolio held by a single country and improved its absolute and relative position as the most important single venue for assets owned by foreign companies. Holdings abroad by Japan reached over one-tenth of the world's total in 1990 but fell back subsequently when the recession slowed down outflows and disappointing results in the United States led to divestments.

The rest of the portrait is mixed. While foreign investment by developing countries remained at around one-tenth of the world's total of outward stock, relatively less inward stock was located in those countries. Africa's share was already low in the 1980s, standing at less than 5 percent; it was halved during the 1990s. By 2002, Central and Eastern Europe reached approximately the same inward and outward percentages of global FDI stocks as Africa. FDI in Eastern Europe tended to be "lumpy" — that is, placed in a few large undertakings, such as the Volkswagen/Skoda (*Wall Street Journal*, 9 March, 17 September 1990) and the Fiat/FSM plants in the Czech Republic and in Hungary (1994). The relative value of assets belonging to foreign companies in Latin America and the Caribbean continued to increase, but assets owned abroad by Latin American companies went in the other direction. The portfolio of foreign-held FDI assets in Asia was almost entirely concentrated in South and Southeast Asia. Its relative weight was diminishing, except in China, where foreign investment rose while it stagnated or fell elsewhere in the region. In all, it was a situation of unevenness and sharp contrasts, from overwhelming concentration in developed countries to increasing predominance of China and marginalization of the least developed countries.

No less salient was the geographic concentration of TNCs in one part of the world. Over 90 percent of parent firms and 60 percent of affiliates were based in developed countries (UNCTAD 1997, 6; Grou et al., 1990). TNCs tend to be capital- and technology-intensive. The more advanced the level of technology, the more affiliates tended to be established in specific areas in developed countries ("clustering"). "Agglomeration economies" encouraged "followers" to imitate the investment decisions of "first movers." "By locating next to other firms, they benefit from positive spillovers from investors already in place. The common sources for these positive externalities are knowledge spillovers, specialized labor, and intermediate inputs" (Campos and Kinoshita 2003).

The composition of the hundred largest TNCs remained stable (see Appendix 9). Between ninety-five and one hundred were headquartered in developed countries. There was little change in the national distribution or the identity of firms. Although the United States lost ground in aggregate FDI flows, its dominance in the area of the largest companies continued. General Electric or Royal Dutch Shell usually topped the list. Others were familiar names of the TNC landscape. Among the few changes

were an increase in the number of UK firms and a diminution in that of Japanese TNCs in the top one hundred. Electronics/electrical equipment, petroleum exploration/refining/distribution, motor vehicles, and telecommunications were the dominant industries.

By the end of the 1990s, TNCs from countries recently integrated in the European Union, most notably Spain (1998),⁵¹ and from outside the "Triad" (in 1995) began appearing on the list. The latter were the largest of the top fifty non-financial TNCs of the developing world. With the exception of a Saudi Arabian company⁵² and a handful of South African firms,⁵³ the list was entirely made up of East-Southeast Asian (two-thirds) and Latin American TNCs (one-quarter). The foreign assets of the top fifty developing country TNCs represented 2.5 percent of the foreign assets of the fifty top TNCs in the world in 1994, 8.2 percent in 2001. The proportion in terms of total assets was 11.5 percent in 1994 and 11.8 percent in 2001 (UNCTAD 1996a, 30-2, 34-5; 2003, 187-90). In 2001, leading developing country TNCs held about 10 percent of the outward FDI stock of their countries of origin, against over 40 percent for leading developed country TNCs. Their ratio of foreign to total assets rose from 9 percent in 1995 to 35 percent in 2001; the ratio of top developed country TNCs was over 50 percent (UNCTAD 1996a, xvi; 2003, 187-90). As for research and development, it was mostly carried out in industrialized countries. Research and development (R&D) by TNCs of the smaller European home countries was internationalized long ago, but it went to other industrialized countries. In contrast, 87 percent (1998) of US and 97 percent (1995) of Japanese TNCs conducted theirs at home (UNCTAD 2001, 81; 2002 19-20). Major non-"Triad" companies were transnationalizing but the preponderance of developed country TNCs remained unchallenged. Real erosion of their dominance has not occurred.

