Copyright in relation to this thesis*

Under the Copyright Act 1968 (several provision of which are referred to below), this thesis must be used only under the normal conditions of scholarly fair dealing for the purposes of research, criticism or review. In particular no results or conclusions should be extracted from it, nor should it be copied or closely paraphrased in whole or in part without the written consent of the author. Proper written acknowledgement should be made for any assistance obtained from this thesis.

Under Section 35(2) of the Copyright Act 1968 'the author of a literary, dramatic, musical or artistic work is the owner of any copyright subsisting in the work'. By virtue of Section 32(1) copyright 'subsists in an original literary, dramatic, musical or artistic work that is unpublished' and of which the author was an Australian citizen, an Australian protected person or a person resident in Australia.

The Act, by Section 36(1) provides: 'Subject to this Act, the copyright in a literary, dramatic, musical or artistic work is infringed by a person who, not being the owner of the copyright and without the licence of the owner of the copyright, does in Australia, or authorises the doing in Australia of, any act comprised in the copyright'.

Section 31(1)(a)(i) provides that copyright includes the exclusive right to 'reproduce the work in a material form'. Thus, copyright is infringed by a person who, not being the owner of the copyright, reproduces or authorises the reproduction of a work, or of more than a reasonable part of the work, in a material form, unless the reproduction is a 'fair dealing' with the work 'for the purpose of research or study' as further defined in Sections 40 and 41 of the Act.

Section 51(2) provides that "Where a manuscript, or a copy of a thesis or other similar literary work that has not been published is kept in a library of a university or other similar institution or in an archives, the copyright in the thesis or other work is not infringed by the making of a copy of the thesis or other work by or on behalf of the officer in charge of the library or archives if the copy is supplied to a person who satisfies an authorized officer of the library or archives that he requires the copy for the purpose of research or study'.

*Thesis' includes 'treatise', dissertation' and other similar productions.
The Rise and Fall
of the
General Theory
of
International Direct Investment

by Michael Rafferty

Thesis submitted in fulfillment of the requirements of Doctor of Philosophy Department of Economics, University of Sydney, March 1997
Acknowledgements

In writing the thesis, I have accumulated a long list of debts to friends, family and colleagues. It gives me great pleasure to be able to acknowledge the generosity of some of those people here.

The thesis had its genesis in my Honours thesis dealing with the rise of the 'entrepreneurial' companies, Bond Corp. and the Bell Group. The encouragement and support of my Honours supervisor, Scott MacWilliam, has continued throughout.

During research for the thesis, I visited the University of London, Centre for Australian Studies. The Centre provided a perfect base for my research, and the support of Kirsten McIntyre in particular was most appreciated. During my stay in Europe, I was accepted as a visitor at the Bank for International Settlements in Basle. The Chief Economist at the Bank, Phillip Turner, was very generous in discussing my research and providing many references. The librarians at the Bank were also very helpful during my visit. While in Switzerland, I also visited the United Nations Centre for Research on Transnational Corporations, in Geneva, where I obtained several valuable references. I would also like to acknowledge the friendship provided by Betty Weillenmann during my stay in Switzerland.

While in London, many people helped to contribute to the thesis research, and that time has also helped in many crucial ways in developing the analytical approach of my thesis. The generosity and advice of Geoff Kay in particular was most important. Professor Jim Gower gave me some valuable insights into the reform of the City and the financial sector in Britain during the 1980's. Sue Harvey shared her wonderful home with me during my stay in London.

I would also like to thank my colleagues at the University of Western Sydney, where I have worked during the final stages of the thesis. The UWS Library, especially Sue Oram and Margaret McIntosh, helped me with many important references. Thanks are also due to Anne-Marie Sykes from IBIS Business Information for her time, advice and access to the IBIS company data base.

My fellow PhD candidates, Neil Ackland, Verity Carney and Gabrielle Meagher, have helped in many ways in clarifying the arguments and ideas presented in the thesis. I would also like to thank my flatmates and friends who have had to endure the research and writing of the thesis. Many thanks are also due to Janece, who has persevered with me and the project.

Bernadette Riordan assisted greatly with laying out the text and making the tables and charts clear and accessible. Lachlan Gilbert helped with proof reading.

Finally, I am deeply indebted to my thesis supervisor, Dick Bryan. His comments and advice have made a lasting impression on the development of the thesis. Like his written work, those comments have also made a significant contribution to my intellectual development.

The thesis is dedicated to my mother and father, Dorothy and Andy Rafferty.
# Contents

<table>
<thead>
<tr>
<th>Chapter 1</th>
<th>INTRODUCTION</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.0</td>
<td>Introduction</td>
<td>6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Chapter 2</th>
<th>THE ANALYTICAL DEVELOPMENT OF INTERNATIONAL DIRECT INVESTMENT (IDI) IN HISTORICAL PERSPECTIVE</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>Introduction</td>
<td>14</td>
</tr>
<tr>
<td>2.2</td>
<td>The Historical Development of IDI before World War Two</td>
<td>17</td>
</tr>
<tr>
<td>2.2.1</td>
<td>Introduction</td>
<td>17</td>
</tr>
<tr>
<td>2.2.2</td>
<td>The Nineteenth Century Theoretical Foundations of Modern IDI Theory</td>
<td>18</td>
</tr>
<tr>
<td>2.2.3</td>
<td>The Development of International Direct Investment in the Nineteenth Century</td>
<td>24</td>
</tr>
<tr>
<td>2.3</td>
<td>THE POST-WAR DEVELOPMENT OF IDI THEORY</td>
<td>30</td>
</tr>
<tr>
<td>2.3.1</td>
<td>The Rationale for an Analytical Watershed</td>
<td>30</td>
</tr>
<tr>
<td>2.4</td>
<td>Competition, Capital and Internationalisation: The Key Categories of IDI Research</td>
<td>32</td>
</tr>
<tr>
<td>2.5</td>
<td>The Breakdown of General Theories of IDI during the 1970's and 1980's</td>
<td>37</td>
</tr>
<tr>
<td>2.6</td>
<td>Conclusion</td>
<td>38</td>
</tr>
<tr>
<td>Appendix 2.1</td>
<td>Rethinking the Nineteenth Century</td>
<td>41</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Chapter 3</th>
<th>IDI IN THE 1950's AND 1960's</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>INTRODUCTION</td>
<td>44</td>
</tr>
<tr>
<td>3.2</td>
<td>The 'Stylised Facts' of Post-War IDI</td>
<td>45</td>
</tr>
<tr>
<td>3.2.1</td>
<td>Rapid Growth of IDI</td>
<td>46</td>
</tr>
<tr>
<td>3.2.2</td>
<td>Corporate Form of IDI</td>
<td>47</td>
</tr>
<tr>
<td>3.2.2</td>
<td>Concentration of IDI by the US</td>
<td>49</td>
</tr>
<tr>
<td>3.2.3</td>
<td>Industrial Composition of IDI</td>
<td>51</td>
</tr>
<tr>
<td>3.2.4</td>
<td>Geographic Pattern of IDI</td>
<td>52</td>
</tr>
<tr>
<td>3.2.5</td>
<td>Trade and IDI</td>
<td>56</td>
</tr>
<tr>
<td>3.3</td>
<td>Explaining 'The Stylised Facts' - The Development of the Key Concepts of Post-war IDI Theory</td>
<td>58</td>
</tr>
<tr>
<td>3.3.1</td>
<td>Introduction</td>
<td>58</td>
</tr>
<tr>
<td>3.3.2</td>
<td>IDI and the Concept of Capital</td>
<td>59</td>
</tr>
<tr>
<td>3.3.3</td>
<td>IDI and the 'New' Form of Internationalisation</td>
<td>62</td>
</tr>
<tr>
<td>3.3.4</td>
<td>IDI and the Concept of Competition</td>
<td>66</td>
</tr>
<tr>
<td>3.3.5</td>
<td>Summary</td>
<td>68</td>
</tr>
<tr>
<td>3.4</td>
<td>Conclusion and Summary</td>
<td>69</td>
</tr>
</tbody>
</table>

| Appendix 3.1 | Portfolio Investment and Exchange-Rate Models of IDI - The Currency Area Model | 71 |
| Appendix 3.2 | Trade Models of IDI | 75 |
| Appendix 3.3 | Industrial Organisation Models of IDI | 77 |
| 3.3.1     | Introduction | 77 |
| 3.3.2     | The Elaboration of Industrial Organisation Models | 79 |
| 3.3.3     | Monopoly Advantage Models | 79 |
| 3.3.4     | Oligopolistic Behavioural Models | 80 |
| 3.3.5     | Monopoly Capital Models | 82 |

<table>
<thead>
<tr>
<th>Chapter 4</th>
<th>IDI IN THE 1970'S</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.1</td>
<td>Introduction</td>
<td>86</td>
</tr>
<tr>
<td>4.2</td>
<td>Stylised Facts of 1970's IDI</td>
<td>87</td>
</tr>
</tbody>
</table>
4.2.1 Introduction
4.2.2 Growth Of Outward IDI from a wider range of Source Countries
4.2.3 Growing Concentration of IDI flows towards the Developed Countries
4.2.4 Changing Industry Pattern of IDI
4.2.5 Changing Institutional forms of International Organisation associated with IDI
4.2.6 IDI and the Growing Internationalisation of Firms
4.2.4 Changing Sources of Financing of IDI
4.2.7 Changing Relationship between International Direct Investment and Trade
4.2.8 Summary

4.3
The Analytical Explanation of the Stylised Facts of 1970's IDI
4.3.1 Trade Theory and Locational Models of IDI in the 1970's
4.3.2 Industrial Organisation Models - Internalisation and Transaction Cost Models

4.4
The Eclectic Model of IDI

4.5
Summary and Conclusion

Appendix 4.1 Trade Models of IDI
4.1.1 The Product-Cycle Model of Trade and IDI
4.1.2 The "Trade Enhancing" (Kojima-Ozawa) Model of IDI
4.1.3 Dependency Analysis as a Model of IDI

Chapter 5
DEVELOPMENTS IN THE STYLISTED FACTS OF 1980's AND EARLY 1990'S IDI

5.1
Introduction

5.2
Spectacular and Uneven Growth of IDI

5.3
Concentration of IDI Between Industrial Countries

5.4
Extension of IDI across all Industry Sectors.

5.5
Changes in the Source and Nature of IDI Funding
5.5.1 Introduction
5.5.2 Growth in International Capital Markets
5.5.3 Reduction in demand for credit from traditional sources
5.5.4 Financial Innovation
5.5.5 International Credit as a Major Source of 1980's IDI.
5.5.6 Global Credit Boom and the Internationalisation of M&A activity
5.5.7 M&A Activity and the Boom in 1980's IDI
5.5.8 Takeover Activity and the Restructuring of Corporations
5.5.9 Global Pools of Finance Exposed Large Firms to Takeover
5.5.10 Changing Forms of International Control

5.6
Summary - The 1980's challenge to the Conventional Conceptions of Capital, Competition, and Internationalisation

Chapter 6
EXPLAINING THE STYLISTED FACTS OF 1980'S IDI

6.1
Introduction

6.2
Theoretical Models of IDI at the beginning of the 1980's

6.3
Reconstituting the Concept of Capital- Exchange-Rate Models

6.4
Reconstituting the Concept of Competition - Trade Models

6.5
Reconstituting the Concept of Internationalisation - Industrial Organisation Models

6.6
The State of IDI Theory in the mid-1990's
6.6.1 Not IDI at all, or just an exceptional period
6.6.2 No general theory and accept a more descriptive paradigm 172
6.6.3 Greater eclecticism 173
6.6.4 A general theory of accumulation not IDI 175

6.7 Conclusion - Towards an Alternative Methodology for the Research of International Investment 177

Chapter 7 IDI IN THE 1980'S AND 1990's- 183
7.1 Introduction 184
7.2 IDI Theory in The Australian context: IDI Inflow 185
7.3 The Emergence of Large-Scale Outward IDI from Australia in the 1980's - An Overview 190
7.4 The Rise and Fall and Rise of Outward IDI from Australia, 1980 - 1995 193
7.5 The Funding of Outward Australian IDI 201
7.7 Conclusion 209

Appendix 7.1 Corporate Case Studies of 1980's and 1990's DIA 213
News Corp. 213
TNT Ltd 218
BHP Ltd 222
Bond Corp. Ltd 225
Elders IXL 228

Chapter 8 SUMMARY AND CONCLUSIONS 232
8.0 Summary and Conclusions 233

BIBLIOGRAPHY 240
INTRODUCTION
1.0 INTRODUCTION

The issue of ‘globalisation’ has become one of the hot topics of contemporary economic discourse. It can be observed that debate and discussion about globalisation has emphasised the ‘newness’ of processes and developments that have led to globalisation, yet the multinational corporation (MNC) is its key analytical subject (Dicken 1992). What lies behind the analysis of MNCs, however, is the generic concept of international (or foreign) direct investment (IDI) - investment by a non-resident which permits foreign control over a corporation. The current debate about globalisation - the forces which drive it; the relation between national and international processes; and the relation between international capital and the state - all have their antecedents in debates about IDI. Yet the concept of IDI itself, and the modern theory used to explain it, have been continually evolving. The analysis of IDI, as indeed with the recent discussion of ‘globalisation’, has therefore been more about evolving processes than of the identification of structural transformations.

