Globalisation, Economic Development and the Role of the State

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Chapter 7

Globalisation, Transnational Corporations, and Economic Development: Can the Developing Countries Pursue Strategic Industrial Policy in a Globalising World Economy?*

1. INTRODUCTION

DURING the last quarter of a century, we witnessed a sea change in the prevailing view on the role of the state. The earlier interventionist orthodoxy that ruled the 'Golden Age of Capitalism' (1950-73) has been subjected to some severe, and in some areas fatal, criticisms, and currently the neoliberal vision, which draws its inspirations from the old liberal world order of the 1870-1913 period, dominates. On the domestic front, the current orthodoxy seeks to restore entrepreneurial dynamism and social discipline by rolling back the boundaries of the state through budget cuts, privatisation, and deregulation. At the international level, it seeks to accelerate global integration and convergence (a trend that orthodox economists believe started around 1870 but was reversed after the First World War) by reducing restrictions on the international flows of trade, direct and portfolio investments, and technology.1


1 It is interesting to note that most neoliberal authors hardly mention the issue of international flow of labour, much less the possibility of liberalising international migration. Cable (1995) is one of the few neoliberal writers who directly confront the issue of international labour mobility. For a discussion of this issue from a 'progressive' perspective, see Hirst and Thompson (1996: Ch.8). For a critical economics, see Chang and Rowthorn (1995: Introduction).
Yet even when considering the shift in the overall intellectual and policy atmosphere, the debate on developing country governments’ policies regarding transnational corporations (TNCs) has arguably experienced the most dramatic about-turn. (For some recent critical reviews of the literature, see Helmuter 1989 and Lall (ed.) 1993: Introduction.) Once regarded by many commentators as agents distorting, if not actually hampering, the development of poorer nations, TNCs are now regarded by many, including some of their earlier critics, as indispensable agents of development, promoting the integration of developing countries into the emerging network of globalised production and thus enhancing their efficiency and growth (e.g., see Julius 1990, 1994; UNCTC 1992; Michalet 1994; Brittain 1995). Even some of those who do not agree with this rose-tinted picture of TNCs accept the fact that increasing international economic interdependence, or ‘globalisation’, and especially the growth in the importance of TNCs in the process, is now unstoppable. Therefore, they argue, countries should adopt a more accommodating attitude toward TNCs whether they like it or not (e.g., see Stopford 1994).

This chapter critically examines the currently popular view that TNCs are the essential agents of economic development in the globalising economy, and it discusses whether the rise of TNCs would prevent the pursuit of ‘strategic’ or ‘selective’ industrial policy by developing countries, as is often alleged.

The structure of this chapter is as follows. After examining some basic facts about globalisation and the rise of TNCs in that process, we discuss the role of TNCs in economic development, drawing on some recent theoretical literature and on the experiences of certain East Asian countries, especially South Korea and Taiwan. We then discuss how much the recent (alleged) rise of TNCs has diminished the ability of developing country governments to conduct strategic industrial policy and examine the policy options open to developing countries on this front. The final section presents our conclusions.

2. GLOBALISATION AND THE RISE OF TNCs: MYTHS, FACTS AND NEGLECTED DETAILS

Discussions of recent trends in the rise of TNCs are often strewn with impressive facts and figures testifying to the increasing importance of foreign direct investment (FDI) and other activities by TNCs, even when compared to other international economic activities such as international trade.

First, for example, there are many statistics showing that FDI is playing an increasingly important and possibly leading role in the process of globalisation (all the following figures are from Stopford 1994, unless indicated otherwise). FDI has been growing four times faster than international trade since 1982. Since the 1970s, the combined output of TNCs has exceeded the volume of international trade. FDI in developing countries has increased as dramatically in recent years (for example, from $36.9 billion to $56.3 billion between 1991 and 1993; see Hutton 1995), suggesting that more and more countries are being drawn into the process of globalisation. TNCs manage about 75% of world trade in manufactured goods, over a third of which is intra-affiliate trade. They account for 75% of all industrial research and development in economies of the OECD (Organisation for Economic Cooperation and Development) (Archibugi and Michie 1995: p.130), and they dominate the international trade in technology payments. The examples could go on.

Secondly, it is argued, albeit anecdotally (partially, but not solely, because of an understandable difficulty in collecting the relevant data), that TNCs are becoming more and more ‘transnational’ and thus ‘stateless’. This process, it is argued, occurs not simply because of the sheer increase in the share of TNC activities that are located outside the home countries, but more importantly, through the relocation of ‘core’ activities such as R&D, and sometimes even of the corporate headquarters, out of the home countries (this process is described as ‘complex integration’ by UNCTAD 1993: Chapter 5). The emergence of the concept of ‘world car’ or ‘global car’ in the automobile industry or the establishment of R&D centres in the US or Europe by the Japanese and Korean computer TNCs are some of the most frequently cited cases in support of this argument.

Thirdly, the fact that some countries that ostensibly have had ‘liberal’ policies toward FDI (or at least toward some form of active TNC involvement) have performed well is often used as a ‘proof’ that liberal FDI policies benefit the host countries (e.g., see UNCTAD 1995: Chapter 5, and Ozawa 1995). The East Asian countries (except Japan, whose illiberal policies toward TNCs are well known) and certain post-reform Latin American countries, especially Mexico
(until the 1994-95 crisis), are often cited as examples of countries whose open attitudes toward TNCs led to industrial development and export success. It is argued that open trade and FDI policies have given them access not only to needed capital but also to advanced technologies, sophisticated managerial practices and distribution networks in the export markets, thus contributing to their spectacular growth and trade performance.