Of the three basic economic activities, the tertiary sector gained most from FDI in the 1980s and 1990s (see Table 23).

Table 23: Sectoral Distribution of FDI

	FDI Inflows (Percentage)		Inward FDI Stock (Percentage)	
	1988	1997	1988	1997
Primary	8.6	4.5	11.7	6.3
Manufacturing	44.0	42.0	41.4	42.5
Services	38.9	47.7	42.3	48.5
Unspecified	8.4	5.8	4.6	2.8

Source: (UNCTAD 1999, 418-425)

Financial services, insurance, consultancy, and legal services were in high demand. Rarely can services be exported; they are produced where consumed. The provider has to be on the spot to respond or lose the market. Nevertheless, the general trend was not valid everywhere. From 1996 to 2000, the breakdown of FDI to Africa was 54.6 percent for the primary sector, 20.6 percent for the secondary, and 24.8 percent for the tertiary (UNCTAD 1995, 33; UNCTAD 2002, 52).

The Notion of an "Integrated International Production System"

The idea of "international production," the economic lynchpin of the globalization paradigm, is hardly novel. More than thirty years ago, the Director of Research of the US Council of the International Chamber of Commerce and a former US Treasury official, broached it (Polk 1968). He noted that

international companies created "a new system of international production involving a far more direct international allocation of resources — in short, an emerging world economy" (Polk 1973, 15). Pointing out that classical political economy assumed factors of production (inputs) did not move, he stressed the want of an adequate theory and provided both a preliminary blueprint and terminology, albeit gropingly.

Conceptualization on international production and FDI⁵⁴ has advanced and become more precise in the context of the globalization perspective. Various stages of integration were identified, their succession and cumulative effect leading to integrated production.⁵⁵ Internationalization is viewed as proceeding in a linear sequential movement. Modes of integration emerge in succession but the more recent do not necessarily render previous ones obsolete. Rather, new modes develop alongside and combine with older forms. Coexistence is the operative word. Trade, the simplest and most ancient variety, constitutes "shallow" integration, in the sense that it does not structurally bind buyers and sellers ("arm's-length" market transactions), and can be terminated at relatively short notice. The export of goods is complemented by the opening of trading affiliates or distribution outlets in foreign markets. Companies such as Singer, National Cash Register, Eastman Kodak, Coca Cola, Dunlop, Unilever, and Nestlé were abroad before 1914.

In order to continue drawing on a brand name, forestall local competition, or benefit from a firm-specific advantage, FDI then gives rise to production on an international or transnational scale which evolves from simple to more complex forms. At bottom, FDI, like investment in general, is rent-seeking, in the sense that it searches for profit in niches where it has advantages competition cannot match, at least for a time; change in technological content and managerial methods derives from this motive force. Simple "horizontal" strategies involve the opening abroad of affiliates or subsidiaries replicating the facilities of the parent firm in smaller shape, producing locally one or more similar products, assembling ("screwdriver plants"), and operating with a high degree of autonomy, except for finance and technology. Acting as stand-alone clones of the parent firm, their object is proximity to the market of the host country, made difficult by transportation and communications costs. When that market is surrounded or perceived to be on the eve of being surrounded by protective trade barriers, the strategy is tariff-jumping and possibly import-substituting. It aims to overcome protectionism and earn national treatment. Simple integration is not defunct; "we're here because the customers are here," said the manager of a US company assembling semiconductors in Malaysia (*Wall Street Journal*, 6 August 1993).⁵⁶ Tariff-jumping FDI should, in principle, become less important as import regimes are liberalized, unilaterally or in successive rounds of multilateral negotiations. This type of FDI is basically market-seeking. Automobile companies, among which General Motors and Ford, adopted this strategy.