This thesis explores the rise and fall of the general theory of (IDI) during the post-Second World War period. The analysis it develops seeks to contribute to an understanding of the evolving analysis of international capital (and in so doing provide a perspective on current discussions such as that on globalisation) by looking at the post-war IDI - both the development of the stated general theory, and the processes it sought to explain, and the processes it could not explain.

IDI, and its institutional proxy, the Multinational Corporation (MNC), are now such a commonplace part of international economic activity it is often not appreciated that until very recently, IDI and particularly the MNC, were understood to have been developments unique to the post-Second World War period\textsuperscript{1}. Similarly, the theory of IDI as a distinct analytical subject, has only a relatively brief history. The modern theory of IDI only emerged in the 1950’s and 1960’s to explain the particular pattern of international investment in the early post-war period. IDI had of course a much longer history, but rather than the evolution of past processes of international investment, the dominant theory constructed 1950’s and 1960’s IDI as a distinctive and ‘new’ phenomenon. The circumstances that made the 1950’s and 1960’s appear as a new era, also helped to encourage the construction of post-war IDI as a unique analytical period constitutive of a new set of theoretical tenets.

The conceptual agenda of post-war IDI theory was thereby invested with particular meanings, derived from the need to explain the ‘stylised facts’ of 1950’s and 1960’s IDI. These characteristics thus dictated a particular understanding of the concepts and categories of IDI research. In this way, post-war IDI theory emerged out of what Dunning and Rugman (1986) termed the “straightjacket of neo-classical-type trade and financial theory”\textsuperscript{1} with a distinct conceptual structure of its own. While the thesis will demonstrate that IDI theory retained much of its neoclassical heritage, one of the advantages of IDI theory over pre-war neoclassical trade and investment theory was that its conceptual framework was established on the basis of explaining actual developments in international capital, not as embellishments of a hypothetical model.

\textsuperscript{1} The terms TNC and Multinational Corporation (MNC) are specifically inventions of the post-war period.
Post-war IDI also became understood and defined by economic theorists so that the patterns and determinants were assumed to be generative of universal and general postulates. It was in this context that IDI researchers were encouraged to think that they had discovered (or were in the process of discovering) a general theory of IDI, which would be applicable for predicting and explaining all future IDI.

The theory of IDI developed in the 1950's and 1960's entrenched an analytical framework which has lasted far beyond the explanation of the early post-war circumstances. The thesis contends that the widely held conception of a new era served to confuse the particular characteristics of IDI in the 1950's and 1960's with theoretical postulates about the nature and motives of IDI for all times. Despite the many changes in the pattern and characteristics of IDI since the 1960's, the conceptual agenda and methodology of IDI theory established in the early post-war period has remained at the centre of IDI research. One consequence of this conceptual framework has been that the focus on the post-war form of IDI imposed a certain analytical inflexibility into the methodology of IDI research. Thus, even though IDI and the TNC have become more and more significant features of the international economy since the 1960's, those patterns and characteristics have not been easy to 'fit' into the conceptual propositions of 1950's and 1960's-derived theory. Indeed, the static and ahistorical nature of IDI theory has now become a widely acknowledged problem (Buckley 1985; Dunning 1986; Casson 1986). Perhaps in this context, theories of 'globalisation' evolving in the current era can be seen in part as a conception of international capital breaking free of the straightjacket of IDI theory. The salutary lesson is that theories of globalisation should not mistake current processes as the future organisational form of capital for all times, and thereby, as for 1950's and 1960's IDI, mistake historically-specific processes for a new systemic logic.

The thesis develops a way of comprehending the apparent paradox that just as IDI theory was reaching its highest point of acceptance as a general theory in the 1970's, the changed stylised facts of 1970's IDI were already beginning to challenge the conceptual underpinnings of the new and apparently general theory. As one astute observer concluded, the changing pattern and characteristics of IDI in the 1970's had "emphasised the unique characteristics of the international economy in the 1950's and 1960's that have colored our view of the direct investment process" (McClain 1983). After explaining how those 'unique characteristics' were constituted as the analytic foundations of the new theory of IDI, the thesis proceeds to examine how IDI theory sought to absorb the unexpected changes in 1970's IDI by way of a modification of some of those 1950's and 1960's-derived concepts. For most of the 1970's, research interest in IDI remained high, and researchers were convinced about the importance of IDI as an international process. They also shared a generally optimistic outlook about the development of a general theory of IDI. By the end of the 1970's, the nature and scale of changes in the 1970's was coming into conflict with the 1950's and 1960's-derived concepts of the general theory. Several of the more perceptive theorists began to raise doubts about some of the more exaggerated claims that were being made about the general and universal nature of IDI theory. In retrospect, it is now apparent that, by the late 1970's, the 'heroic age' of IDI theory was already over.
The 1980’s proved to be a watershed in the post-war development of IDI theory. Transformations in both IDI, and its relationship with other international processes, moved analytical debate beyond a discussion of the difficulties in explaining some aspects of IDI, to the identification of structural weaknesses common to all models of post-war IDI. By the mid-1980’s, this had extended to a shared recognition that there was no really satisfactory general theory of IDI at all. Theoretical scepticism has since extended to the conclusion that a general theory of IDI is now not even possible. In an analytically confronting environment opinion is predictably divided.

There already exists many literature reviews examining divisions and debates, juxtaposing different general themes of IDI theory. Yet if there is now doubt that there ever was a general theory of IDI (that is, no more than the depiction of historically specific circumstances), or that there can no longer be a general theory, IDI research can no longer be performed as if the theoretical foundations of IDI are still constitutive of a general theory. This necessitates consideration not just of the explicit points of difference within the general theoretical debates, but more importantly a ‘deconstruction’ of those debates. The thesis explores those debates by providing an historical and analytical framework for exploring the development of post-war IDI theory, and providing a basis for contextualising both the changes in IDI as well as the continuities. This will also involve an examination of the particularities of recent IDI as a way of providing a way of reconstituting the analytical framework of IDI theory.

The thesis argues that the structuring of IDI theory as a distinct and evolving object of analysis can be understood through three concepts which have informed IDI research - the concepts of competition, capital and internationalisation. The way these concepts were deployed by the new theory helped to mark IDI theory off from other branches of economics, and also formed the basis of the evolution of division and debates within IDI theory. The concepts of capital, competition and internationalisation are also used to show that post-war IDI theory embodied a methodology that made it vulnerable to ongoing change in the 1970’s and 1980’s.

Most of the thesis is divided into chapters that are constructed broadly around the post-war decade, but the thesis emphasises the need to understand historical change as a continuous process, and the continuity of change is a major analytical theme of the thesis. Historical change and epochs are no respecters of decades, and the division of Chapters into decades is therefore more a matter of convenience of exposition than a representation of distinct breaks in the evolution of IDI. During the period under investigation, some changes were occurring quickly, while others were occurring more slowly, and many trends ‘spilled’ across decade boundaries.

Nevertheless, a segmentation of chapters by decades is not without significance. The 1950’s and 1960’s cover roughly the period of the long boom and the international economy during this boom was associated with a new surge in IDI. The 1950’s and 1960’s were also characterised as a new era in the international economy, and the development of IDI can be understood in terms of the attempt to explain a form of international capital that appeared to unique to this new era. Similarly, the decade of the 1970’s starts with the unravelling of the long boom, the onset of recession and
changing determinants of IDI - in particular a diversification of both sources of IDI and forms of international control.

Finally, the 1980's and 1990's has been marked by a more pervasive globalisation of capital flows (and the blurring in the earlier descriptive boundaries between forms of international capital). Although these processes were clearly developing during the second half of the 1970's, associated with the progressive lifting of capital controls, the widespread impact of that change, and its reflection in IDI theory, manifested only in the 1980's and 1990's. The breakdown in the notion of a general and universal theory of IDI can thus usefully be considered in terms of a post-1970's demarcation. The thesis has attempted to acknowledge threads of change running through the history of IDI, but it bears emphasising at the outset, lest the formal separation into discrete chapters be taken as over-exaggerating ruptures in the process of change.

Chapter 2 considers the analytical problem of post-war IDI in historical perspective. In the context of the breakdown of the post-war theory of IDI as a universal and general theory, it is necessary to explore the terms of earlier debates that made the explanation of post-war IDI generative of a general theory of IDI. The chapter outlines the pre-Second World War history of international investment as the antecedent which provided the appearance that the analytical framework of post-war IDI was a departure. The chapter also introduces the conceptual categories of capital, competition and internationalisation within which the development of IDI theory has taken place.

Chapter 3 explores the process by which a general theory of IDI emerged out of attempts to explain the ‘new’ pattern of IDI in the early post-Second World War period. The chapter addresses the ‘stylised facts’ of IDI in the 1950's and 1960's, and shows that indeed the post-war pattern of international capital underwent some important changes. However, the way that post-war IDI was understood tended to obscure an appreciation of pre-war IDI. Hence, a central conclusion of the chapter is that the depiction of post-war IDI as ‘different’ can be verified, but the proposition that it was ‘new’ and therefore warranted a discrete and ahistorical theory to explain it, was to misunderstand a novel form as a new phenomenon.

In Chapter 4, the continuities and ongoing changes in the patterns and characteristics of IDI during the 1970’s are explored. It is shown that the continued growth in 1970’s IDI and the areas of resemblance with 1950’s and 1960’s IDI, emphasised the importance of the IDI process, and reinforced the conception of a new analytical era. The 1970’s also marked the highpoint in optimism that a general theory of IDI had been (or was being) developed. Although there were by now a growing number of competing models of IDI, and active debate between them, the models operated mostly within a shared conceptual framework. At one level then, the 1970’s seemed to provide support for both the distinctiveness of IDI theory, and of the relevance of the concepts that had underpinned and unified post-war IDI research. The Chapter shows, however, that just as the general theory was reaching the peak of its popular acceptance, the concepts underlying the theory were already starting to unravel in the face of ‘unexpected’ changes in the stylised facts of 1970’s IDI.
Chapter 1 - Introduction

During the 1980’s, a hiatus in the development of IDI theory was transformed into a crisis for the general theory. Whereas in the 1970’s, there had been a growing recognition that all models were encountering difficulties in explaining one or more aspects of ongoing change in the patterns characteristics of IDI, by the 1980’s, structural weaknesses began to be identified within the core analytical assumptions and propositions of IDI theory. In the 1990’s, models of IDI are no longer advanced within a shared discourse of a general theory. Instead, models are now advanced only in terms of descriptive paradigms or of historically and nationally specific models.

Chapters 5 and 6 consider the changing stylised facts of 1980’s and 1990’s IDI, and how the problems encountered in their explanation, turned a general uncertainty about how to reconcile ongoing change through existing models of IDI, into a generalised crisis in IDI theory. In Chapter 5, the stylised facts of 1980’s and 1990’s IDI are considered separately from their analytical explanation in Chapter 6. The rationale for such a separation is that IDI theorists have not been able to agree about which facts of 1980’s and 1990’s IDI are relevant for, and therefore warrant investigation within, IDI theory. In the context of a growing apprehension about the general and universal nature of the theoretical framework for IDI, the stylised facts of 1980’s IDI cannot therefore remain a solely descriptive question. The problem of whether to include many recent developments, and even how those developments should be constituted into the stylised facts is also very much a theoretical problem. Indeed, the blurring in the boundaries between IDI and other forms of international capital has signalled the difficulty of developing an analytical framework ‘internal’ to IDI. Nevertheless, the broader range of relevant ‘facts’ warrants a separate chapter, because the changes have been so profound in terms of their impact upon the general theory of IDI.

Chapter 6 also suggests an alternative methodology for IDI research. IDI theory has concentrated on the changing internal organisation and structures of capital, on the international circulation of capital, and commences with an analytical focus on the national dimensions of international capital. By contrast, an alternative methodological agenda addresses the transformations in international capital in terms of their implications for social relations of accumulation, as an inherently global process. This methodology is explored in terms of a case study of direct investment abroad from Australia in the 1980’s.

Australia represents an important and interesting case study, and not simply because it happens to be the author’s primary place of residence. Australia was the site of large IDI inflow in the 1950’s and 1960’s and studies of Australia proved to be important in the development of post-war IDI theory. Further, in the 1980’s, from a very low base DIA from Australia increased rapidly before collapsing in the late 1980’s. The recovery of DIA growth in the 1990’s has likewise shown several particular characteristics, with a large proportion of the growth continuing to come from just a few companies, but this time concentrated in the banking and finance sector. This exaggerated the national pattern of DIA from Australia by global standards and can thus be used to illustrate (and indeed qualify) some of the theoretical and methodological contentions of made in Chapters 5 and 6.
The thesis sets out to trace the rise and fall of the general theory of IDI in the post-war period. It is necessary to note that such a thesis cannot hope to cover all the IDI literature and facts comprehensively. What the thesis has attempted to do is to provide a representation (and acknowledgment) of the key contributions and positions. Such a task presents notable difficulties for IDI theory, because the concept of IDI has been and is still a ‘moving target’. Not only have the statistical definitions changed over time (especially in terms of the criteria of foreign ownership and control), but the theory and facts are not separate. Theory dictates how facts are collected as well as how they are interpreted. In identifying the evolution of categories as well as in the ‘facts’, it is difficult to stay outside the contemporary discourse and yet to still give substance to the interplay between the facts and theory over time.