For many neoliberal commentators, such facts and figures seem to offer incontrovertible evidence that the world economy is becoming increasingly borderless and globalised, that in this process TNCs are playing an increasingly important (and now arguably leading) role, and that countries with open FDI policies have performed better than those with more restrictive policies. However, such a picture, as we shall see below, not only is inaccurate in many respects but, even where it is broadly correct, conceals an important degree of unevenness of the globalisation process across regions, countries, and industries. In the rest of this section, we offer an alternative picture to that painted by the supporters of globalisation, and try to show how many of their claims are exaggerated and overly generalised. Although some of the facts cited below are well known and are discussed in much further depth and in a much broader context elsewhere (for some recent examples, see Bairoch and Katz-Wise 1996; Hirst and Thompson 1996; Milberg 1998), it will be useful to state them in summary form here in order to put our later policy discussions into perspective.

First, the bulk of FDI occurs among the developed countries; only a handful of developing countries take part in the transnational investment story (Dicken 1992: Chapter 4). For example, in 1989, the Group of Five (G5) economies alone received 75% of world FDI (Hirst and Thompson 1992: p.366). By comparison, between 1983 and 1989, only 19.7% of world FDI went to developing countries (see Table 4). Although this share has increased (to 29.2% during 1990-94), it is still not of the size it is often made out to be. Consider, for example, the assertion by Sir Leon Brittan, former vice president of the European Commission, that 'over half of world FDI now goes to developing countries' (Brittan 1993: p.3). Especially when we exclude the flows to China, the increase in the share for developing countries is even smaller (from 17.8% to 21.0% between 1983-89 and 1990-94).2 Moreover, even within the developing world, FDI is highly concentrated among a few countries. Between 1981 and 1992, the 10 largest developing countries receiving FDI accounted for 72% of the developing country total (UNCTAD 1994: p.14, Table 1.5).3 These concentrations of FDI occurred despite the liberal FDI policies that many developing countries introduced during this period on the

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<tr>
<td>World total</td>
<td>106,827</td>
<td>211,072</td>
<td>162,662</td>
<td>164,399</td>
<td>206,320</td>
<td>231,125</td>
<td>195,116</td>
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<tr>
<td>Developing countries</td>
<td>21,024</td>
<td>34,687</td>
<td>40,878</td>
<td>54,634</td>
<td>72,642</td>
<td>82,131</td>
<td>56,994</td>
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<td>China</td>
<td>2,047</td>
<td>3,487</td>
<td>4,266</td>
<td>11,156</td>
<td>27,515</td>
<td>33,800</td>
<td>16,065</td>
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<td>Developing countries excluding China</td>
<td>18,977</td>
<td>31,200</td>
<td>36,512</td>
<td>43,478</td>
<td>45,127</td>
<td>48,331</td>
<td>40,929</td>
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Note: Figures in parentheses are shares in world total
Source: Calculated from UNCTAD, World Investment Report 1995, Annex Table 1.
*Estimates

2 Some commentators also suspect that a large portion of FDI into China is in fact domestic investment routed through overseas Chinese communities in order to exploit the privileges extended to foreign investors (see e.g., Hutton 1995).
3 Part of this concentration is obviously due to the fact that many of the largest recipients of FDI are also large economies (in terms of GDP). However, even after adjusting for the size of the economy, the concentration of FDI within the developing world still remains high. During the 1980s (1980-89), the 10 largest developing country recipients of FDI received 16.5% of the world’s total FDI, even though these countries accounted for only about 7.3% of the world’s total GDP (for 1980-89). The figures are extracted from Hirst and Thompson (1996c: Tables 5.2 and 3.4).
recommendation of neoliberal economists.

Secondly, while increasing ‘globalisation’ of TNCs is occurring, it is happening at a much slower pace and in a more uneven pattern than the proponents of the globalisation thesis believe. Most TNCs remain international firms with a strong base, in terms of assets and production activities, in their ‘home’ countries, and the alleged recent reduction in the importance of the home countries has been neither marked nor uniform across countries and industries (Hirst and Thompson 1996: pp.95-7). In addition, at most TNCs, the top decision makers are home country nationals (Kozul-Wright 1995: p.160). And when ‘core’ activities are relocated, they are moved primarily to other developed countries, usually in North America, Europe, and Japan (Hirst and Thompson 1992: p.368). As a survey by The Economist puts it, generally speaking, ‘what [TNCs] have done is to extend their home bases into neighbouring countries’ (The Economist, March 27, 1995, pp.15-6). Archibugi and Michie (1995) corroborate this statement by showing that the liberalisation of R&D, which is often regarded as the primary indicator of increasing liberalisation of TNCs through complex integration, is basically a ‘regional’ phenomenon – specifically US and Japanese TNCs do not do much R&D outside their home bases (except in Canada in the case of the US firms), while European TNCs do substantial amounts of R&D outside their home bases but mostly in other European economies.4

Thirdly, the attempt to support pro-TNC policies by using the examples of East Asian developing countries needs to be critically scrutinised. Many countries in East Asia, while not against hosting TNCs in certain areas, have had rather restrictive policies overall toward FDI. Only Malaysia and Hong Kong had largely (and even then not entirely) liberal attitudes toward TNCs. Singapore heavily relied on TNCs, but deliberately directed FDI toward government-designated priority sectors. Only in these three economies among the seven East Asian developing countries has the contribution of FDI as a

4 Also note the parallel phenomenon that, despite its allegedly growing importance, intra-industry trade also remains basically a ‘regional’ phenomenon – that is, there is little intra-industry trade between the three regional ‘clubs’ (Streeck 1993). Taken together, these two phenomena seem to suggest that there is a minimal efficient scale of the economy of which all European economies fall short. Of course, this does not imply that the size of the economy is the only factor involved in the determination of trade and TNC activities.

source of capital accumulation been exceptionally high by international standards (see Table 5).