Simple integration moves to a higher stage when firms begin outsourcing and subcontracting ("externalization") to their foreign affiliates and other companies abroad for some of their inputs. Only a few components are produced, mainly to benefit from lower factor cost in a specific country, falling transportation and communications costs, and the removal of impediments to international trade. The affiliate or subcontractor produces intermediate goods, not final marketable products, and is therefore not autonomous. Simple "vertical" integration relocates portions of the productive process to the host country, especially labour-intensive tasks. It is motivated by the need for cost-competitive standardized products. Its main locational determinant is not the host country's domestic market but lower-cost factors of production, especially labour, and export infrastructures, such as transportation. Industrial free zones, export processing enclaves, and extra-territorial export platforms, such as Mexico's maquiladoras, created an off-shore environment which suited this type of integration. With the improvement of communications, management over long distances of fragmented

labour-intensive functions becomes possible. However, FDI specializing in export activities is unlikely to have growth-generating spillover effects to domestic firms. Simple "vertical" integration is often part of an oligopolistic parent company's export drive aimed at the international market. It also occurs in accessing location-bound natural resources; imports of raw materials are followed by FDI to the resource-rich country or FDI leads to exports from the host country. Adidas, Nike, and many producers of electronic components rely on this form of asset- or resource-seeking FDI.⁵⁷

With "complex" integration, all activities are transferable to foreign affiliates operating under the common governance of parent TNCs, "and hence potentially part of an integrated international production system — the productive core of the globalizing world economy" (UNCTAD 1994, xxii). The "value chain" is divided into discrete functions. Production is dispersed geographically according to criteria of economy and efficiency, but linked in a single network. Intra-firm linkages are strong and level of integration high. Local production is more integrated, with increasing value added locally. Improvements in communications and information technologies allow central coordination of far-flung interconnected units of the firm, "giving rise to a *cohesive global production system*, with specialized activities located by TNCs in different countries linked by tight, long-lasting bonds" (UNCTAD 2000, 3). Lower transportation costs and less stringent trade regimes facilitate mobility of inputs and intra-firm trade ("internalization" of market functions). More uniform consumption patterns, in the sense of demand for similar commodities, favour mass production on a global scale. As trade barriers are lowered, national markets tend to be viewed as part of regional markets.

"Deep" integration mobilizes competitiveness-enhancing FDI less toward traditional natural assets, such as cheap labour and natural resources, than toward intangibles, "created assets" and "an enabling environment" (Michalet 1994, 20) — such as trained "human resources," skills, technological capabilities, easy linkages with supply networks, quality infrastructures, social order, solid institutions, and a transparent and stable legal framework — needed to take advantage of changing technologies.⁵⁸ Host country policies can influence FDI flows by improving locational advantages; policy/institutional variables matter (Gastanaga, Nugent, and Pashamova 1998). Governance infrastructure, including political governance, is an important determinant of FDI inflows and outflows (Globerman and Shapiro 2002). The primary motivation of firms changes from seeking markets and natural resources to exploiting competitive advantages (Dunning 1995). It is highly oligopolistic and competition-driven, as exemplified by the computer industry. TNCs tend to replace multinational, local-market strategies by global world-market approaches (Michalet 1994, 17-8). The type of FDI associated with it is efficiency-seeking. High value-added sectors, such as information technology, biotechnology, and pharmaceuticals, engage in this most recent form of FDI.

From emphasis on the quest for large markets to that of factor endowments (low-cost unskilled or semi-skilled labour, abundant natural resources) and finally to economy, efficiency, and flexibility, determinants of FDI evolve from the labour- to the skill-intensive type. Independent production by satellites abroad gives way to integrated global production structures. Upstream (backward) and downstream (forward) linkages, as well as multiplier effects in the form of extensive networks of subcontracting and procurement relations with local firms, are expected to result from "complex" integration and to densify wherever it comes into effect. "In the process, the nature of the world economy is undergoing a fundamental change: from being a collection of independent national economies linked primarily through markets, the world economy is becoming, for the first time, an international production system, integrated increasingly through numerous parts of the value-added chain of production" (UNCTAD 1994, 146).

This is a grandiose, almost stirring, vision, expressed with some flourish. The academic literature

subscribes to the general outlook and to the terminology. How accurate is this portrait? Lack of hard data about the extent of the transition to "complex" integration is a serious handicap. What emerges is a picture of the likely course of events. There is no way of knowing how far it has become fact.