Looking back from the vantage point of the 1990’s, it is of course possible to see many limitations in the 1950’s and 1960’s-derived theory. There is a danger here of analytical smugness, or a sort of historical condescension by using present insights as the benchmark by which to judge the competence of past theoretical and empirical analyses. The thesis is a considered attempt to restrict this tendency by engaging with the literature on its own terms, as well as in its historical context. Much of the detailed interstices of the historically specific debates about IDI theory appears in appendices to chapters, but these appendices should be considered an integral part of the analysis. They provide more than just an acknowledgment of the rigorous analytical work and important debates by which IDI theory has developed and evolved. If there is one basic point to come out of this thesis, it is that no single interpretation offers the final word. Nevertheless, each contribution should put its case forcefully. That is the spirit in which this thesis has been written.
CHAPTER 2

THE ANALYTICAL DEVELOPMENT OF INTERNATIONAL DIRECT INVESTMENT (IDI) IN HISTORICAL PERSPECTIVE
2.1 **INTRODUCTION**

International investment has been a longstanding feature of the world economy\(^1\), yet international direct investment (IDI) has been widely considered to be a phenomenon mainly of the post-World War Two period. At least that is the way the development of post-war IDI theory presented history until relatively recently\(^2\). The paradoxical effect of the post-war focus has been to present the particular processes of that period as if they formed the basis of a general theory of IDI which could apply to all periods. Hence the theory of IDI has not only tended to neglect the nature of international investment before the Second World War because it did not fit the post-war pattern or ‘logic’, the theory has continued to understand 1970’s and 1980’s IDI in the same terms as 1950’s and 1960’s IDI. The effect of this focus has been to dictate a particular understanding of IDI\(^3\).

Rather than a development or evolution of past processes of international investment and exchange, the dominant theory constructed 1950’s and 1960’s IDI as a *new* phenomenon - there seemed to be something distinctive and exceptional about the decades after the Second World War which generated this *new* form of international investment. The circumstances that made the 1950’s and 1960’s appear as a ‘new’ era also resulted in the construction of post-Second World War IDI as a unique analytical period. This view of a new epoch was widely shared by IDI theorists. Judd Polk (1969) noted that modern IDI theory began as a ‘lagging reaction’ to the post-war growth of the international company in particular and to the form of post-war internationalisation of production more generally\(^4\). Fieldhouse (1986) suggested in this context, that the modern theory of the international firm developed out of the belief that the post-war large-scale international company was a unique phenomenon, while Buckley and Casson (1987) have suggested that the post-war ‘take-off’ of international investment and business was one of the key phenomena that any model of IDI was required to explain.

A further consequence was that this focus on the post-war form of IDI imposed a certain analytical inflexibility into the underlying nature of IDI, presenting the ‘new’ post-war logic as if it were an analysis for all IDI at all times. Research in the 1960’s and 1970’s generated certain areas of debate, but seemed to confirm that the process of international direct investment was related to a number of fairly novel (and universal) characteristics\(^5\). These characteristics dictated a particular understanding.

---

1 Polanyi 1957; Braudel 1982; Hobson 1965; Hobshawn 1974; Kay 1975; Bryan 1995.
2 It will be shown during the thesis that this theoretical blindspot to pre-war IDI and pre-war international investment theory has been largely undermined. However, it has had a lasting effect on the way the theory’s own history has been understood. A recent comprehensive 24 volume reference library on the MNC devoted a whole volume to the theories of IDI and the MNC (Dunning 1994). It contained no theoretical material written before the Second World War.
3 It will be observed later that historians of IDI and the international company have recently emphasised the counterfactual to modern IDI theory that both IDI and the international firm have a considerable history before the Second World War (Wilkins 1970, 1975; Fieldhouse 1978; Jones 1987).
4 It will be shown in the chapter that IDI theory has been playing 'catch-up' with ongoing changes over the entire post-war period.
5 The development of IDI theory in a period when global IDI was dominated by firms from the US meant that as Hertner and Jones (1986) observed "American concepts and data have dominated most of both the theoretical and historical research on MNEs". Because early post-war IDI was dominated mostly by large industrial companies,
of the institutional form of IDI. The conceptual agenda of modern IDI theory was therefore established in terms of the requirement to explain the underlying economic logic to the observed pattern and institutional form of early post-war IDI.

The explanation of these post-war developments was critical in shaping the modern theory of IDI, and the concepts used to explain those developments represented a watershed in the economic theory of IDI. They were also the basic circumstances that created the appearance for economists in the 1950’s and 1960’s that the post-war phenomenon of IDI was new and discrete. It was in these circumstances that the post-war theory of IDI came to be presented as a general theory, not as an explanation of historically specific patterns.

As with most theoretical discoveries, there was a tendency to overplay both the degree of novelty and the universality of the discovered process. In overplaying its universality IDI theorists were, however, no more guilty than, for instance, the post-war Keynesians who believed they had developed a new ‘general theory’ of macroeconomics. And, as for Keynesianism, the stability of the long post-war boom appeared to provide support for that belief. Nevertheless, as with Keynesianism, history has shown that the confidence in the IDI theory of the 1950’s and 1960’s was not sustainable. The important question, in writing a history of IDI theory therefore, is not just to show that post-war theory was in some sense ‘wrong’, but to ‘deconstruct’ the categories which were used to make historically-specific processes appear as if they were universal across space and time.

The seemingly universal categories of IDI research developed in the 1950’s and 1960’s have been remarkably durable, and contemporary patterns of IDI are still understood largely in terms of the early post-war theory. Charles Kindleberger (1984), one of the leading figures in the development of modern IDI theory, suggested that despite the many advances in IDI research and the many changes in patterns of IDI over the post-war period, contemporary theoretical models of IDI were still largely based on the insights and concepts of models developed in the 1950’s and 1960’s.

Nevertheless, the durability of the overall theoretical paradigm has not prevented considerable adaptation within IDI theory. By contrast with other branches of economics, modern IDI theory has been shaped both by the requirements of describing the (unique) characteristics of early post-war international investment,

---

6 For surveys of the characteristics of post-war IDI see Giddy and Young (1982); Cantwell (1982) and Hufbauer (1975).
7 In particular, Kindleberger suggested that there was nothing being offered by contemporary models of IDI that was very different from insights offered by Stephen Hymer’s 1960 PhD thesis.
8 The particular pattern of IDI in the 1950’s and 1960’s is what Casson referred to as the ‘stylised facts’ that provided the stimulus to the theoretical development of IDI. He suggested that “the need to explain these facts has guided the development of the theory throughout, and this has conferred on the theory its major strength relative to other branches of economics, namely its immediate practical relevance” (1987). This can be contrasted with for instance, general equilibrium theory which is not, except in a very limited sense, an explanatory or descriptive paradigm (Harcourt 1982, p 227).
and in explaining ongoing change in IDI, within the broad paradigm established in the 1950’s and 1960’s. Nevertheless, responsiveness to change has been both a strength and a weakness of IDI theory. Both the fact of change (the theory’s inability to anticipate it) and the nature of that change (the increasing difficulty of any individual model of IDI being able to explain all aspects of IDI) have meant that in many ways IDI theory has been forced to retrospectively modify the categories that have underpinned it as a universal and general theory.

Since the 1970’s, and particularly in the 1980’s and 1990’s, developments in the financing of investment, in the globalisation of production, in the forms of intra- and inter-firm organisation and trade, in modes of cross border business, and in the mobility of capital, have transformed the nature and context of IDI. These developments surely challenge the usefulness of analytical categories developed on the basis of 1950’s and 1960’s processes. It will be shown in the following chapters that the theory of IDI and the MNC, conceived in the particular circumstances of the 1950’s and 1960’s, has had great difficulty comprehending these changes, and in integrating an explanation of them into a general theory.

Indeed, the effect of these developments has been to cause some IDI theorists to call for a radical re-think of the way IDI has been conceptualised in the past, and for some to even declare an end to the whole project of a general theory of IDI. Leading IDI theorists such as Mark Casson (1986), Peter Buckley (1986) and John Dunning (1987) have all ruled out the possibility of a single predictive theory. For them, the project of IDI theory is now to provide a descriptive framework or paradigm for IDI research. Fieldhouse (1987), on the other hand, has gone even further and suggested that IDI theory was flawed from the outset, because it attempted to put together a range of disparate processes into a single theoretical model. In an analytically-confronting environment, opinion is predictably divided.

It is germane to this chapter to provide a historical context to examine those divisions and debates. There already exist numerous of literature reviews juxtaposing different general themes. Yet if there is now doubt that there ever was a general theory of IDI (that is, no more than the depiction of historically-specific circumstances), or that there can never be a general theory, it is essential to first to explore the terms of earlier debates. This will necessitate consideration not just of the explicit points of difference in the general theory debates, but more importantly a ‘deconstruction’ of those debates. This chapter explores those debates by providing an analytical framework for exploring post-war IDI theory in historical context, and providing a basis for contextualising both the changes in IDI as well as the continuities.

The current chapter begins by outlining the pre-Second World War history of international investment as the antecedent which provided the analytical framework

---

9 The strength of IDI theory has been its engagement with immediate empirical material. The weakness lay, as noted in the fact that IDI theory had attempted to generalise explanations based on one historical period without recognising that these developments were themselves part of a longer-term process.

10 A general conclusion to emerge from the crisis of IDI theory has, however been to call into question the universality of some of the underlying conceptual categories used in IDI research.

for which the ‘new’ theory of IDI was a departure. A second and related issue involves a consideration of some of the key conceptual categories within which the IDI debate has taken place. There has been ongoing debates within IDI research, and a number of competing models of IDI have been advanced. There are also underlying concepts which give an overall coherence to the theory of IDI (Casson 1987).

The structuring of theories of IDI and their conceptual agenda as a distinct body of research is embodied in three concepts which have informed IDI research - the concept of competition, the concept of capital and companies, and the concept of internationalisation. The way in which these concepts are used help to mark IDI theory off from other branches of economics, and also forms the basis of the evolution of divisions within IDI theory.\textsuperscript{12}

After exploring the historical background to post-war IDI, this chapter examines how the development of IDI through these three broad themes (or concepts) was related to the nature of the historical epoch within which IDI theory developed. The chapter then provides an overview of the key contemporary developments in the pattern of IDI during the 1970’s and 1980’s, and how they have provoked a crisis in theory and broken down the idea of a general theory of IDI. The chapter concludes by noting how a parallel re-evaluation of IDI theory - by economic historians of nineteenth century IDI - also challenged the conceptual agenda of post-war IDI and its claims to universality.

The purpose of the chapter is twofold: to show that there was a nineteenth and early twentieth century tradition to analysing international investment, for which the development of post-war IDI was not compatible; and to establish the historical and theoretical circumstances within which the interpretation of international investment patterns during the 1950’s and 1960’s appeared to have produced new and (what were then thought to be) universal theoretical categories.

\section*{2.2 The Historical Development of IDI before World War Two}

\subsection*{2.2.1 Introduction}

It is generally agreed that the modern theory of IDI and the multinational corporation (MNC) is a relatively recent development, dating from the post-Second World War period, and especially from the 1960’s. The term ‘multinational corporation’ (MNC) is itself a specifically post-war invention. The origin of the term has been traced to David Lilienthal, who first used it in April 1960 to describe the problems being faced by American corporations with operations involving direct managerial responsibility abroad. He suggested that MNCs “have their home in one country but which operate and live under the laws and customs of other countries as well” (quoted in Fieldhouse 1984).

\textsuperscript{12} The concept of capital, competition and internationalisation are broadly linked and no attempt is made to suggest that the concepts are separate and distinct. They are however, sufficiently distinct to separate for explanatory purposes.
Yet investment has moved on an international scale (including as international direct investment) long before the Second World War\textsuperscript{13}. And investment was in many ways ‘international’ even before most modern nation states as such existed and certainly before the large public corporation had developed\textsuperscript{14}. The depiction of IDI as a post-World War Two phenomenon therefore involves a ‘blind spot’ in the way investment was understood. This section seeks to establish the historical and theoretical circumstances that made the post-war theory of IDI appear as though it was explaining a unique or ‘new’ pattern of internationalisation and that the categories used to explain that period’s IDI could be then used to explain IDI for all times.

2.2.2 The Nineteenth Century Theoretical Foundations of Modern IDI Theory

Theories of international exchange were quite well developed in the century before the development of the modern theory of IDI. Most of the theories of the international economy were not, however, constituted as theories of international investment as such. The development of mainstream international economics in the nineteenth (and early twentieth) century was characterised by the generalisation of the assumption of international factor immobility. The prevailing assumption of international economics in the nineteenth century was that commodities were exported, but capital reinvested at home to expand production. This was never an entirely valid assumption\textsuperscript{15}, but in the mid-nineteenth century investment was still enough of a subsidiary process that economists could explain international investment in derivative terms. Until the late nineteenth century, it was still widely held by the leading economists of the time, such as Cobden and Mill, that commodity export was the ‘normal’ basis of international exchange and international investment a minor process only undertaken in abnormal circumstances. This view of abnormality often extended to a criticism of international investment as a ‘delusion’ and a ‘snare’ (Blake 1939).