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<td>Developed</td>
<td>n.a.</td>
<td>n.a.</td>
<td>2.3%</td>
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<td>European Union</td>
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<td>4.6%</td>
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<tr>
<td>Austria</td>
<td>1.8%</td>
<td>0.9%</td>
<td>1.3%</td>
<td>1.5%</td>
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<tr>
<td>France</td>
<td>1.8%</td>
<td>1.9%</td>
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<td>Germany</td>
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<td>0.8%</td>
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<td>Netherlands</td>
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<td>Sweden</td>
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<td>UK</td>
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<td>Switzerland</td>
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<td>US</td>
<td>0.9%</td>
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<td>Canada</td>
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<td>Japan</td>
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| Developing    | n.a.    | n.a.    | 3.3%    | 3.2%    | 5.7%    |
| Africa        | n.a.    | n.a.    | 2.3%    | 3.5%    | 4.6%    |
| Latin America | n.a.    | n.a.    | 4.1%    | 4.2%    | 6.5%    |
| Argentina     | 0.1%    | 2.1%    | 5.0%    | 11.1%   | 37.6%   |
| Brazil        | 4.2%    | 3.9%    | 4.3%    | 1.7%    | 1.5%    |
| Chile         | 7.3%    | 4.2%    | 6.7%    | 20.6%   | 8.5%    |
| Mexico        | 3.5%    | 3.6%    | 5.0%    | 7.5%    | 6.8%    |
| Asia          | n.a.    | n.a.    | 3.1%    | 2.8%    | 5.5%    |
| Bangladesh    | n.a.    | n.a.    | 0.0%    | 0.1%    | 0.2%    |
| China         | 0.0%    | 0.1%    | 0.0%    | 2.1%    | 10.4%   |
| Hong Kong     | 5.9%    | 4.2%    | 6.9%    | 12.9%   | 5.7%    |
| India         | 0.3%    | 0.1%    | 0.1%    | 0.3%    | 0.4%    |
| Indonesia     | 4.6%    | 2.4%    | 0.9%    | 2.1%    | 4.5%    |
| Korea         | 1.9%    | 0.4%    | 0.5%    | 1.2%    | 0.6%    |
| Malaysia      | 15.2%   | 11.9%   | 10.8%   | 11.7%   | 24.6%   |
| Pakistan      | 0.5%    | 0.9%    | 1.3%    | 2.3%    | 3.4%    |
| Philippines   | 1.0%    | 0.9%    | 0.8%    | 6.7%    | 4.6%    |
| Singapore     | 15.0%   | 16.6%   | 17.4%   | 35.0%   | 37.4%   |
| Taiwan        | 1.4%    | 1.2%    | 1.5%    | 5.7%    | 2.6%    |
| Thailand      | 3.0%    | 1.5%    | 3.0%    | 6.5%    | 1.7%    |
| Turkey        | n.a.    | n.a.    | 0.0%    | 2.1%    | 3.2%    |
| Eastern Europe| n.a.    | n.a.    | 0.0%    | 0.1%    | 12.2%   |

It should also be noted that, even in the case of these economies, it is general economic conditions and not exceptional FDI-specific incentives that mainly explain the large FDI inflows (World Bank 1985: p.130); this phenomenon is observed all over the world, not just in East Asia (Helleiner 1989: p.1467). In Korea, Taiwan, and Indonesia, the contribution of FDI to capital accumulation was in fact below the developing country average, with Korea distinguishing itself as having one of the lowest such ratios in the world (if not quite approaching the Japanese level, which is arguably the lowest in the world; see Table 5). In Thailand, which is usually regarded as a model ‘FDI-driven’ economy, the ratio of FDI to gross fixed capital formation was not much above the developing country average, and the ratio has actually slipped below the average in the early 1990s. Thus, the alleged importance of TNCs in East Asian development largely depends on one country’s experience, namely Malaysia, if we exclude the very exceptional cases of the two city-states of Hong Kong and Singapore.5

The above discussions show that, while TNCs are increasing in importance, the phenomenon is by no means a truly ‘global’ and even process. Most TNCs are still ‘national’ firms with peripheral operations abroad than truly ‘stateless’ bodies globally rearranging their activities in search of higher profits. Although there are signs that the picture is slowly changing, it is not clear at all how far this process will or can go (see Milberg 1998). Many developing countries and former Communist countries are still excluded from international FDI flows, and their ability to attract FDI has changed little (with some notable exceptions such as China and Vietnam), despite policy changes they have adopted during the last decade or so at the urging of (their own and foreign) neoliberal economists.

The alleged importance of TNCs in the developmental process of East Asia also turns out to be highly exaggerated. Many East Asian economies were not particularly reliant on FDI by international

5 Some commentators, while agreeing with our assessment of the past contribution of FDI to East Asian development, argue that the picture is changing, as shown in the rising importance of FDI within the East Asian region. However, this increase is mainly due to the recent rush of investment out of Japan and the first-tier newly industrialising countries (NICs) to the second-tier NICs and China. A lot of this investment is of a once-and-for-all nature, and therefore unlikely to be sustained.

standards, and most of their governments have taken ‘strategic’, rather than laissez-faire, attitudes toward TNCs to one degree or another and tried to influence the direction and the terms of engagement of incoming FDI. This is the broad empirical background against which we place our discussion.