There is a startling gap between current thinking on, allegedly, globalization-induced changes in international competition for FDI and the lack of recent empirical evidence on shifts in the relative importance of traditional and non-traditional determinants of FDI in developing countries....We find surprisingly little has changed so far: traditional market-oriented determinants are still dominant factors shaping the distribution of FDI. In particular, the large-country bias of foreign direct investors persists. Non-traditional determinants, such as cost factors, complementary factors of production and openness to trade, typically reveal the expected correlation with FDI. However, the importance of non-traditional determinants has increased at best modestly so far. (Nunnenkamp and Spatz 2002, 26)

As for FDI, unevenness in its spread and disparities persist across industries, countries, and TNCs. All three forms of integration are proceeding at the same time. More recent types of links are superimposed on older ones. Coexistence seems more tangible than replacement. Gaining market shares in host countries, exploiting low-cost locational assets, and benefiting from performance-enhancing advantages are proceeding simultaneously. As the productive process continues to be split, advanced locations are getting skill- and technology-intensive FDI; less developed areas are assigned assembly and packaging (UNCTAD 2001, 85). In accordance with the notion of comparative advantage, the process of specialization leaves lower-skill, more labour-intensive activities to the less-developed world and keeps the benefits of capital, know-how, and management to higher-income countries. The "value chain" is more like a vertically-positioned "value ladder" with affiliates placed on specific rungs. The exploitation of comparative advantages is aided by the existence of unequal or asymmetric levels of development and their effect on the international division of labour.

Conclusion

Gross outflow of long-term capital (FDI and portfolio) in the world was 3.3 percent of GDP in 1989-1991, up from 0.6-1.1 percent in the 1960s and 2 percent in 1984. However, the increase was in fact a recovery. The proportion had been at least 3 percent at the preceding peak in 1913, before the interwar trough during which even an active year like 1929 recorded no more than 1 percent. For the developed Western world, stock of FDI stood at 14-19 percent of GDP in 1913, 6.3 percent in 1980, and 12.9 percent in 1996 (Bairoch 2000, 205, 209). Has nothing changed? Is the situation basically one of continuity? Not quite. The greater relative importance of FDI, of the transnationalization of firms and of international production are laying the groundwork for globalization. They represent new steps potentially leading to globalization. The composition, density, and texture of capital flows is changing, although it is an exaggeration — or, possibly, premature — to write that "today's global companies are decentralized and willing to manufacture, design, or assign managerial authority wherever they can best serve the customer" (*Wall Street Journal*, 27 April 1990). In Dunning's (1995, 125) prudent formulation, economic activity is moving in the direction of globalization rather than away from it: "Perhaps the most distinctive feature of globalization — as compared with other forms of internationalization — is that it integrates the international value added activities of firms and countries in such a way that the prosperity of any one firm is inextricably bound up with that of its foreign production and marketing activities."

In contrast with the pre-1914 era, movement of capital is now mostly a North-North or rich-rich affair (Obstfeld and Taylor 2003, 173-6). In the North-South direction, flows, and rewards accruing therefrom, are by no means two-way. There is little reciprocity between developed and developing countries. Capital moves mostly from the former to the latter. Flow the other way is only a trickle; flow between developing countries is barely a drop. The identity of the chief exporters and importers of capital has changed but little. Understood as a "level playing field" on which actors interrelate in interchangeable roles, globality is far off.

Globalization is making headway. Some diffusion is occurring in three respects. The principal initiator and agent of internationalization in the past was the United Kingdom. Its share of the world's stock of capital invested abroad was 42 percent in 1914 and 39 percent in 1938; its share in the stock of FDI was 46 percent and 40 percent. The equivalent figures for the United States were 8 percent, 26 percent, 19 percent, and 28 percent. The US share of FDI stock was 49 percent in 1960 and 41 percent in 1978. Dropping steadily since then, it was recorded at 22 percent in 2002. In the area of international financial flows at least, the lead country or hub of the capitalist economy is less dominant than in the past.

Second, integration of the US and European or Japanese economies was a unidirectional affair from the 1940s to the 1960s, with the United States and its TNCs setting the agenda. Since the 1970s, European and Japanese TNCs have played a greater role. Integration is less one-sided and, therefore, becoming more global. Interdependence was either overstated or mere rhetoric when it was touted in the past. Now it is taking shape and giving substance to globalization. US TNCs have a historic lead in size, positions acquired in the world, and control of key technologies, but none of these are beyond the reach of European or Japanese TNCs.