In the second half of the nineteenth century, several developments, (including the financial success of the flotation of American railroad companies) began to increase the significance of international investment and changed the “financial emphasis of many countries” (Blake 1939)\textsuperscript{16}. The increasing importance of international investment did not, however, include emphasis on what is now termed international (or foreign) direct investment (IDI). Increasing international investment was understood mainly as a financial flow - and thus in terms of portfolio investment and loans. Yet as Kay (1974) has argued in nineteenth century, while industrial capital


\textsuperscript{14} The standard notion of investment has been that of capital ‘outgrowing’ or ‘overflowing’ the nation. The notion of capital outgrowing the nation has been a powerful metaphor of modern international economic theory. The historical counterfactual of international investment pre-existing the formation of most nation-states has important implications for the historical accuracy of international direct investment theories and has implications for the way that recent internationalisation has been conceptualised. This issue is explored in more detail in later chapters.

\textsuperscript{15} As Blake (1939) noted, the Dutch invested internationally in ‘trickles’ as early as the seventeenth century, “and part of the plunder of the Indies and the slave trade found its way back in the eighteenth”.

\textsuperscript{16} In 1880, the international investment of European countries amounted to $US5 billion, by 1890, $US10 billion, and by 1914 it had exceeded $44 billion (Blake 1939).
became central to domestic economic and political processes in the leading industrial nations, productive capital scarcely stayed from its homelands. The primacy of trade in international economic theory (and the understanding of investment as a derivative process) was therefore related in part to the historical fact that for much of the nineteenth century, traders and merchants had provided the main connection between the existing capitalist countries and the new geographic frontiers of accumulation. While economic historians have now shown that the origins of the internationalisation of production stretch back into the nineteenth century, it was not until the twentieth century that the internationalisation of industrial capital as more than trading or merchant capital became significant. If the growth of IDI is taken as a crude proxy for the internationalisation of industrial capital, then it can be seen in part why mid-twentieth century IDI was thought to be such a novel process. And it was not until the rise of significant volumes of IDI from the US (ie from a non-colonial power) directed largely to other industrial countries that it became necessary to study IDI with concepts and categories other than those used to explain trade\textsuperscript{17}.

Nineteenth century theories of international economics tended therefore to explain international investment as an adjunct to international trade. Because trade became understood to be the central unit of international exchange between nations, international investment was also often treated in terms of a trade flow, or as an adjunct to it. International investment even came to be referred to as a form of capital ‘export’. Again, this approach was conditioned by the evidence that many international investments were related to international trade. (Fieldhouse 1974)\textsuperscript{18}.

The use of trade theory to explain investment also carried with it the key concepts of trade theory. As with trade theory, investment was understood in terms of relations between nations. The conceptual linking of investment and the nation-state in the nineteenth century was also conditioned by the fact that it was an era when colonialism was a feature of the international political order (Svedberg 1981; Dunning et al. 1986). Colonialism was not simply a political arrangement. Colonialism also helped to structure (and was itself structured by) economic processes, including the relocation and subsequent expansion of capitalist economic and social relations to new territories. Furthermore, a large proportion of international trade in the nineteenth century was structured by colonial economic arrangements.

The nineteenth century theory of international exchange was thus conditioned by evidence that, inasmuch as investment was a feature of international economic processes, it was thought to flow from the metropolitan powers to their colonies to finance trade or trade-related activities. International investment theory, it was a theory of cross-border capital flows in general, and of loans and portfolio investment in particular. It was not a theory of what is now termed direct investment. Direct investment was subsumed under the general rubric of investment, and international investment itself based on concepts of internationalisation that paralleled that of

\textsuperscript{17} This also helps to explain why in the early twentieth century, when Lenin predicted that the highest (or last) stage of capitalism was going to be characterised by the export of capital rather than commodities, capital export was understood in terms of portfolio capital and loans.

\textsuperscript{18} Infrastructure investment was also significant but did not fit in either one category, and was instead associated with both these developments.
trade. In particular, investment was considered in terms of an extension (or overflow) of domestic economic activity.\(^{19}\)

From the late 1890's, a growing theoretical interest in international investment began to occur. The period was marked by a number of important transformations and conflicts\(^ {20}\), and these transformations seemed to be portending a 'new' era in capitalist history (Kay 1991). Many leading economists began to predict that the future would be an era in which international investment would become much more important. Even here there is an important point of contrast with the development of post-war IDI theory. While post-war IDI theory began as a lagging reaction to post-war investment, those writing at the turn of the century about international investment were, as Etherington (1984) observed so acutely, "economic and political thinkers trying to understand the present order in order to predict the future". There was debate over the particulars and indeed consequences of the forthcoming era\(^ {21}\), but theorists from a range of political and theoretical perspectives were expecting that it would be an era characterised by increased international investment, because a problem of 'surplus' of capital was emerging in several advanced industrial nations\(^ {22}\).

As a consequence of the tremendous accumulation of productive capacity and, especially in the case of the US, the growth of trusts and monopolistic firms, capital was seen as becoming 'congested' within its own national economy. Capital was therefore understood as beginning to 'spill-over' from these nations. In an era when the world was territorially divided, it seemed to some economists that in order for capital to move abroad from its home base, state power would be required to secure that investment. The relationship between international investment and state power became linked through theories of what became known as 'imperialism'. Although theories of imperialism did not have a great influence on orthodox international economic theory, it became an important intellectual foundation for much of the mid-twentieth-century radicals when they came to consider the link between post-war IDI (and the MNE) and the nation-state as a new form of imperialism (Etherington 1984).

\(^{19}\) Dunning et al (1986) noted that there were exceptions to this approach. Whereas economists were increasingly considering international economics in cross-national terms, Marx suggested that the world market was "the very basis and living atmosphere of the capitalist mode of production" (1981 p 205). It has only been relatively recently with the tremendous growth in international capital movements and the emergence of more explicitly global institutions that similar concepts of internationalisation have been introduced into mainstream international economics.

\(^{20}\) These changes included: the growing scale of production; the tendency for firms in some industries to be absorbed by a few large firms; and the consequent change in market structures. In place of open competition between many small firms, industrial concentration encouraged forms of organised collaboration between a few large firms. Along with the end of perfect competition in product markets, the state became increasingly involved in arranging these new forms of inter-firm relations. Taken together, these developments marked the end of what is usually called the competitive of laisser faire period of capitalism.

\(^{21}\) Lenin and others suggested that it was the highest or final stage of capitalism, while others such as Hobson suggested that there were remedies for the conflicts (such as the 'surplus capital problem'), such as a redistribution of income.

\(^{22}\) The particular reasons for the expected growth in the importance of international investment related to factors such that production was occurring on a scale beyond the size of the domestic market; the existences of growing pools of investment searching for profitable investment; the rise of other industrial nations (especially the US and Germany) without extensive colonial possessions the need to find new markets for production and investment, which helped to create considerable tensions in international relations.
Economists in the nineteenth and early twentieth century did not develop distinct theories of IDI or the MNE\(^{23}\), but elements of the conceptual agenda that became visible in the post-war period were already evident in attempts to develop explanations of patterns of 1920’s and 1930’s IDI. The theoretical agenda of pre-war theories of the international economy and international investment were by no means uncontested. There were important differences in the key assumptions between the neoclassical international theory, radical and Marxist theories, although some areas of commonality were also evident, such as in terms of the broad concept of internationalisation.

The first half of the twentieth century was marked by the twilight of British international hegemony. The rise of other industrial powers (notably the US and Germany) in a period of considerable social and economic turmoil, was also an era of increasing economic nationalism in policy and economic processes. National categories became much more central to the economic analysis and state policy increasingly focused on national development.\(^{24}\) Trade relations between nations became the central way that international economic processes were now understood, and investment as more national in nature. In the 1920’s and 1930’s, the concept of internationalisation was understood and elaborated through the metaphor of the growing degree of national interaction. In conjunction with the theory of comparative advantage, especially with the development of the Heckscher-Ohlin model, economists increasingly came to understand international processes through international trade, with investment as a secondary adjunct to trade relations.

The analytical centrality of the nation was consistent with other theoretical developments in economics. With the formalisation of what became known as Keynesianism and macroeconomics, the national economy increasingly became both the unit of analysis and the object of economic ‘policy’. Indeed national accounting was a reflection of this conception of the nation in the world economy. Balance of Payments accounting, as Polk (1969) observed, was designed for an epoch of when national economies could be reasonably understood as ‘closed’ (in terms of capital and labour mobility). National accounting was based on the assumption that economic exchange between nations were conducted primarily through trade, with capital flows as largely derivative items. International economics tended therefore to become largely the economics of international trade, with limited capital flows as a means of payment for trade and in certain cases as a ‘substitute’ for trade between the major industrial economies and the ‘developing’ world.

National economies were never closed in the way that national accounting (and international economics) assumed (Williams 1992), and the patterns of both international trade and investment in the nineteenth century more complex than being simply colonial and national in nature. And international economic processes were always more complex than simply international trading. In an era that was marked by a transition toward the modern international economy, economists of the

---

\(^{23}\) Inasmuch as the origins of theory of IDI and MNCS can be traced to pre-Second World War economists, the major figures usually cited include Adam Smith, David Ricardo, Edward Wakefield, Karl Marx, Alfred Marshall, J A Hobson, Vladimir Lenin, Rudolf Hilferding, Bertil Ohlin, John Williams and Joe Bain. See Cantwell, Corley and Dunning (1986) for a discussion of the antecedents of IDI theory.

\(^{24}\) See Cowen and Shenton 1996.
time were however considering the world economy as much in theoretical terms as a concrete empirical reality. Not surprisingly, the development of international economic theory during a period marked by the relocation and subsequent growth of capitalist relations from the established nations to new regions also conditioned theoretical developments. While the international mobility of investment and other resources was not a new process to the 1960’s and 1970’s, developments in the first half of the twentieth century formalised the nationalist concepts in economic theory and policy. This did not prevent ongoing modification in these concepts, so that by the mid-twentieth century international investment flows were increasingly understood as motivated not so much by colonial ties, but by international interest-rate differentials between nations.

The prevailing orthodox theory of international capital that had developed in the first half of the twentieth century was an extension of international trade theory, and is especially associated with the Heckscher-Ohlin (H-O) and later Heckscher-Ohlin-Samuelson (H-O-S) trade models. The H-O model was largely a model of trade, based on national specialisation. Insofar as it could embrace international investment, H-O was a theory of international portfolio capital. The H-O model was premised on the assumption that nation-states were the principal units of international exchange - factors of production (including capital) were held to be perfectly mobile within nations, but immobile between them. That is, the H-O model was based on relative international capital immobility. Limited cross-border capital movement was permitted in the model and explained as an arbitrage process, facilitating an interest-rate equalisation between countries with differences in relative factor endowments.

The arbitrage interest-rate equalisation involved limited capital flow from capital-rich and capital-scarce nations, operating in a hierarchical manner. The model’s predictions of the direction and effect of capital flow operated only on the basis of a number of restrictive assumptions. The model predicted that international capital flow would move (unilaterally) from relatively capital-abundant (generally richer) nations to relatively capital-scarce (and generally poorer) nations. Such flows were expected to abate once relative supplies of capital between nations were balanced and cross-national interest-rate differentials equalised. International capital flow was therefore understood to be a relatively short-term stock adjustment process. The model did not offer a very robust explanation of growing international direct investment in the pre-war period, but for a number of reasons the problem did not become significant. Direct investment in particular had not yet become a significant ‘problem’. In part this was because investment flows were structured by colonialism, and in part also because of its relatively junior status within international capital. By mid-twentieth century, developments in the international environment were challenging the key assumptions of the theory and increasingly seemed to require the introduction of some new explanatory concepts.

25 International trade was however, seen as a substitute for international factor movements as a way of achieving international factor price equalisation.
26 In the H-O model this was expressed as a flow from nations with higher relative abundance of capital to nations with a lower relative abundance, measured by relative factor prices (for capital in the cross national differences rates of interest).
Pre-Second World War theories of international investment shared a broad concept of internationalisation, but they differed in their understanding of competition. Most theories of international investment in the nineteenth century understood relations of exchange in terms of models of perfect competition, with non-perfect forms of competition as an aberration. As the twentieth century moved on, neoclassical economists began to observe that the market structure of many industries were becoming incompatible with the paradigm of perfect competition. This forced a modification in the concept of competition in some branches of economics. The empirical evidence of non-perfect forms of competition helped to spur the development of concepts of imperfect competition and monopoly, especially in the work of industrial economists such as Bain (1956), Chamberlain (1958). Alternatives to the concept of perfect competition began to also emerge from other economic paradigms; Lenin, for instance, suggested that monopolies and cartels were becoming the basis of modern imperialism. Nevertheless, differences in the concept of competition remained, and helped to establish one of the terms of the later divide between radical and liberal theories of post-war IDI.

Pre-war theories of international trade and investment did not incorporate a significant role for explanations of the role of firms in international economic processes: the concept of ‘capital’ remained uncontested or at least undeveloped in pre-war international economic theory. As a consequence, the concept of capital in international economics did not include an analysis of the particular institutional form of international capital. In part, this had to do with the development of the theoretical agenda of neoclassical economics, based on a focus on equilibrating and perfect markets. Capital was understood more as fund than as a firm, and most models treated the representative firm as small, price-taking units, which were analytically unimportant (Marshall 1983). It was a concept of capital where all firms were assumed to be homogenous and where the institutional form of capital was as a consequence analytically unimportant. It was for this reason that the concept of capital did not become a critical part of pre-war international investment theory on the same level as that of competition or internationalisation.