3. TNCs AND ECONOMIC DEVELOPMENT

Those who argue for the liberalisation of policies toward TNCs have a strong belief that what is good for TNCs is good for the host country, and that the recent trend in globalisation is eliminating whatever minor conflicts of interests may have once existed between the two. So, for example, Julius (1994: p.278) argues that ‘[I]t is no longer appropriate to assume that government and corporate objectives conflict’. They regard the restrictive TNC policies that were popular in the 1960s and 1970s in many developing countries as ideologically motivated, and argue that ‘fortunately’ now ‘investment’ is recognised for what it is: a source of extra capital, a contribution to a healthy external balance, a basis for increased productivity, additional employment, effective competition, rational production, technology transfer and a source of managerial know-how (Brittain 1995: p.2).

However, the fact that there are few justifications for the extreme anti-TNC view that was once popular in some developing countries should by no means suggest that TNCs are unambiguously beneficial for economic development. (For some recent literature reviews, see Helleiner 1989; Lall (ed.) 1993; and Chudnovsky (ed.) 1993). While some earlier concerns about the ‘inappropriateness’ of the production technology or the product mix of TNCs were often misconceived and exaggerated, the problem itself is real and can be important in certain circumstances. Earlier criticisms of ‘surplus extraction’ through transfer pricing or excessive royalty payments, again, may at times have been out of proportion but the practices exist and can be significant and damaging. Predatory behaviour or manipulation of consumer preference by TNCs may not necessarily be more severe than that carried out by their local equivalents, but these are still practices to be reckoned with. Restrictions imposed by TNC headquarters on the exporting or R&D activities of subsidiaries may not be as widespread or important
as once thought but they nevertheless have to be minimised, especially if the host country government is keen on technological spillovers from the TNCs. The fears about manipulation of the overall national policy regime by TNCs through political influence may have been overplayed in the past, but these fears cannot simply be dismissed as unfounded.

More recently, careful analyses of empirical cases as well as developments in the economics of technology have shown the importance of domestic technological capabilities in sustaining long-term growth, and thus have raised further doubts as to whether inviting TNCs into a country is the best way to promote industrialisation (Fransman and King (eds) 1984; Fransman 1986; Haq et al. 1996). There is a growing consensus that accepting a ‘package’ of finance, technology, managerial skills, and other capabilities offered by TNCs may not be as good for long-term industrial development as encouraging national firms to construct their own packages using their own managerial skills – with some necessary outsourcing. As Lall (ed.) (1993) points out, while having more FDI may, on the margins, bring in net benefits to the host country, there still is a question of choosing between different strategies regarding the role of FDI in long-term development.

This critique of TNCs does not mean to imply that countries cannot develop if they rely extensively on TNCs. Singapore, as one obvious example, has managed to thrive. However, it should be noted that the Singapore government, while welcoming and actively courting TNCs, did not take a laissez-faire attitude to TNCs; rather, it deliberately directed FDI into strategic sectors. If Singapore, given its city-state status and unique political economy, looks like too much of an exception (which it is), one can always cite the example of Malaysia, where FDI indeed has played a crucial role in development. However, these cases still do not prove the desirability of a pro-TNC developmental strategy or the feasibility of its widespread adoption.

First of all, given its relative lack of experienced indigenous managers, qualified engineers, and skilled workers – a situation which is at least partly due to its reliance on TNCs – Malaysia is likely to find it difficult to move into the more sophisticated industries that will help it sustain long-term growth (e.g., see Lall 1995). Moreover, as Rowthorn (1996) argues, those who recommend the ‘Malaysian road’ to other developing countries do not realise that an implausibly large amount of additional FDI will have to be generated if the experience is to be replicated on a large scale.6

The experiences of the two ‘star performers’ of East Asia, namely, Korea and Taiwan, especially during their earlier days of industrialisation, also provide interesting insights into the role of TNCs in economic development. (For more details, refer to Koo 1993 on Korea and Schive 1993 on Taiwan.)7 While these countries have not been hostile to foreign technology or capital per se, they have clearly preferred, if the situation allowed, to use such technology and capital under ‘national’ management, rather than relying on TNCs.8 This preference was necessarily somewhat more tempered in Taiwan than in Korea due to the relative absence of large private sector firms in Taiwan, but both their governments have possessed a clear and sophisticated notion of the costs and benefits of inviting in TNCs, and they approved FDI only when they thought there were potential net benefits (the Korean government’s 1981 White Paper on Foreign

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6 Rowthorn (1996) calculates that if the share of FDI in GDP for the average developing country (excluding the first-tier NICs of Korea, Taiwan, Hong Kong, and Singapore) were to reach the same level as that of Malaysia between 1991 and 1993, namely, 10% of GDP, the world total level of FDI, which was already near its historical peak during this period, would have to increase by seven times, reaching a level equivalent to 1.7 times the total manufacturing investment of the OECD countries – a spectacularly unrealistic scenario. Rowthorn, however, does not take account of the fact that the 10% figure was exceptional even by Malaysia’s own historical standard, and therefore his calculation may exaggerate the situation.

7 At the time of final revision to this chapter (December 1997), it was announced that FDI policy is to be greatly liberalised in Korea following the conditionalities of the IMF bailout. However, the details of such changes are as yet not known, and how much change this liberalisation will eventually bring to the role of FDI in the Korean economy is not now clear.