Third, East and Southeast Asia is participating in two-way flows, more regional and more modest by comparison with North-North flows but not negligible. It is also integrating as an economic zone. Some handing down of industries or relocation of functions of the productive process in less developed neighbouring countries is taking place. In the "flying geese" model, the "lead goose," first Japan, then Korea, saw its home production move to capital- and technology-intensive activities, and passed on labour-intensive activities to more competitive, lower-labour-cost countries in the region (OECD 1998, 112). Emanating from the most developed countries, a regional division of labour has emerged among the "newly industrializing economies." Whether the model will hold for the integrated countries and how long it will be before they move up the "value chain" or "ladder" of production and pass on activities to next-tier areas remains to be seen. Whether Southeast Asia as a whole will ascend on the world "ladder" to a position such as Western Europe is too early to tell. Reciprocal FDI flows with the developed economies, an index of globalization, are still remote.

Internationalization and globalization have identifiable engines, namely some countries and the firms and capital located in those countries. Agency is determinable. Internationalization includes all types of capital, from the most rudimentary forms of merchant capital to FDI commanding complex multinational production. The more advanced the type of capital, the deeper the integration. Simple one-to-one ties are replaced by chains of production where participants are assigned given functions. Internationalization tends to be unilateral or lopsided. When backed by coercion, it can lead to exclusive (colonial) or hegemonic (imperialist) control.

If globalization is viewed as the pursuit of internationalization, then it is another term for an old fact. If not, then what distinguishes internationalization from globalization is not the type of capital or the depth of integration, but the capacity of the parties to act in a similar way toward each other. Can they

internationalize to the same degree vis-à-vis each other? Can they integrate each other to the same extent in the course of their internationalization? Internationalizing vis-à-vis third parties is continued internationalization. If globalization is new, then it implies reciprocal criss-crossing internationalizations. Where this is not the case, as in North-South relations, globalization is in fact internationalization renamed.

On a world scale, integration remains a hierarchic, top-down process still closer to continued internationalization conducted by and radiating from practically the same developed countries and TNCs than to a level global environment. Globalization is, at best, in its early stages. It should be understood as a process, not yet as a universal fact. At the moment, it is a localized phenomenon, verifiable in the developed countries of the North Atlantic and, to a more limited extent, in East and Southeast Asia but barely discernible elsewhere. In the rest of the world, the term is a misnomer or a more up-to-date package for internationalization, whether in old portfolio or in renewed FDI forms. Financially and industrially the world is not globalized but, barring reversals, it is globalizing.

In principle, globalization is not imperialism. The mobility, interconnectedness and integration it posits assume a world of equal conditions and opportunities, as free trade does. In practice, such conditions rarely exist and globalization occurs in an environment of inequality and capitalist competition. There is a gap between the ideal and the real. Globalizers have to possess the wherewithal to embrace globality and take advantage of it. Like free trade, globalization favours those with the means to benefit from a world outlook. It can reinforce or establish imperialist relationships. At the same time, it can be a convenient screen or justification for imperialism, and it is often taken to be one or the other or both.

The quest for autonomy is a response to internationalization and globalization, as well as to imperialism, their hegemonic variant. In the past, parrying internationalization implied loosening or severing ties with foreign capital (with or without rupture with capitalism as a system) and/or undertaking internationalization of one's own in geographical areas unoccupied by foreign capital. Parrying internationalization today is a more complicated proposition. Rupture with capitalism has ceased to be an option and is unlikely to become one again until socialist thinking is updated. Even keeping foreign capital at bay is considered no longer possible. All discussion of internationalization, globalization, or autonomy is, for the time being, framed within the capitalist system.