Theoretical developments were, however, occurring against a background of the development of both large-scale industry and large conglomerate firms (Bain 1956; Berle and Means 1931). By the 1920’s and 1930’s, many larger firms had also become very visibly international in scale, but within international economics, it was not until the 1950’s and 1960’s when industrial firms from the US began to undertake large-scale investment in Europe that an institutionalised concept of capital became critical to explaining international economic processes. The incorporation of an explicit concept of capital into international economics as more

---

27 Even for Lenin, the evolution of monopoly was a movement from free competition, and as such understood as a signal of a decaying capitalism.
28 With the possible exception of Marx (1981); Hilferding(1985), Schumpeter (1934), Southard (1931) and Plummer (1934) and to a lesser extent Lenin (1959).
29 It has been noted that the consistency and internal logic of the theoretical framework of neoclassical economics required that the firm was little more than a ‘black box’ (Baumol 1976; Barro 1986).
30 Southard, in a largely descriptive work, raised the theoretical problem of the growing internationalisation of industry. He suggested that whereas trade theory predicted internationalisation as a process of national specialisation, capital mobility and the ‘new’ internationalisation of industry was indicating a process of diffusion and the worldwide dispersion of production.
than just the Marshallian firm represented a significant stage in the development of modern IDI theory\textsuperscript{31}.

A general conclusion to emerge from the diverse range of pre-Second World War models of international economics was that investment was not central to most theories of international economics. Where investment was a focus, the differences between IDI and other forms of investment were not critical to the analysis\textsuperscript{32}. Nor, except in one or two cases, was the institutional form of international investment a critical object of analysis in the pre-war period\textsuperscript{33}.

\subsection*{2.2.3 The Development of International Direct Investment in the Nineteenth Century}

The dominant theoretical categories used for understanding the nineteenth century therefore served to diminish (to the point of neglect) the analytical significance of the phenomenon of IDI. But that was not to say that IDI was not already a reality in this period. Mira Wilkins (1972, 1974), in the encyclopaedic two volume history of IDI and the multinational firm from the US, concluded that their development spanned a period stretching back into the nineteenth century, and was not simply an invention of the immediate post-war decades. Thanks partly to this work, the initial era of development of the modern US MNE is now commonly dated from the late nineteenth century (Wilkins 1988). Importantly also, economic historians found that the MNE was more than simply an invention of the US in the post-Second World War period.

Figure 2.1 shows the composition of outward investment from the US in the late-nineteenth and early twentieth century. It shows that even by the late 1890’s, outward IDI from the US had become a significant form of international capital flow, and was by far the most significant form of international investment from the US. The 1890’s was also a period in which the US was still a substantial international net debtor. Similarly, by 1914, there were over 40 US-based companies engaged in IDI activity valued at around $US2,650 million. In as much as IDI was a distinctive form of US internationalisation (a US ‘model’ of lending or investment as Penrose (1962) termed it), it is now widely accepted that the first sustained wave of international investment by firms from the US came as early as the 1860’s. Wilkins (1974) has even suggested that by the end of the nineteenth century, the critical features of post-

\textsuperscript{31} There is a parallel here to the ‘Cambridge’ controversy in the 1960’s and 1970’s in the debate over capital theory (see Harcourt 1975,1982).

\textsuperscript{32} Its importance was at this stage more a prospective one; investment was seen as becoming a critical feature of the next stage in the international economy. In the case of Hobson and others, where investment was understood as becoming significant, as Egherington (1984) has noted regarding it was linked with notions of imperialism and of ‘surplus’ capital in certain nations and the need in the future to find outlets for that investment.

\textsuperscript{33} Hilferding (1985) was an exception here. While retaining the national identity of capital, except under exceptional circumstances, he differentiated between two forms of capital ‘export’ - ‘interest-bearing’ capital and ‘profit-yielding’ or industrial capital. Hilferding suggested that “from a quantitative point of view it is more advantageous for a country to export its capital in profit-yielding rather than interest-bearing form, because the profit is greater than the interest. Furthermore, if the exporting capitalists invest their capital as industrial capital, they retain a more direct control over its disposal and use”. Lenin made a scathing criticism of Kautsky on the basis of his distinction between finance and industrial capital as characteristic of imperialism.
Second World War American multinational enterprise were all practically evident. If there was indeed an ‘American’ model of the international firm, it had its origins in the nineteenth not the mid-twentieth century.

Figure 2.1 Stock of US Investment Abroad, by Type
(millions of US dollars, current prices)

*Net of repatriations and repudiations

Source: Lipsey 1988, p 480.

Significantly, the comparative scale of international investment was also found to be quite significant in the nineteenth century. There was quite a high level of international control and organisation of business in the nineteenth century. In fact, international investment, relative to domestic investment, was more important in the nineteenth century than it was even in the 1950’s and early 1960’s. (Turner 1992; Dunning 1984). While there was steady growth in the relative importance of IDI

---

34 In some ways, the work of economic historians like Wilkins was a re-discovery and development of the work of economists in the pre-war period, who had traced the international expansion of firms from the US, especially in Canada, but also in Europe to the late-nineteenth century (Innis 1930; Southard 1931). Marshall, Southard and Taylor (1936), for instance, found that there had been an acceleration of the ‘branch plant’ movement between the US and Canada (in both directions) from 1900 to 1932. It was not, however a new phenomenon even then, and not even a product of the twentieth century. They traced the origins back to the 1840’s although they suggested that the really significant movement began after 1870, and especially from the late-1880’s. Similarly, the work of post-war IDI theorists was a development of critiques of international trade theory. Williams (1931) had questioned the Ricardian assumption of an analytical distinction between external and internal factor mobility, and the theoretical adequacy of a method of an analysis that “assumes as a first fact national entities, economically organised, internally mobile and coherent, and then attempts to study contacts between them on the assumption that international mobility of factors is so imperfect that for value purposes it may be ignored...”
abroad in total corporate assets during the post-war period, it was not until the mid-1950’s that the stock of US IDI as a proportion of total corporate assets exceeded the level reached in the mid-1930’s (UNCTC 1989).

One problem that emerged from historical research of nineteenth century IDI was that the international operations of firms didn’t necessarily take the form of the wholly-owned subsidiary of joint-stock companies that post-war theory assumed. Instead, organisation and control were conducted through a range of institutional arrangements, including family firms and kinship, partnerships, investment groups, trusts, agency contracts, private companies; unincorporated branches and in the case of Britain especially, ‘free-standing’ firms. These developments were also themselves part of a longer historical process of internationalisation. The post-war concept of capital (and the form of organisation of international production) was also thus too restrictive to capture or explain the wide range of forms of international organisation in the nineteenth century.

An example of the diversity in the forms of nineteenth century international firms was that while many multinational and multidivisional firms developed in the US and to a lesser extent Germany, small-to-medium firms remained the most characteristic form of business in even the leading sectors of industry in Britain until the 1920’s. Later research has revealed that many of these small-to-medium firms were themselves part of larger ‘investment groups’ or ‘free standing’ branches of a family firm, many of which had extensive international interests in the nineteenth century (Chapman 1986). The economic strength of investment groups and free standing firms were largely obscured from public view by the practice of preserving the parent organisation as a partnership or private company, or local registration of the branch firm. Its international activities were often run and registered abroad by junior partners, sometimes under quite different names and legal forms. The investment group was therefore a device used to maintain effective economic power in a few hands, and its small nominal capital base in Britain concealed a large and diverse operation overseas with a group capital well in excess of many of the largest British joint-stock concerns of the period (Chapman 1986; Turrell 1986). The neglect of this form of organisation is one reason why there had been a serious underestimation of the scale of international enterprise from Britain.

Figure 2.2 shows the value of outward IDI stock from the US in the first half of the twentieth century. It shows a more than four-fold growth in the value of IDI stock over the period as a whole, albeit in a somewhat volatile way. Growth of the stock of IDI was particularly vigorous in the 1920’s and late 1940’s. By 1950, when the

36 It has been noted for instance that “The decision by a number of British manufacturing companies in the late nineteenth century to establish factories in foreign countries did not herald a fundamental departure in British business organisation. If the term multinational enterprise is defined broadly... then the phenomenon has a long ancestry” (G Jones 1984).
37 Wilkins (1988) noted that while large-scale enterprise were the pioneers of international business, even firms from Germany, which had several large electrical and chemical companies, also had many family firms with business activities both at home and abroad.
38 Turrell and VanHelton (1987) however, questioned the generalisation that this was a characteristic 'British' form of international organisation.
process of IDI was thought by many to be just beginning, the stock of US IDI abroad had already reached $US11.8 billion.

Figure 2.2 Stock Of US international Direct Investment, 1914-1950
(Millions of dollars of current prices)

![Graph showing stock of US international direct investment, 1914-1950.](image)

Source: UN Centre on Transnational Corporations, 1989, p5.

Research by economic historians also found that the timing of the internationalisation of production by firms from the US, the size of international investments and the specific reasons why companies began to internationalise as an MNC varied greatly among companies (and even within them)\(^{39}\). And no single factor, such as firm size, technology, industry type or other factor could be identified that provided unity to the early process of IDI. Such explanations awaited IDI being constituted as a distinct object of analysis, and this did not arise until after the Second World War.

IDI (and the MNE) was not only part of a process that stretched back well into the nineteenth century, it began in a range of countries including but not limited to the US. Historical research also revealed that IDI and the MNE were not even an American invention. Businesses from other countries had quite significant operations abroad in the mid-to-late nineteenth century (Hopkins and Cain 1980; Jones 1980; Chapman 1986; Franko 1976; Fieldhouse 1978; Jones and Schrooter 1993). And the internationalisation of firms from other countries proceeded through different forms from those coming from the US. Internationalisation was not in short necessarily mirroring that of the "American model" as Penrose (1968) and Wilkins (1986) termed it. Britain and other European countries also had substantial IDI stocks abroad and

\(^{39}\) Wilkins said that "For some American enterprises the emergence of the multinational corporation began in the 1850’s and for others in the 1960’s..." (1974: p 414).
Britain in fact remained the largest single source of IDI right up until the Second World War (Dunning 1983; Franko 1976). New research also established that firms from Britain and other European countries (which had established operations abroad from at least the 1880's), had ‘multinationalised’ their business much earlier and in much larger numbers and size than had earlier been accepted (Platt 1977; Chapman 1977). By the early twentieth century, there were a large number of MNEs based in Britain and Europe (Stopford 1974; Fieldhouse 1978; Nicholas 1983).

More significantly, according to Wilkins (1988), there were ‘literally thousands’ of British registered firms with international operations, and in 1914, Britain was by far the largest source of outward IDI, with around 45 percent of total IDI stocks. Even in 1938, Britain still accounted for almost forty percent of the worldwide stock of IDI. These figures may even underestimate the dominance of IDI by firms from the UK. The problem was that the forms of international investment and organisation were not uniform and many forms of IDI (such as that by the ‘free-standing’ firms) were often not immediately visible to government statisticians (or business historians). The 1950’s and early 1960’s was indeed a time of rapid establishment of new subsidiaries abroad by firms from the US, but firms from the US were establishing subsidiaries abroad over a much longer period. Similarly, while the most rapid growth of establishment of subsidiaries abroad for other countries was in the second half of the 1960’s, firms from other countries were also ‘multinationalising’ their operations over a longer period.

Closely associated with this re-evaluation was a questioning of the implicit assumption of most earlier historical studies that the form of internationalisation that defined IDI was that of a joint-stock public company establishing a wholly-owned subsidiary abroad. It was increasingly recognised that diversity of international organisation was not new to the 1970’s, and had been an important feature of the nineteenth century.

From a comparative historical perspective, what now seems unique about the history of US IDI was that IDI had been the characteristic form of outward investment from the US, and that outward IDI took place on quite a large scale even while the US was still a net borrower (see Table 2.1 below and Lipsey 1994). It was also observed that international portfolio and direct investment from the US moved in different directions and behaved differently at different periods of history (Lewis 1938). While research by economic historians into the origins of IDI confirmed that IDI represented a much smaller proportion of the total international investment of other nations, such as Britain and Germany, the distinction became understood more a matter of degree rather than one of absolute distinction.

---

40 The empirical findings of diversity in international organisation has also made the concept of capital and the company inherent in post-war models of IDI a significant and largely unresolved problem for business history (Wilkins 1986).
Table 2.1 Share Of Foreign Direct Investment In Total Stock of United States Long-Term Investment Abroad, 1897-1914 (Percentage)

<table>
<thead>
<tr>
<th>Year</th>
<th>Share of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1897</td>
<td>93</td>
</tr>
<tr>
<td>1908</td>
<td>65</td>
</tr>
<tr>
<td>1914</td>
<td>76</td>
</tr>
</tbody>
</table>

Source: UN Centre on Transnational Corporations, 1989, p.4.