8 This tendency was more pronounced in Korea. According to Armedon (1989), only 5% of total foreign capital inflows into Korea between 1965 and 1982 (excluding foreign aid, which was important only until the early-1960s) was in the form of FDI (p.92, Table 5).
Investment provides a fine specimen of such policy vision; see EPB 1981.\(^9\)

The most important policies toward TNCs employed by Korea and Taiwan were the restrictions on entry and ownership. In entry, for example, FDI in industries supplying critical intermediate inputs using sophisticated technology (e.g., petroleum refinery, synthetic fibres) or labour-intensive export industries generating foreign exchange and jobs (e.g., textile, electronics assembly) was encouraged when compared, say, to domestic market-oriented consumer durable goods industries. In Korea as late as the early-1980s, around 50% of all industries and around 20% of manufacturing industries were still ‘off-limits’ to FDI (EPB 1981: pp.70-1). Even when entry was allowed, the government of these countries tried to encourage joint ventures, preferably under local majority ownership, in an attempt to facilitate the transfer of core technologies and managerial skills. Again, in the case of Korea, even in sectors where FDI was allowed, foreign ownership above 50% was prohibited except in areas where FDI was deemed to be of ‘strategic’ importance, which covered only about 13% of all manufacturing industries (EPB 1981: p.70).\(^10\) As a result, as of the mid-1980s only 5% of TNC subsidiaries in Korea were wholly owned, compared to 50% in Mexico and 60% in Brazil – countries that are often believed to have had much more ‘anti-foreign’ policy orientations than Korea (Evans 1987: pp.208). Due to the scarcity of huge domestic firms that could become plausible joint venture partners, the Taiwanese government was more flexible on the ownership question, and thus in terms of ownership structure of TNC subsidiaries Taiwan was somewhere in between Korea and Latin America, with 33.5% of TNC subsidiaries (excluding the ones owned by overseas Chinese) being wholly owned as of 1985 (Schive 1993: p.319).

Policy measures other than the ones concerning entry and ownership were also used to control the activities of TNCs in accordance with national developmental goals. First, there were measures to ensure that the ‘right’ kinds of technologies were acquired in the ‘right’ terms. The technology that was to be brought in by the investing TNCs was carefully screened to ensure that it was not overly obsolete and that local subsidiaries were not subject to excessive royalties. Second, there were measures to maximise technology spillovers. Investors who were more willing to transfer technologies were selected over those who were not, unless the willing investors were too far behind in terms of technology. (For an interesting recent example, refer to the case of the Korean fast train project, described in the next section.) Third, local-content requirements were strictly imposed in order to maximise technological spillovers from the TNC presence. Targets for localisation were set realistically, however, so that the requirements would not seriously hurt the export competitiveness of the host country. It was in fact the case that in some industries they were more strictly applied to the products destined for the domestic market.

In this section, we have argued that the belief of some neoliberal commentators that what is good for TNCs is also good for the host economy is unwarranted. While some of the earlier criticisms of TNCs may have been misconceived, over-generalised, and exaggerated, there are many important areas where there exists an obvious conflict of interest between the TNCs and the host country. These include the issues of ‘appropriateness’ of technology, transfer pricing, monopolistic practices, restrictions imposed on the subsidiaries, particularly regarding exports and R&D, and even their ability to manipulate the overall national policy regime. Most importantly, recent theoretical
developments and empirical studies suggest that long-term productivity enhancement may be better achieved by an industrialisation strategy that puts emphasis on building local managerial and technological capabilities and uses TNCs in a selective, strategic manner to accelerate that process. We further illustrated this point with the examples of Taiwan and Korea, briefly commenting on their policies on TNC entry, ownership, contractual terms, technological spillovers, and local-content requirements. The policies employed in Korea and Taiwan suggest that, while TNCs can and should be used, their role needs to be clearly defined in relation to the overall industrialisation strategy and with reference to the specific needs of the particular industries concerned.

4. DOES THE RISE OF TRANSNATIONAL CORPORATIONS MAKE STRATEGIC INDUSTRIAL POLICY BY DEVELOPING COUNTRIES IMPOSSIBLE?

The proponents of the globalisation thesis have emphasised the constraints that the high degree of globalisation has placed on the policy autonomy of national governments (e.g., Julius 1994; Michalnat 1994). While sensible commentators are careful to dismiss the talk of the ‘demise of the nation-state’ as too simplistic and premature (e.g., Ostry 1990; Cable 1995), there seems to be a feeling among the majority of the writers on globalisation that a serious erosion, if not a total elimination, of national policy autonomy is only a matter of time, if it has not already happened. Together with the increased international financial capital flows that restrict the effectiveness of national macroeconomic policy, the role of TNCs in eroding such autonomy is often emphasised (Julius 1994; Michalnat 1994).

These commentators argue that, in such an environment, it is not possible anymore for developing country governments to employ ‘strategic’ (or ‘selective’) industrial policy. They believe that, whatever the benefits of this policy in the past (which they think were nonexistent or even negative anyway), it is not viable anymore, given the increasing importance of TNCs, which can relocate any or all of their activities in search of a better ‘investment climate’. Thus, by ‘voting with their feet’, it is argued, TNCs force the governments to stick close to the industrial policy regimes of their competitors, and indeed to move toward a more liberal policy regime in their competitive bids to attract the FDI that, in their view, is becoming increasingly important for wealth creation.