What is left? Carrying out one's own internationalization is one method of gaining the leverage needed to be more autonomous. Reverse internationalization in the home of foreign capital — in other words, globalization — would tend to level the field. Globalization would then be endowed with the unexpected quality of being an agent of autonomy. But setting out on the path of internationalization is a daunting challenge, given the material prerequisites or barriers to entry, and the advantages possessed by better-established competitors. Striving to rise on the "value ladder" designed by TNCs is another method. Its corollary is acceptance of the pattern of internationalization set by them. Can autonomy be political without being economic? Can political autonomy coexist with the absence of autonomy in the economic sphere? The existence of international legally based institutions and their capacity to enforce their rulings might help bridge the gap, but these waters are uncharted.

Appendices

Appendix 1: FDI Inflows and Outflows [View PDF](#) [Download Excel spreadsheet](#)

Appendix 2: International Capital Flows [View PDF](#) [Download Excel spreadsheet](#)

Appendix 3: Inward and Outward FDI flows as a Percentage of Gross Fixed Capital Formation [View PDF](#) [Download Excel spreadsheet](#)

Appendix 4: FDI Inward and Outward Stocks [View PDF](#) [Download Excel spreadsheet](#)

Appendix 5: Inward and Outward FDI Stocks as a Percentage of GDP [View PDF](#) [Download Excel spreadsheet](#)

Appendix 6: FDI Inflows and Outflows [View PDF](#) [Download Excel spreadsheet](#)

Appendix 7: Leading Recipient and Source Countries (Cumulative FDI Flows 1991-2000) [View PDF](#) [Download Excel spreadsheet](#)

Appendix 8: FDI Inward and Outward Stocks [View PDF](#) [Download Excel spreadsheet](#)

Appendix 9: Number of Companies in the Top 100 Non-financial TNCs (ranked by foreign assets) [View PDF](#) [Download Excel spreadsheet](#)

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Notes

1. There were exceptions, such as the purchase of over two-fifths of the shares of the Suez Canal Company by the British government on 25 November 1875 and a majority of the shares of the

Anglo-Persian Oil Company by the British Admiralty on 20 May 1914.

2. Until 1914, $1\text{£} = \$4.87$; $\$1 = \text{£}0.21$ (Maddison 1989, 157). Dollars referred to in the paper are US dollars expressed in current values.

3. International exchange rates were stable until 1914. They fluctuated after WWI with the onset of inflation, budget deficits, and other financial difficulties, but the dollar/pound parity did not change significantly until after WWII.

4. Of this $\text{£}3,763$ million, $\text{£}1,780$ million were in the Empire, $\text{£}755$ in the United States, $\text{£}757$ million in Latin America, $\text{£}218$ million in Europe and $\text{£}253$ million in the rest of the world.

5. Three-quarters of Britain's stock was concentrated in the United States, Canada, Australia and New Zealand, India and Ceylon, South Africa, and Argentina.

6. Until 1914, $1\text{F} = \$0.19$; $\$1 = \text{F}5.18$ (Maddison 1989, 157).

7. Until 1914, $1\text{M} = \$0.24$; $\$1 = \text{M}4.2$ (Maddison 1989, 157).

8. "Other countries" includes Belgium, the Netherlands, Portugal, Russia, Sweden, Switzerland and Japan. For a slightly different evaluation see (Fishlow 1985, 394).

9. Germany was the world's leading capital importer from 1924 to 1929. It absorbed nearly \$4 billion or twice what it paid out as reparations (United Nations 1949, 18).

10. In 1938, the parity of the dollar and the pound relative to each other was close to the 1913 level: $1\text{£} = \$4.89$, $\$1 = \text{£}0.20$ (Maddison 1989, 127).

11. "Other Countries" includes nineteen European countries. Total includes investments not classified by region.

12. Data in the United Nations publication is based on IMF *Balance of Payments Statistics Yearbook*

13. Based on US Department of Commerce *Survey of Current Business*, yearly table on "The International Investment Position of the United States." "Other sectors" include public utilities and trade.

14. Based on IMF *International Financial Statistics* and national sources. Hong Kong excluded. "Other Investment Liabilities" include short- and long-term trade credits, official bilateral and multilateral loans, currency and deposits, and other assets.

15. Based on World Bank *Global Development Finance* database (2001).

16. Based on BIS (1993-94, 148).

17. Based on IMF *International Financial Statistics*. Level of liabilities is largely due to rising imbalance of US accounts.