In researching the origins of IDI and the MNC, economic historians in the 1960’s and 1970’s also found it necessary to re-evaluate the definition used to distinguish between IDI and portfolio investment. Earlier estimates of the relative distribution of direct and portfolio investment in nineteenth century international investment flows from other investing countries suggested that they had been overwhelmingly in the form of portfolio capital and loans. An important insight gained from historical research was that the standard definitions of international investment had obscured much that was properly direct investment and instead classified it as portfolio investment (Svedberg 1978, 1981; Stone 1977; Platt 1980; Stopford 1974). It was now concluded that whereas “This investment had long been cast as portfolio and rentier in nature: much of it was now recast as direct” (Jones and Schrotter 1993). Once again, the re-evaluation led to a significant change in the proportion of total international investment of countries like Britain now classified as direct investment. At least one third of international investment from Britain in the mid-to-late nineteenth century involved forms of management control or influence, and was now taken to be direct investment (Platt 1986). It was also estimated that Britain was the largest source of global IDI in the pre-First World War period (Dunning 1988). The problem of distinguishing between portfolio and direct investment was underscored by the empirical evidence that international portfolio and direct investment from the US had flowed in different directions and behaved differently during different periods of history (Lewis 1938).

---

41 It had been widely accepted up to this point that in the nineteenth century between two-thirds and up to ninety percent of long-term international investment was in the form of portfolio investment and loans (Dunning 1970; Rosenstein-Rodan 1967).

42 According to the earlier definition, investment had to meet two criteria to be classified as direct investment: the medium through which ownership was transferred and the securing of control. While portfolio investment referred to investment in shares acquired on the stock market that didn’t secure control, direct investment referred to the establishment of a branch-plant or subsidiary financed from the parent (not usually from a stock market flotation). By the 1970’s, the medium of transfer part of the definition was dropped, and only the securing of control remained was required for direct investment. As noted earlier, however, the level of ownership that was deemed to secure control remained a contentious issue (Jones 1987).

43 It was also observed that the significance of the internationalisation of business organisation in the nineteenth century could not be captured simply by measuring cross-border capital flows. Nineteenth century IDI is now understood at best as a proxy to indicate the general timing and direction of internationalisation or multinationalisation of production and firms. It was pointed out for instance that before 1914, many firms from Britain invested management and technology resources rather than money capital in overseas subsidiaries (Jones 1984).

44 Research into pre-war IDI had found that the internationalisation of investment in the first half of the twentieth century was not a smooth or even process and was accentuated by the way that the process was captured by Balance of Payments accounting. For instance, the US Balance of Payments accounts showed that at the
Although the definitional issues of direct and portfolio investment became significant problems for researching the pre-war origins of IDI, it was the emerging evidence that post-war investment was occurring as a *cross-flow* of investment between the industrial economies that was critical in transforming the theory of IDI. Pre-war international investment could not comprehend the post-war US experience of concurrent outflows and inflows of investment. International cross-flow of investment had become an important feature of capital flows even before the Second World War\textsuperscript{45}, but it was the cross flows of investment in the 1950’s and 1960’s, when US became the world’s largest creditor nation (but when direct investment abroad expanded rapidly, concurrent with inflows of portfolio investment) that confounded the national taxonomy of pre-war investment theory. It was this development, as much as any other that led researchers to conclude that portfolio and direct investment were ‘two different things’, and that the explanation of post-war IDI required a different analytical concepts.

### 2.3 THE POST-WAR DEVELOPMENT OF IDI THEORY

#### 2.3.1 The Rationale for an Analytical Watershed

In the 1950’s and 1960’s, IDI underwent both significant growth and important changes in its geographic and industrial patterns. The pattern and behaviour of post-Second World War IDI did not conform with the existing theoretical explanation of international investment, which was based on a model of investment flowing down a hierarchy of nations as an arbitrage process (Hymer 1979)\textsuperscript{46}. Two significant and related problems emerged in explaining the post-war changes. The rapid growth of IDI was a development not anticipated by orthodox theory; and the pattern of post-war IDI was increasingly incompatible with the assumptions of pre-war theory. It became increasingly untenable to deal with IDI in derivative terms as either a subsidiary form of portfolio investment (motivated by interest rate arbitrage), or as an ‘exception’ to the general rule of international trade movements (motivated by national specialisation on the basis of relative national factor endowments) (Dunning et.al. 1986).

Since the operation and control of production on an international scale by firms could not logically exist in perfect markets, it was necessary to introduce some concept of market imperfection into investment theory. Perfect markets provide for

\textsuperscript{45} It has already been noted that companies from the US had been investing abroad even while the US Balance of Payments was still recording large a net inflow of capital.

\textsuperscript{46} Some pre-war researchers had already made similar observations (see for instance, Southard 1931, and Williams 1929).
uniformity of producer-firms and there is, therefore no rationale under which identical companies would endure the additional costs of transnational operation (except of course in the purely hypothetical case of perfect mobility).

It was in these circumstances where it also became necessary to understand the organisation of the international firm as more than just a 'black box', of no real significance to economists. The fact that resources were increasingly being organised and mobilised within firms across national borders was one indication that markets were not the only mechanism of resource exchange. The explanation of post-war IDI therefore required different concepts of capital (to incorporate an explanation of IDI that considered the role of international firms), competition (imperfect markets), and eventually a different concept of internationalisation (firms outgrowing the nation and engaging in IDI needed a compensating 'advantage' in order later to compensate for the additional costs of operating abroad). It was in the context of the development of new concepts to explain post-war IDI that the post-war theory of IDI was developed as if the process that was being explained was a general and immutable one. These concepts therefore provide a useful way of understanding the development of IDI theory and will be the focus of the remainder of this chapter.

The immediate post-Second World War period ushered in a number of important changes in international relations. The 1950's and 1960's were a time of decolonisation and, the rise of the US as the major economic, political and military power. The rapid growth of international investment posed new problems for the existing theory of international investment. The fact that much of this investment took the form of IDI by the US and was directed to other industrial countries, was even more problematic. The growth and changing patterns of IDI formed the basis of a critique of existing theories of international capital movement47. One of the formative features of IDI research was that a significant strand of IDI theory developed out of critique of existing theories, and often out of a critique of the process or the effects of IDI on host countries48.

It was argued that once many of the portfolio capital model's assumptions were relaxed to account for changes in international investment, the model was incapable of explaining either the growth or the direction of international capital flows (Hymer 1960). By the early 1960's, it was being suggested that IDI had become indeterminate within the interest-rate arbitrage model. Stephen Hymer, one of the founders of modern IDI theory observed that "the existing [arbitrage investment] theory in its simplest form is too naive. The difficulty is that when risk, uncertainty and barriers to movement are introduced, almost anything can happen" (Hymer 1976, p6).

---

47 Many of the standard concepts and terms of IDI theory, including such terms as transnational corporation were developed from critiques of the international companies that were being described. This applies from the beginning of the modern theory of IDI by writers such as Hymer's early 'liberal antitrust' critique to the radical 'monopoly school' of IDI.

48 For many IDI researchers, the theoretical critique extended to a critique of the welfare effects of post-war IDI.
2.4 **COMPETITION, CAPITAL AND INTERNATIONALISATION: THE KEY CATEGORIES OF IDI RESEARCH**

The post-war theory of IDI can be understood in terms of a number of unifying concepts that have informed IDI research. Three concepts in particular provide a way of understanding the initial development and subsequent evolution of post-war IDI theory: the concept of competition; the concept of capital and companies; and the concept of internationalisation. Each will be discussed in turn.

One of the key features of IDI theory is the concept of competition shared by all post-war models. The concept of competition that developed in post-war IDI theory was linked to two related empirical developments. The first was that the patterns of post-war IDI were observed to be most heavily concentrated in industries characterised by oligopolistic market structures or with other market imperfections. The second was the recognition that the post-war patterns of IDI were incompatible with the standard predictions of international capital models, based on perfect competition. Whereas conventional models of international trade and capital market theory had been based on the assumption of perfect competition, the explanation of post-war IDI seemed to be linked not to perfect competition but to market failure. It was in this context that IDI and the multinational corporation became understood as ‘creature(s) of market imperfections’ (Krugman 1983; Dunning and Rugman 1985). Market failure and imperfect competition therefore became critical concepts of the new theory of IDI.

In the 1950’s and early 1960’s, the forms of market structure that permitted firms to expand abroad by IDI were thought to be quite rare, and related mostly to the (oligopolistic) market structure of particular industries, or the (oligopolistic) advantages of particular firms. In this context, it was perhaps not surprising that early IDI theory was often identified with a concept of competition in terms of market failure and monopoly.

As IDI grew and became more common in the 1960’s and early 1970’s, IDI growth tended to become understood more as a consequence of imperfect competition rather than market failure per se. A basis of debate in early IDI literature was therefore over the form or nature of market imperfection leading to IDI. While earlier theorists emphasised structural market failures (leading to monopolistic or oligopolistic markets), later IDI researchers developed an explanation of IDI through ‘natural’ or transaction cost imperfections. This in turn generated ongoing debates over the welfare implications for nations, classes and individuals of the market failure that led to IDI. Nonetheless, it warrants emphasis that virtually all models have derived their concept of competition from the premise of imperfect competition. From the perspective of the 1990’s where the presence of IDI is pervasive, the notion of exceptionalism implicit in such a concept, appears a limiting starting point. One paradoxical effect of this conception of competition has been that IDI theory has

---

49 IDI was also expected to be a relatively uncommon form of investment, with intra-national direct investment and international loans and portfolio investment the general way that capital moved.

50 It appears limited because the growth of IDI (as one form of increased international capital mobility) has to be explained as an imperfection.
been forced to explain the increasing mobility of capital as an increase in market failure. Imperfect competition has continued to be a critical concept of IDI theory so that it could be concluded even in the early 1980’s that “the growth of international production must be associated with increased market failure...” (Dunning 1983).

In the early period of post-war IDI research, it still seemed possible to explain IDI by simply relaxing the assumption of perfect competition within existing international investment theory. IDI by firms were assumed to be a relatively uncommon occurrence and a special market advantage was required to make IDI profitable. By the late 1950’s and early 1960’s however, IDI and MNCs had already become a significant form through which production and exchange was being organised on an international scale. Far from being the exception, by the late-1960’s, the global value of production undertaken by international companies was already approaching the global value of international trade by nations. It was in this context that the concept of (imperfect) competition had to be incorporated into a different theoretical agenda. The concept of imperfect competition therefore provided one of the connecting links between the old and new models. The explanation of later empirical developments in post-war IDI would require more than simply a different concept of competition to be incorporated within existing international investment theory, it would require a different concept of capital and internationalisation as well.

The concept of capital and the corporation that informed the development of IDI theory has been similarly binding. Post-war IDI occurred as part of a growing cross-flow of investment between countries. IDI was not the only form of international capital flow, and nor did IDI ultimately depend on an actual international capital flow at all. A significant and increasing proportion of the funding of the international operations of MNCs was being derived from local sources in the host country, by retained earnings and capital raising in the host or third country markets. This suggested that inter-country interest-rate differentials could not explain the developments in post-war IDI. IDI was recognised as being more closely associated with the international extension of (control over) operations by firms than with a capital movement per se (Hymer 1960, Kindleberger 1969). The theory of IDI therefore incorporated an institutional concept of capital along with notions of imperfect competition to explain the types of markets that would allow firms to undertake the international control of production abroad. The concept of capital (and

51 MacDougall (1960), for instance, recognised that the assumption of perfect competition needed to be relaxed, but concluded that “imperfect competition does not seem to require much, if any, modification of our previous analysis” (1960, p 203).

52 Kindleberger (1969) on the other hand concluded that the explanation of IDI had to lie outside of the world of perfect competition inherent in trade and capital market theory, since IDI would not logically exist in a world of perfect competition for goods and factors. Dunning and Rugman (1985) noted how the introduction of models of imperfect competition into the post-war theory of IDI marked a significant break in “escaping the intellectual straightjacket of neoclassical-type trade and financial theory” and introducing institutional economics into IDI theory.

53 The importance of retained earnings and offshore capital raising in funding post-war IDI was recognised as early as the late-1950’s (Arndt 1957). Hennart (1982) provided evidence to suggest their importance increased over the 1960’s, such that only a small percentage (estimates varied between 13 and 20 per cent) of the capital expenditure by subsidiaries and affiliates of ‘US multinationals’ in the 1960’s and early 1970’s was being funded by the parent.

54 Later it was recognised that a firm can establish a ‘controlling’ interest in an operation abroad without any cross-border capital transfer at all (such as by converting debt for equity in the overseas country) or by local borrowing in that country (Casson 1987).
competition) would also become critical to radical models of IDI, especially the ‘monopoly capital’ model.

One of the most distinctive features of IDI theory within international economics has been that it has made individual corporations an important object of analysis. IDI theory has sought to both explain the decisions and actions of individual companies and to establish those decisions in terms of systematic patterns. The theory of IDI shifted analytical focus of international investment from capital market theory (where cross national interest-rate differentials are crucial) to industrial organisation theory (where profits and the behaviour of individuals matter). The post-war growth of IDI was not simply a cross-border movement capital and could not be explained adequately through standard international capital theory. The concept of capital that became incorporated into IDI theory (and in Balance of Payments accounting from which it is derived empirical evidence) was associated with cross national capital flows under the control of a single firm.