At one level, it seems difficult to deny such a claim. As firms become less bound by national constraints, it seems only natural that the effectiveness of ‘strategic’ industrial policy at the national level is bound to be reduced. And if this is the case, it also seems only natural that putting restrictions on TNCs when competitor economies do not would lead to the exodus of TNCs. However, this kind of reasoning is based on a number of explicit and implicit assumptions that do not have sound empirical justification or are products of unwarranted extrapolation from a limited number of cases. Let us examine them one by one.

First, the argument that TNCs will migrate to the country offering the best deal is based on the assumption that TNCs always have an upper hand in bargaining. (For further discussion of the bargaining issue, see Helleiner 1989.) However, the relative bargaining strengths of TNCs and national governments depend on which industry and which country we are talking about and when the bargaining is taking place (relative advantages change over time).

11 Unlike some other terms used in economics, the term ‘industrial policy’, also known as ‘strategic’ or ‘selective’ industrial policy, suffers from a serious definitional ambiguity. While many authors have tried to define it as encompassing all policies that affect industrial performance, we reject such a broad definition, which almost entirely takes away the analytical edge that the term has, and adopt a narrow definition, namely a policy that attempts to affect the evolution of specific industries (and even specific firms when they are large enough) through state intervention in order to effect ‘national’ efficiency and growth. See Chang (1994; pp.56-61) for a more systematic discussion of this problem. Also, it should be noted that, in the context of the present chapter, aiming for ‘national’ efficiency and growth does not rule out the use of ‘foreign’ firms, as far as these firms do not seriously undermine national policy autonomy.
While there are some industries for which many countries qualify as feasible investment sites, there are certain other industries for which feasible investment sites are limited for a number of reasons; many mineral-related industries require investments near the depositories; some industries require particular types of skilled labour at reasonable prices, which many countries may not be able to supply; some countries have locational advantages, say, as an entry point into a big market; some countries have exceptionally large and/or fast-growing markets; and so on.

So, it is not just that governments compete for FDI, but also that TNCs compete for attractive host countries. The clearest example of the latter is the recent bargaining between the Chinese government and various automobile TNCs regarding the selection of a partner to produce the 'people's car'. Lured by the prospect of being the first mover (or at least one of the first movers) in what may soon become one of the biggest passenger car markets in the world, many TNCs (including the German luxury car makers Benz, BMW, and Porsche, which emphasised that its founder, Dr. Porsche, was the original designer of the proverbial 'people's car', Volkswagen) were putting forth fiercely competitive bids (Financial Times, November 23, 1994).

While few countries can expect to have China's level of bargaining power, they can still extract substantial concessions from TNCs. The recent granting by the Korean government of its fast train project to the Anglo-French joint venture GEC Alstom, organised around the producer of French TGV (which offered more in terms of technology transfer than the Japanese or German firms that offered superior products), is one such example (Financial Times, August 23, 1993). Another instructive example comes from the upstaging of GM's talks with the Polish government regarding the takeover and restructuring of the ailing state-owned automobile company FSO by the South Korean automobile maker Daewoo (which, ironically, was a 50-50 joint venture with GM until 1992) in 1995. Daewoo's offer to inject a large amount of capital ($1.1 billion) in order to transform FSO as its major platform for exports of passenger cars and car parts (engine and gear boxes) to the European Union suddenly gave the Polish government enormous bargaining power. GM upped its offer, but eventually

Daewoo clinched the deal (Financial Times, various issues between August and October, 1995).12

These examples show how even governments from countries that do not have the Chinese government's kind of unique bargaining power can play one TNC against another in order to extract greater concessions. Needless to say, many developing countries have few attractive productive assets or locational advantages for which TNCs will compete, and as a result they may not be able to follow the Chinese lead. However, a few will have at least some 'bargaining chips'. And once TNCs are interested in a country, their political vulnerability as 'foreign' firms can make them even more responsive than their domestic equivalents to the demands of the government. It is also worth noting that newly-emerging TNCs from East Asia are pursuing an aggressive strategy of expansion in order to challenge the established TNCs from North America and Europe, thus offering valuable additional room for manoeuvre for host country governments — as was so dramatically illustrated by the Polish automobile industry example cited above.

Second, regarding the freedom of TNCs to seek the best deal, there are certainly some industries with low sunk costs involved in investments and which are therefore 'footloose' (e.g., garments, shoes, toys). But many other industries have high sunk costs, not only in terms of dedicated physical equipment (e.g., chemicals, pharmaceuticals) but also in terms of subcontracting networks and other relationship-specific activities that firms have taken time to build (e.g., advanced electronics, automobiles). In such industries, TNCs are not entirely footloose, and they cannot pull out at the slightest adverse change in host country policies.

Of course, this does not mean that in such industries governments can do anything they want once TNCs have made the investments, since what the government does now will affect future investment

12. It was reported that the granting of the deal for FSO to Daewoo could result in the injection of an extra $1 billion through the establishment of another joint venture to produce vans at PZ Lubaź, where Daewoo had entered into a separate joint venture to assemble small passenger cars. If that deal were to occur, the total investment from Daewoo could amount to $2.1 billion, which will be just under half the total FDI that has flowed into Poland since its economic reform (Financial Times, August 28, 1995).
decisions by TNCs. However, as Ostry 1990: p.98) suggests, the larger TNCs are able and often willing to accommodate a lot of 'restrictive' policy measures, as long as they are stable and the changes predictable. Thus, although we have surprisingly little systematic evidence in this regard, it seems reasonable to say that [the real question to ask of TNCs] is not why they are always threatening to up and leave a country if things seem to go bad for them there, but why the vast majority of them fail to leave and continue to stay put in their home base and major centres of investment’ (Hirst and Thompson 1992: p.368).