18. Output of goods and services, less foreign income.

19. Based on IMF *Balance of Payments Statistics*; e = estimate.

20. The 300 largest institutional investors in the United States held \$535 billion in 1975, equivalent to 30 percent of the country's GDP. In 1993, the sum was \$7,200 billion, or 110% of GDP (Cartapanis 1997, 168).

21. Four-fifths of Japanese holdings of overseas securities were in dollars, with half purchased in the United States, and one-quarter to one-third in Eurodollar bonds (Turner 1991, 58).

22. Based on J. P. Morgan. 1989. *World Financial Markets* 5.

23. Based on IMF *Balance of Payments Statistics* and national sources. See also (Alworth and Turner 1991, 136).

24. Based on IMF *Balance of Payments Statistics* and national sources. See also (Alworth and Turner 1991, 134).

25. Based on World Bank *World Debt Tables*, 1996.

26. The flight of capital belonging to Latin American nationals and its hoarding abroad, especially in US banks, raises questions about the extent of the input to host economies from outside. Apart from fear or the desire to speculate against the national currency, the country's inability to quickly absorb additional resources lead to a displacement of domestic resources.

27. Net transfers equal new finance minus dividend, interest, and capital repayments remitted abroad.

28. Data for Brunei and Hong Kong not available. The Asia-Pacific Economic Cooperation Council comprises developing economies (Korea, China, Hong Kong, Taiwan, Malaysia, Singapore, Thailand, the Philippines, Indonesia, Brunei, Papua New Guinea, Mexico, and Chile) and developed economies (Australia, New Zealand, Japan, United States, and Canada). Based on IMF *Balance of Payments Statistics*.

29. *Wall Street Journal*, 3 July 1997; 2 September 1997, 15 October 1997; 16 October 1997; 7 November 1997; 14 January 1998; 22 January 1998; 23 January 1998; 3 February 1998; 4 February 1998; 12 February 1998; 2 June 1998; 8 June 1998; 2 September 1998; 1 September 1999; 11 January 2001; 20 March 2001; 15 June 2001; 30 July 2001; 22 August 2001.

30. *Wall Street Journal*, 18 August 1998; 9 September 1998; 11 September 1998; 29 October 1998. Russia also defaulted.

31. See also the running debate in the *American Journal of Sociology* (Firebaugh 1992; 1996; Dixon and Boswell 1996a; 1996b).

32. However, FDI, a balance of payments concept, is distinct from the concept of "foreign-controlled enterprise," a subsidiary more than fifty percent-owned by a foreign parent company.

33. Whatever the threshold, only single transactions are considered. The fact that a non-resident may cross the threshold by means of more than one below-the-threshold transactions will go unnoticed

and add another element of uncertainty.

34. In 1994-1995, 60 percent of outflows from the United States were financed from reinvested earnings (UNCTAD 1996a, 44).

35. Based on IMF *International Financial Statistics*.

36. Authors' data drawn from the Bureau of Economic Analysis of the Department of Commerce, published in *Survey of Current Business*.

37. To secure a diversified portfolio of locational advantages, according to the current management lingo.

38. Foreign-owned US assets increased by an average of \$155 billion per annum during the 1980s, but at a rate of \$833 billion since 2000 (\$1 trillion in 2000) (Poole 2004, 2).

39. In fact, the Mannesmann acquisition was an exception to the rule. CbMAs by British companies were far more transatlantic than European.

40. *Wall Street Journal*, 21 May 1990; 1 March 1993; 1 July 1996; 8 July 1996; 29 July 1996; 24 September 1997; 1 December 1997; 9 December 1997; 3 January 2000.

41. Fifty-one percent in 1991, 62 percent in 1992, 68 percent in 1993 (OECD 1995, 23; World Bank 1997, 11).

42. Gulf started exploring in Cabinda Province in 1957 and found oil in 1966. Exploration by several companies continued impervious to a quarter-century civil war (*Wall Street Journal*, 13 November 1985).

43. See also (Basu and Srinivasan 2002).

44. Whether FDI represents "good cholesterol" and whether its increase, relative to portfolio investment and bank loans, is a symptom of good or poor economic health is a matter of controversy.