The post-war development of IDI thus became closely associated with the study of trans- or multinational corporation as the institutional form of existence of international capital. The concept of capital within IDI theory was also initially understood as an institutional process whereby firms extended control abroad in a particular form - by establishing or enlarging a wholly-owned subsidiary in another country. While in the early post-war period the wholly-owned subsidiary was the predominant way that firms established operations abroad, other institutional forms became more common in the 1960’s and 1970’s. The explanation of these other forms of international capital eventually required a relaxation in the strict institutional association between IDI and the wholly-owned subsidiary. IDI and international production have become identified with a growing range of institutional forms of organisation. Nevertheless, for many models of IDI, the particular institutional form of IDI (the wholly-owned subsidiary) was analytically critical, because centralised control was seen as one of the distinctive characteristics of IDI. For the radical theories, for instance, this became the centrepiece of a focus on foreign control.

Later empirical developments in the 1980’s and 1990’s have required incorporation of an even wider range of institutional forms of international organisation. These changes, developed in Chapters 5 and 6, included control through lower levels of equity ownership, and even non-equity (and non-corporate) forms of organisational control. By the mid-1980’s, such developments had begun to challenge the very concept of capital that had formed the basis of post-war IDI theory (Dunning 1984, Jones 1987). In a similar way, the retrospective attempt to explain pre-Second World War IDI in terms of the post-war theory highlighted problems with the

---

55 Post-war models of IDI, as Charles Kindleberger (1974) suggested, were transformed from models based on trade or capital market theory to those based on industrial economics and the theory of the firm.

56 It also led to a reduction in the threshold level of ownership upon which IDI was defined. In the 1960’s, the definition was relaxed to incorporate majority-owned subsidiaries. In the 1970’s, equity levels understood as securing effective control were reduced further to incorporate joint ventures and even minority ownership.

57 A parallel development was also occurring by economic historians investigating international economic organisation. It was pointed out that the joint-stock company was not the major way that control of international operations was exercised in the nineteenth century, but that a range of other institutional mechanisms existed. These included family networks, agency contracts and so on (Jones 1987, Nicholas 1980).
particular institutional forms of international capital in the 1950's and 1960's. Mark Casson, for instance has noted that "The [IDI] theories' preoccupation with the firm and its arm's-length contractual alternatives make them difficult to apply to earlier times in which the extended family, the partnership and merchant guild and the cartel were also important forms of economic organisation" (1986, p 43).

Finally, models of IDI can be contrasted with models of international trade and capital, in terms of the concept of internationalisation. In international economic theory, 'internationalisation' had been framed largely in terms of trade (and limited capital) flows, and these were understood to be relations of exchange between nation-states with different relative factor endowments. In the dominant theories of international exchange up until the mid-twentieth century, investment was assumed to be relatively immobile between countries, and to the extent that investment was mobile, it was understood largely in derivative terms. In international capital theory, this was explicable in terms of a flow from capital surplus to capital deficit countries. As noted earlier, a key problem for IDI theory was the need to explain the post-war pattern of IDI from the USA to other advanced industrial countries - and cross-flows of investment between them (Hymer 1960; Casson 1986).58

The new theory of IDI had to explain a seemingly nationally-determined process, but one that was moving in the 'wrong' direction to the predictions of orthodox models of international economics (Buckley and Casson 1976). Since IDI did not adhere to the logic of international capital flow from surplus to deficit nations, the issue of the costs and benefits of IDI for both host and home market became points of analysis and debate. This conception of internationalisation becomes critical in combination with the theory of the firm identified above59. In post-war IDI, firms were still assumed to be inherently national in character. A starting point for models of IDI was that there were innate advantages of being an indigenous firm (Hymer 1960; Buckley and Casson 1976). Firms 'moving out' from their nation of origin (or 'home') through IDI were therefore thought to require some advantage over companies in the host country to compensate for the additional costs of operating across borders (Hymer 1960). Critically, the advantages enabling some firms to engage in IDI were also initially hypothesised to be home-country specific (Dunning 1990; Vernon 1992).

The pattern of early post-war IDI supported the proposition that advantages were related to the firm's country of origin. Indeed, in the formative period of development of models of IDI, and at least up until the mid-1970's, outward IDI was a significant activity for only the few most advanced industrial nations. In orthodox international economics, it had been assumed that free international exchange was mutually beneficial for both nations (i.e. international trade produced potential gains

---

58 The cross-flows of investment became an increasingly important feature of international investment in the 1960's and 1970's. Between 1950 and 1970, private investment abroad from the US increased from $US19 billion to $US70 billion, mostly in the form of IDI. Over the same period, liabilities incurred by the US increased from $US13 billion to $US70 billion, mostly in the form of loans and portfolio investment (Hennart 1982). A distinction raised earlier is again relevant here. That is, unlike trade, IDI may involve no international capital flow at all, but may occur at the expense of indirect investment (loans and portfolio investment) by the conversion of indirect to direct investment.

59 It was also recognised that a large and growing proportion of international trade was occurring within firms, not on international markets (Hennart 1982).
all round). IDI models, by contrast, retained the nation-state as the principal unit of analysis of the effects of exchange, but the national effects (or ‘national interests’) of IDI on the host (and later home) markets was an issue of ongoing debate between IDI models. While not always posed so explicitly, the concept of internationalisation has often been posed in terms of the ‘benefits’ and ‘costs’ of IDI on the nation-state (for Australia, see Arndt 1958; MacDougall 1960; Wheelwright 1962; Hogan 1962). For the radical models of IDI, this concept of internationalisation was combined with the concept of capital and competition to form the basis of a theory of foreign monopoly capital, where MNCs, particularly US MNCs were assisted by the US state and constituted a new form of imperialism.

But not all patterns of IDI growth in the 1970’s supported such concepts. For instance, IDI also became associated with the emergence of outward IDI from an ever-widening range of countries, including developing countries (Lall 1974; Casson 1986). Other problems also emerged that required changes in the definition of corporate nationality, that made such definitions an increasingly difficult project. The concept of firms as inherently national in character has continued to be a feature of significant strands of IDI research, despite a growing recognition that such a concept has become increasingly problematic.

Post-war models of IDI provided some powerful insights into the process of post-war internationalisation, and research into IDI generated a large body of work in the 1960’s and 1970’s. In contrast to models of international trade and other branches of international capital, based upon deriving empirical predictions from a set of theoretical propositions, IDI theory was based on explaining actual empirical processes.

The very strength of early theory of IDI in explaining particular conditions was also its a main source of weakness as the analytical basis of a general theory. To repeat, the new theory attempted to generalise descriptive categories of the post-war period into universal theoretical categories. As patterns of IDI changed in the 1970’s (and as IDI historians attempted to apply these categories to the pre-Second World War period), models of IDI were modified by the introduction of insights from other models of IDI, and even from outside of IDI theory altogether. In the face of changing IDI, models of IDI became more eclectic and descriptive, so as to maintain the generality of the models. As later chapters will show, the need for IDI theory to remain flexible in response to historical change has come increasingly into conflict with the 1950’s and 1960’s derived categories of competition, capital and internationalisation which were central tenets of post-war IDI theory.

---

60 It had been recognised early in IDI research that a significant proportion of the funding of international operations of firms was coming from sources within the host country - local capital markets and retained earnings (Hymer 1960). However, the basis of determining nationality of international companies become more complex as funding, production, and ownership became more internationalised (UN 1979; Casson 1984). The possible definitions of corporate nationality became wider, and the basis of corporate nationality more a question of the nature of the state policy.

61 Despite this, the assumption of corporate nationality has retained considerable weight within IDI theory. One researcher has recently tried to construct indices of multinational ‘domination’ of particular national economies (Ietto-Gillies 1992).
In each of the conceptual areas outlined above (of competition, capital and internationalisation), changes in the actual patterns and processes of IDI since the 1960’s have undermined the notion that they constituted universal and general analytical categories. In retrospect, post-war IDI theory, by crystallising categories designed to explain IDI in one historical period, contained inherent weaknesses. From this perspective, it is possible to see how later developments in IDI in the 1970’s and 1980’s would erode the basis of the general theory.\(^{62}\)

2.5 THE BREAKDOWN OF GENERAL THEORIES OF IDI DURING THE 1970’s AND 1980’s

By the close of the 1960’s, the broad conceptual framework of the new theory of IDI had been laid out, and the chapter has contended that the development of IDI theory can be understood through the evolution of three concepts: capital, competition and internationalisation. These categories derived their explanatory capacity from their ability to explain the pattern of 1950’s and 1960’s IDI, but appeared to also have provided the basis for a general theory of IDI applicable for all times. The chapter has already shown that IDI was part of a longer process, but developments in the 1970’s and 1980’s provided the most important test of the new theory.

The orthodox theory of IDI that emerged from the 1950’s and 1960’s had presented both the period as a new epoch and the theory as a new paradigm with new concepts and categories. It was also claimed for a time that modern theory was a general and universal theory of the IDI process. The chapter has suggested that post-war IDI theory was not theorising a new empirical form of international investment. The chapter has also attempted to show that post-war IDI theory and its conceptual agenda were not new, and also developed over a much longer period. Of course, at this stage these points have been developed only in a cursory way and much of the detailed analysis to support these propositions are developed in subsequent chapters.

The chapter has also indicated the broad outlines of the transformations in both the pattern of IDI and the environment in which IDI took place in the 1970’s that forced modifications in the conceptual agenda of IDI theory. The modifications were part of what Kindleberger termed a ‘new wave’ of theoretical speculation and debate. While that debate produced some new insights into the IDI process, it also occurred in such a way that undermined the earlier optimism that IDI research was in the process of developing a general theory of IDI. Instead, by the mid-1980’s, a general pessimism emerged about the general theory of IDI, and IDI research has since become a much more explicitly eclectic and descriptive project.

More particularly, the new theory of IDI that had developed as an explanation of 1950’s and 1960’s IDI, could neither predict nor adequately explain changing IDI in the 1970’s and 1980’s. The pattern of 1970’s IDI offered a different perspective on

---

\(^{62}\) In the case of several countries, such as the USA, UK, Switzerland and the Netherlands the value of output produced abroad by firms based in those countries in the mid-1960’s already exceeded the value of national exports by a considerable margin (Dunning 1983). Bergsten, Horst and Moran (1978) reported that in the case of the US, in the mid-1970’s, over 80 percent of the foreign sales of American multinationals were being derived from their majority-owned foreign affiliates and less than 20 percent from exports from the United States.
the IDI process to that which was constituted as the analytical basis of early post-war IDI theory. David McClain (1983) made the point that the 1970’s IDI, had emphasised the ‘unique’ characteristics of 1950’s and 1960’s IDI which had informed the analytical understanding of the direct investment process. Transformations in 1980’s IDI served only to reinforce McClain’s observation and helped to finally undermine claims of the new theory of IDI to being a general and universal one. A similar conclusion also began to emerge when the new theory was used to explain IDI in the nineteenth century (see Appendix 2.1). The historical research attempted to apply the concepts and categories of post-war IDI theory to earlier periods. It was found that pre-war IDI did not ‘fit’ readily into post-war theory, and these findings also helped to force a re-evaluation of the claims to generality of post-war IDI theory.

2.6 CONCLUSION

In the nineteenth century, the world economy as an empirical reality was still in the process of development. Nineteenth century economists had limited historical experience with the world economy, and it was possible to grasp the global nature of capitalism only in a fairly particular way. The global spread of capitalism though colonialism and trade offered a fairly limited perspective on the international nature of capitalism. To paraphrase Geoffrey Kay (1991), nineteenth century economists were dealing with the world economy, and international investment in particular, as much from an examination of abstract categories as from direct experience.

The emerging world economy was therefore understood mainly through the relocation and subsequent growth of capitalist economic relations to new areas and usually in terms of relations of exchange (especially commodity trade). Indeed, international economic processes in the nineteenth century, structured by colonialism appeared to economists at the time as the unfolding of international relations between colonial powers and their colonies. International investment, like trade came to be understood largely in terms of an outgrowth of these colonial relations. While this was never an entirely accurate depiction, colonialism did structure international trade and investment patterns in particular ways. Investment and trade from Britain for instance, was heavily oriented toward its colonies, but as the world’s major trading and financial centre, Britain was always integrated into the world much more than simply as a colonial power. Nevertheless, international trade and investment was structured in important ways by the characteristics of the dominant colonial powers, and the extensive relations they had with new areas of development.

In the 1950’s and 1960’s, international investment grew rapidly and was directed to other industrial nations - in the ‘wrong’ direction to the predictions of theory. With the growth of IDI and the emergence of what became known as the MNE, internationalisation also came to be understood through firms moving out of their national borders, and the firm became incorporated into the concept of internationalisation. The post-Second World War period was also associated with the obtaining of full political sovereignty by most former colonial countries (the post-colonial era), but the post-colonial period was not necessarily accompanied by the growing international economic development of former colonies. Traditional trade
and investment theory did not anticipate that the post-war growth of international investment would be concentrated between the advanced industrial nations. Contrary to the interest-rate differential model of international investment, capital flows were not moving mainly from the capital-rich countries to the post-colonial capital-poor nations. Post-war international investment increasingly became a relation between the advanced industrial nations.