Third, those who criticise ‘restrictive’ policies toward TNCs, assume that FDI decisions are mainly affected by the amount of business freedom granted to them (e.g., Julius 1994: pp.278-9). However, FDI decisions are much more strongly affected by the overall performance of the economy, especially the prospect for growth. Even the World Bank, which is often associated with liberal policies toward TNCs, argues that ‘[t]he specific incentives and regulation governing direct investment have less effect on how much investment a country receives than has its general economic and political climate, and its financial and exchange rate policies’ (World Bank 1985: p.130). In other words, the evidence suggests that growth leads to FDI rather than the other way round (see Milberg 1998). If so, it is questionable whether adopting a more liberal FDI policy will lead to any substantial increase in FDI flows, since there is no evidence that such a policy leads to an improvement in the country’s growth performance – which is by far the most effective way to attract FDI.

This argument is also supported by the fact that, as we also have seen above (Table 4), the share of developing countries (not counting China) in the world’s total FDI has increased only marginally over the last decade, despite the extensive liberalisation of FDI policies. Thus, it may be argued that as far as they do not involve asset appropriation and other measures that threaten basic capitalist property relations, FDI policies seem to be much less important than other factors, such as the growth prospect of the country’s domestic market or the country’s political stability, in determining investment decisions by TNCs. Such an observation leads us to conclude that the current argument for liberal policies for TNCs in developing countries based on the ‘globalisation’ thesis is at best distracting our attention from more important issues, or at worst is being used, if unconsciously, as a stooge in the scare tactic to drive more developing countries onto a neoliberal ‘reform’ path.

This section discussed how the claims of the impossibility of strategic industrial policy in an era of growing TNC importance have been exaggerated and are based on questionable assumptions. It should be emphasised that, perhaps except for the poorest countries with meagre natural resource endowments, small domestic markets, and no locational advantage, potential host countries are not merely passive victims: they have, and often exercise with substantial success, considerable bargaining power in their dealings with TNCs. Claims about the footloose nature of TNCs are also often exaggerated. There are many industries where investments involve a large amount of sunk costs (both in terms of physical capital and production networks) that restrict the mobility of the firms involved. It is also the case that the largest TNCs are able and often willing to live with restrictive policies as long as they are stable and predictable. Overall, the regulatory regime for TNCs is, as far as it is not impossibility restrictive, only a minor consideration in TNCs’ choice of investment sites when compared to things like the market growth prospect. Given that promoting growth is the most effective way to attract FDI, having a well-conducted selective industrial policy may, contrary to the conventional wisdom, help the country attract more FDI.

5. POLICY OPTIONS FOR DEVELOPING COUNTRIES

All the skepticism expressed in the preceding sections regarding the conventional wisdom about the role of TNCs in developing countries is not meant to imply that therefore the rise of TNCs can be comfortably ignored. While the current claims about the end, or at least a serious weakening, of the nation-state are often exaggerated, it is true that the growth in the number and scope of TNCs (and globalisation in general) has resulted in restrictions on the scope of strategic industrial policy and other national policies as well (see Panic 1998). Such restrictions result not only from the greater bargaining power that firms will have against national governments due to their ability to shop around for investment sites, but also from the concern by the
government that, if it provides TNCs with some help as a part of its industrial policy, the benefits will spill over the national border and thereby reduce the cost effectiveness of the policy (Chang and Rowthorn 1995: pp.44-5).

Despite such problems, intelligent governments should try, and have tried (as seen in some East Asian countries), to use TNCs in a strategic way in order to acquire necessary capital, technology, marketing networks, and so on. What exactly the 'strategic way' means will depend on various factors, such as the country's relative bargaining position, the technological nature of the industry, the role of the particular industry concerned in the bigger scheme of industrial development, and so on, but we illustrate our point with a few examples. (See also Stopford and Strange 1991: Chapter 4.)

In those industries where what is needed is a simple injection of capital to create jobs and foreign exchange earning capability, it may be acceptable, or even important, that the country have an open policy toward FDI. 'Cash cow' industries like garments, shoes, and toys are examples of such industries. In industries where the capital and technological requirements are high and where the government expects the major return to be the 'rent' element - such as oil, mineral, and other natural resource extraction industries - having an open attitude toward FDI may be crucial. However, in such cases, the bargaining skills to extract the largest possible shares of the rent element and, more importantly, the plans to effectively use the rent from such industries for the development of other industries will be crucial to the success of overall industrial policy.

When the industries concerned are the ones in which a country hopes to become internationally competitive in the long run but that require a major injection of new technology and capital, TNC participation may be desirable. However, in such industries, a tough bargaining position on issues like technology transfer or export and R&D restrictions imposed on the subsidiary will be crucial (as seen in the examples of the Chinese car industry and the Korean fast train project cited above). In other industries, where a country is reasonably close to achieving international competitiveness, keeping the TNCs out may be necessary in order to allow local firms maximum learning opportunities, especially if the domestic market is small. Even in high-tech industries, where the ability to keep up with the technological devel-

opments of the most advanced TNCs is (allegedly) becoming crucial, it is possible to devise effective 'national' technology policies based on selective interactions with foreign TNCs (see Fransman 1994 for the example of Japan; see Evans 1998 for examples from developing countries).