45. China's "path" has come under criticism because of its reliance on bureaucratic incentives, such as fiscal and commercial advantages, for foreign investment, at the expense of local capital (Huang 2003).

46. *Wall Street Journal*, 26 May, 22 September 1989; 10 April 1990; 24 May 1990; 21 October 1991; 7 February 1992; 9 April 1993; 24 June 1993; 17 September 1993; 22 October 1993; 15 December 1993; 27 December 1993; 12 May 1994; 3 July 1995; 25 July 1995; 4 August 1995; 7 August 1995; 22 August 1995; 23 August 1995; 25 September 1995; 21 November 1995; 29 December 1995; 4 January 1996; 25 October 1996; 10 February 1997; 19 February 1997; 28 February 1997; 3 March 1997; 18 March 1997; 30 June 1997; 19 August 1997; 22 September 1997; 19 March 1998; 14 April 1998; 23 October 1998; 5 February 1999; 29 March 1999; 7 May 1999; 7 October 1999; 7 December 2000; 7 February 2001; 11 May 2001; 5 July 2001; 20 September 2001; 6 December 2001.

47. Japan's investment in the United States rose nearly 28-fold to \$4.2 billion between 1973 and 1980, taking its share of overall foreign investment from 0.1 to 6.4 percent (*Financial Times*, 23 April

1982).

48. The UK was, nevertheless, the largest foreign direct investor in the United States.

49. Incidentally, Japanese divestment calmed mounting concern in the United States about foreign control, a novel situation for that country. See (Kudrle 1991; Reich 1989).

50. High-profile investments made in the late 1980s in real estate, such as the Waikiki beachfront and New York landmarks, and in Hollywood movie studios lost value.

51. Following Spain's entry in the European Union in 1986 and domestic liberalization, Spanish firms had to adapt, modernize, and grow quickly. FDI provided a potential strategy for growth. Spanish TNCs made acquisitions in the services sector in Latin America as privatization of state-owned enterprises was opened to foreign capital. The majority of telecommunications companies came under the control of Telefonica, the first real Spanish multinational. Itself a subsidiary of ITT until nationalization in 1944, Telefonica purchased ITT subsidiaries. Repsol (oil, gas, and chemicals), Endesa (electric utility), Banco Bibao Vizcaya, and Santander (bank) also participated in the "new conquest" by Spanish capital. Such acquisitions were among the few instances where cbMAs represented the mode of entry in developing countries (Arahuetes 2004; Toral 2001; *Wall Street Journal*, 23 May 1996; 3 May 1999).

52. SABIC (Saudi Basic Industries Corporation), a petroleum company, in 1997 and 2000.

53. Two companies in 1995, three in 1997 and 1998, four in 1999 and 2000, five in 2001 — Sappi, South African Breweries, Barloworld, Naspers, and Johnnic Holdings, respectively, paper, foods and beverages, diversified, media, and telecommunications companies (UNCTAD 1997; 1998; 1999; 2000; 2001; 2002; 2003).

54. The literature on the determinants of FDI is immense and well established. In particular, see (Ragazzi 1973; Krugman 1982; Lizondo 1991; Clegg 1992).

55. Reference here is to manufacturing. Because of the essentially international character of resource extraction, such as oil production, TNCs and FDI were common from the beginning.

56. The electronics industry is more closely associated with the next type of FDI.

57. Labour-intensive processing, assembly, and component manufacturing in low-income countries within vertically integrated international industries and with the object of exporting to other countries is not a novel phenomenon (Helleiner 1973). This author even refers to the "'globalization' of the outlook of international business" (ibid., 13).

58. Whereas in the past TNCs lined up to seek entry, now countries compete for FDI in a seller's market. One possible outcome is a "beauty contest," whereby aspiring host countries attend to domestic institutions, improve governance practices and transparency, enforce rule of law, streamline the judicial and supervisory frameworks, and so on, in order to be "attractive" (OECD 2001, 97). Another is a race-to-the-bottom lowering of standards, an unprotected expendable just-in-time work force, and a slash-and-burn attitude to the natural and social milieus as key features of an "attractive enabling environment."

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