This list can be further elaborated, but the point here is that an intelligent government pursuing a strategic industrial policy will not have a 'uniform' policy toward TNCs across industries, as many neoliberal economists recommend. Each industry serves different functions in the greater scheme of industrial development, and it would be foolish to have either uniformly restrictive or uniformly liberal policies toward TNCs across different industries. This also means that the same industry may, and indeed should, become more or less open to FDI over time, depending on the changes in the various internal and external conditions that affect it. For example, the government could initially have a liberal FDI policy for a new industry in order to establish it, but subsequently impose tougher restrictions on TNC subsidiaries when it is deemed that the industry has developed enough local technological capability so that with continued, if diminishing, government support, it can operate competitively within the domestic economy and internationally. Alternatively, when there is a major technological change in a certain industry that makes the country's present technological capability inadequate for international competition, the government may relax rules concerning TNC participation in the industry in order to gain access to the new technology.

It is one thing to say that countries should use TNCs in a strategic manner and another to say that they can actually afford to play such a strategic game. The poorest developing countries, for example, will have weak bargaining power vis-à-vis TNCs in most industries, as the industries for which they are attractive investment sites are usually the ones in which TNCs are the most mobile. On the other hand, many developing countries have some 'bargaining chips', at least in relation to some industries. Some can offer the prospect of a large and/or rapidly growing domestic market, especially in industries where transportation costs are relatively high or where proximity to consumers is important for marketing (e.g., China, India, Brazil, and the rapidly growing East Asian countries). Some countries, somewhat paradoxically due to their anti-capitalist past, possess workforces that
are relatively well educated and well trained for what they cost (e.g., Eastern Europe, Vietnam, and China). Some other countries possess the locational (and legal) advantage of having easier access to large markets (for example, Mexico, the Central European countries, and the Southern European countries). Even some very poor economies have mineral and other natural resources to offer.

Needless to say, having such potential bargaining power does not directly translate into the right amount and composition of FDI, unless general economic conditions are right. Achieving the right balance of FDI will require an internally coherent government that is politically willing and administratively capable of actually exercising such bargaining power. However, adopting liberal FDI policies across all sectors and industries will mean giving up one's potential bargaining power in those sectors before even exercising it, and that does not seem to be particularly wise. Even if many developing countries have relatively little bargaining power vis-à-vis TNCs, and even if such power is diminishing with globalisation, they need not give up what little bargaining power they still have, since what national governments do still matters greatly for the determination of the costs and benefits of FDI.

6. CONCLUSION

In this chapter, we tried to question some myths about globalisation, and more specifically myths about the growing importance of TNCs, by presenting some basic but often neglected facts. While the interdependence between different parts of the world may be increasing, and while the role of TNCs in that process is growing, it is still too early to say that we now live in a totally new world in which national policies are at best ineffective and at worst obstacles to the achievement of 'world efficiency', as some proponents of the globalisation thesis

seem to believe.

We also argued that, while some of the early fears about TNCs were clearly unwarranted, there are good reasons to believe that an industrialisation strategy based on a laissez-faire attitude toward TNCs may not be as successful in the long run as a more selective, strategic approach, as seen in the examples of countries like Korea and Taiwan. Moreover, as we pointed out, despite the recent increases in their importance, TNCs do not have unambiguously superior bargaining power in all industries in relation to all countries. Their bargaining power ranges from almost absolute (e.g., Nike looking for an investment site for shoe production) to close to zero (e.g., automobile TNCs trying to curry the favour of the Chinese government for the people's car), depending on the industry and the country. This observation actually strengthens, and not weakens, the case for strategic industrial policy, because it means that governments should design their policies toward TNCs according to the particular sector concerned, rather than taking a uniform approach across sectors.

Although the constraint imposed by TNCs on national industrial policy may be growing, it is nowhere near the point where a strategic industrial policy is impossible. The current literature tends to regard the process of globalisation and the rise of TNCs as an unstoppable process that no one can control and in which nations, especially developing nations, are passive agents that will have to fully embrace this process or perish. However, such a view is misleading, since there is a lot of room for manoeuvre for national governments and since such room may even be increasing for some countries in some industries, especially with the recent aggressive expansion of some TNCs from East Asia (also see Milberg 1998 and Evans 1998). It would be a big mistake for a developing country to voluntarily give up all such room for manoeuvre by adopting a universally liberal FDI policy across all sectors. What is needed is a more differentiated and strategic approach to TNCs, which will allow host countries to intelligently 'use' TNCs for their long-term developmental purposes.

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13 Many governments suffer from interdepartmental rivalry in the design and execution of policies toward FDI. Moreover, a large country with a de jure and de facto decentralised power structure (e.g., the US, China) may see its national bargaining powers weakened due to competition among the local governments. The author thanks William Milberg for raising this point.
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Chapter 8

Intellectual Property Rights and Economic Development: Historical Lessons and Emerging Issues*

1. INTRODUCTION

As will become clearer later in this chapter, the role of intellectual property rights (henceforth IPRs) in economic development has always been a controversial issue. However, the debate surrounding it has become even more heated after the Trade-Related Intellectual Property Rights (TRIPS) Agreement. Initially, TRIPS was not even a central issue in the Uruguay Round of the GATT talks that led to the birth of the World Trade Organisation (WTO) (Siebeck 1990a), and therefore did not get much attention. A number of recent events, however, have come together to make people realise that this could become the biggest point of contention in the running of the WTO in the coming years.

The first thing that drew public attention to TRIPS was the fact that the ‘transition’ period allowed for the developing countries to ‘upgrade’ their IPRs regimes in accordance with the TRIPS Agreement was coming to an end, thereby exposing them to greater dangers of trade sanctions by the advanced countries (end of 2000, except for the least developed countries, which were given until 2006). Second,

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