As long as international investment was dominated by the leading industrial nation, it was still tenable to understand international investment processes in national terms. But by the late 1960’s, the growth of large international trading and industrial companies, the changing nature of international trade (especially in the concentration of intra-industry trade in intermediate commodities such as semi-finished manufactures) and the scale and pattern of international investment began to change this understanding. These developments made it more difficult to maintain that international processes were simply an outgrowth of national processes, and that the nation was the unit of analysis of global processes.

The chapter has shown through a ‘deconstruction’ of 1950’s and 1960’s theory, that attempts to explain IDI since the 1970’s, has required a ‘loosening up’ of the concepts of IDI theory, including its concept of internationalisation.

By the mid-1980’s, there was widespread recognition from a number of directions that models of IDI can only now be models of specific aspects of IDI, or of IDI for only a particular period. The leading theorists of IDI were reaching the same broad conclusion, that the notion of a general theory of IDI had proven to be illusory. Instead, IDI theorists have begun to suggest that in changed conditions of IDI, “both the concepts and the policy prescriptions of our forefathers are becoming less relevant each day” (Dunning 1995).

The purpose of the remainder of the thesis is to explore how the development of theories of IDI and the MNC as a post-war phenomena has also influenced the way that recent internationalisation has been understood. From the perspective of the 1980’s, the debates of the 1950’s and 1960’s now appear to be quite particular and conjunctural. The current chapter has examined historically how certain features of the 1950’s and 1960’s that were assumed to be universal, were in fact part of a longer process. The analytical concepts of IDI research formed in the 1950’s and 1960’s came to be presented as general theories have evolved by responding to ongoing changes in IDI, but explaining those changes eventually required a relaxation in some of the theory’s original universal assumptions. By the 1980’s and 1990’s, transformations in the characteristics of (and in the international context for) IDI have undermined much of the post-war theoretical agenda, and made that theory seem quite particular and unhistorical.

The next chapter analyses the development of the post-war theory of IDI. If there is now a widely held view that there can no longer be a general theory (and perhaps

---

63 Two further trends are relevant here. As IDI growth became more closely associated with the corporate form of its transmission, IDI theory became increasingly a model of the multinational firm. Also, the growing number of firms that were internationalising through IDI required that models of IDI become less models of the unique advantages (and monopoly position) of a few multinational firms and more models of common control of intermediate activities (and market replacement) by many firms.
that there never was one) it is important here not to simply provide a review of the earlier literature, but to review the terms of earlier debates that seemed to have generated universal concepts and categories. Later chapters will consider the change and subsequent breakdown of many of the 1950’s and 1960’s concepts in response to changing patterns of IDI in the 1970’s and 1980’s. But those debates have been conditioned by the concepts and categories developed in the formative period in IDI theory.

The review also has relevance for another contemporary theoretical dilemma. There is an argument being advanced that we are now in or entering a new (global) era, requiring a new set of general theoretical categories. To date, debate on the claims for a new era have been largely empirical, addressing the question of whether recent changes represent a significant enough departure from the past to constitute a structural transformation in the nature of economic activity? Establishing the conditions which then made early post-war international capital appear analytically as new, and generative of a new set of theoretical tenets, may also then help to provide a theoretical (or at least methodological) perspective on contemporary debates about globalisation.
APPENDIX 2.1 RETHINKING THE NINETEENTH CENTURY

Alongside and coincident with the problem of explaining IDI after the formative period of IDI theory in the 1950's and 1960's, was research by economic historians into nineteenth and early twentieth century IDI. Using insights from post-war models of IDI to understand pre-Second World War IDI, researchers shed new light on the history of IDI and the origins of the modern MNE. It will be recalled that the global pattern (and growth) of early post-war IDI appeared as new, and they also seemed to generate categories and concepts that could be applied universally to other time periods. And, in a similar way to the deconstruction of 1950's and 1960's theory in the 1970's and 1980's, research by economic historians into pre-Second World War Two IDI required the 'loosening up' of the concepts of post-war theory.

Research into the pre-Second World War history of IDI and the MNE, that began as an attempt to examine the empirical consequences of applying the mid-twentieth century concepts and models to nineteenth century data, also therefore raised wider issues for each of the three conceptual categories of IDI theory. Not only did the 1950's and 1960's categories of IDI theory start to break down in the 1970's and 1980's, they can also be seen to have 'retrospectively' broken down in the re-evaluation of pre-World War Two IDI. It is pertinent to examine these as they establish the other point of reference to the breakdown of general theories of IDI in the late 1970's and 1980's.

It has already been noted that economic historians found that IDI was not a post-World War Two invention and that IDI was occurring on quite a large scale before the Second World War. Similarly, it was found that the association between IDI and particular types of (monopolistic) market structure was not a generalised experience of pre-war IDI. Although IDI from the US may have been linked to firms in oligopolistic industries, this was not a characteristic feature of outward IDI from other countries, such as the UK.

IDI in the 1950's and 1960's was closely associated with the wholly-owned subsidiary, and this dictated that a particular institutional form of international capital was incorporated in the development of IDI theory. Models of IDI incorporated a concept of capital that was based on the international expansion of joint stock companies establishing wholly-owned subsidiaries abroad. This concept of capital was found to be far too restrictive to capture the wide range of forms of cross-border business control in the nineteenth century. Nor could it capture the fact that the funding of nineteenth century IDI was associated with a different international monetary regime, where the financing of IDI occurred under colonial rule. Historical research suggested that the pre-War period was associated with a much more diverse range of institutional forms of international capital (Wilkins 1988; Jones 1987). In the light of this research, Mark Casson (1986), one of the most important IDI theorists, was forced to conclude that post-war IDI theory had been far

---

64 According to Geoffrey Jones (1984), the relationship between internationalisation, firm size and oligopoly was uncertain at best.
too steeped in the particular institutional forms of foreign investment that prevailed in the early post-war period\textsuperscript{65}.

The post-war 'American' model of IDI was based on the metaphor of the cross-border spread of 'national' firms, which had begun and grown large in the home (ie US) market. This was a model of the international operations of 'national' firms\textsuperscript{66}. Historical research also raised doubts about the usefulness of this metaphor for understanding pre-Second World War IDI. The distinction between domestic and foreign (or international) investment requires an unambiguous definition of the nationality of investors. The distinction between cross-border investment on the basis of nationality was critical to IDI theory, and nationality was therefore constructed as an economic concept. IDI theory helped to focus on the individual firm in the international investment process, but on the assumption that firms were inherently national in nature. This was an assumption that also encountered problems in explaining nineteenth century evidence.

In an echo of what was being observed about 1970's and particularly 1980's and 1990's IDI, economic historians raised the problem of defining the nationality of firms (and therefore of calculating the scale of international investment by various nations). The problem here was that there was often a separation in the nationality between the legal owners, the funds providers, the corporate headquarters and the place of production. How a firm acquired a nationality, and for what purposes was an open issue in the nineteenth century. In the case of Britain for instance, a considerable amount of money raised in the City of London to fund international investment abroad was itself obtained from international sources\textsuperscript{67}.

Problems were therefore encountered in applying mid-twentieth century definitions of corporate nationality to the nineteenth century, when the residency of the organising units of business (including both firms and families) were changing, and the concept of nationality itself was in a state of flux (Jones 1987)\textsuperscript{68}. Historical research thus raised the wider question of the attachment of capital to the nation-state (Platt 1977; Stopford 1979; Chapman 1986; Cowen 1986; Wilkins 1986)\textsuperscript{69}.

\textsuperscript{65} Casson concluded that the pre-occupation of theories of IDI "with the firm and its arm's length contractual alternatives make them difficult to apply to earlier times in which the extended family, partnership, the merchant guild and the cartel were also important forms of economic organisation (as some still are today)" (1986, p 2).

\textsuperscript{66} It will be recalled that this was the title of Hymer's seminal PhD thesis.

\textsuperscript{67} As Rubenstein noted, "England's role as 'Clearing House of the World' preceded its emergence as 'Workshop of the World'... and even during the mid-day of Victorian prosperity it predominated over it" (quoted in Cain and Hopkins 1980).

\textsuperscript{68} To paraphrase Benedict Anderson (1983), capitalists in the nineteenth century were still in the process of imagining themselves as part of national communities.

\textsuperscript{69} Stopford attempted to capture the ambiguous nature of nationality by adding a third category of identity national, foreign and 'expatriate' investment. Chapman, on the other hand suggested that British-based should refer to firms that had their base in Britain and conducted a large part of their operations through London. However, Platt goes so far as to suggest that nationality was largely irrelevant to forms of investment in Latin America in the nineteenth and early twentieth century. Charles Jones found that the use of mid-twentieth century descriptive categories such as nationality part of the problem of understanding the nature of international business in the nineteenth century. He concluded that these categories were out of place in a world where widely dispersed structures of kinship and acquaintance were central to economic relations. While observing that there was an increasing attempt to define firms in national terms in the late-nineteenth century, Cowen found that there was no necessary correspondence between what was being defined as national need and the national interest and the universal properties of capital, let alone the propensities of profitability of individual firms. A company could acquire a national stamp even though its finance, production and management shifted from country to country.
By utilising models of IDI developed to explain post-Second World War developments for the nineteenth century, economic historians were able to develop some significant insights into the nature of internationalisation and especially into the nature and evolution of the international firm in the nineteenth century. But as the chapter has shown, these insights came at a cost. Economic historians encountered several empirical problems of applying post-Second World War models and concepts of IDI to earlier historical periods. The scale of these problems also raised wider conceptual issues about the generality and the historical durability of these categories. The possibility of any single set of descriptive concepts and criteria being able to adequately capture changing patterns and forms of internationalisation over time was increasingly being raised by economic historians at a time when IDI researchers were also in the process of reaching the same conclusions about 1970’s and 1980’s IDI (Jones 1987; Fieldhouse 1986).

It was observed earlier in the chapter that during the 1970’s and 1980’s, the claims to universality of post-war models of IDI (and the concepts upon which they were based) were challenged by the evidence that patterns of IDI were changing and becoming inconsistent with those models. From a different, but parallel direction, historical research into the nineteenth and early twentieth century patterns of international investment provided similarly confounding evidence. Historical research has also suggested that post-war IDI was part of a longer process of internationalisation, in which the 1950’s and 1960’s marked one (albeit important) phase in that development. Taken together, these findings were also important in forcing a re-evaluation of both the basic concepts of IDI research and the claims for generality of post-war theory of IDI theory.

Further, Cowen found that the actual forms of internationalisation (or relocation) of capital had as much to do with national state action, as with the technical conditions and relative prices of production.
IDI IN THE 1950’s AND 1960’s

The historical basis of a ‘new’ theory
3.1 INTRODUCTION

This chapter explores the process by which a general theory of IDI emerged out of attempts to explain the ‘new’ pattern of IDI in the early post-Second World War period. The growth and pattern of international (or foreign) direct investment (IDI) in the 1950’s and 1960’s suggested that IDI had become a significant form of international capital flow, and was behaving in quite different ways to international portfolio capital. IDI was moving in the ‘wrong’ direction to the predictions of portfolio capital theory, and seemed to be motivated more by the expectations of higher profits arising from the ownership and control of production abroad, than from the gains arising from international interest-rate arbitrage. It was in the context of explaining the patterns of 1950’s and 1960’s IDI that it was recognised that IDI was not simply a minor or derivative form of international portfolio investment, but was an important and distinct form of international capital in its own right. These developments helped to give rise to the proposition that post-war IDI was a ‘new’ development, and that the explanation of this development required a new set of analytical concepts.

The particular pattern of early post-war IDI thus became cast by researchers as constitutive of a ‘new’ set of theoretical tenets. Yet in the previous chapter it was observed that the process of IDI was not an invention of the early post-war period, nor was it even a new object of analysis. The origins of IDI as a phenomenon can be traced back to at least the mid-to-late nineteenth century, and research on IDI from at least the early twentieth century. Nevertheless, the pattern of post-war IDI, the context within which it took place, and the conceptual categories which came to dominate post-war analysis tended to obscure an appreciation of pre-war IDI. It was in this way that the conceptual ‘slate’ was wiped clean and the pattern of early post-war IDI became the foundations for the development of a new and general theory of IDI. Yet the new theory was based on stylised facts which turned out to be largely peculiar to the 1950’s and 1960’s.

The new theory of IDI entrenched an analytical framework which has lasted far beyond the explanation of the early post-war circumstances. Despite the many changes in the pattern and characteristics of IDI since the 1960’s, the conceptual agenda of IDI theory established in the 1950’s and 1960’s has remained at the centre of IDI research (Kindleberger (1984)). Hence it is a central proposition of the current chapter that the depiction of post-war IDI as ‘different’ can be verified, but the proposition that it was a ‘new era’ and therefore warranted a discrete and ahistorical theory to explain it, misunderstood a novel form as a new phenomenon.

In the previous chapter, it was contended that the development of IDI theory can usefully be explored through the evolving concepts of capital, competition and internationalisation. In the 1950’s and 1960’s, these categories were invented with

---

1 Instead of flowing from developed (capital surplus) countries to developing (capital deficit) countries, IDI was flowing increasingly between the developed countries.
2 Mark Casson has for instance noted that “The current economic theory of the MNE began as an attempt to explain post-war US corporate investment in Western European industry” (1986, p 42).
3 Kindleberger was making the more specific point that despite the many claims by 1970’s researchers to have developed ‘new’ and general theories of IDI, there was little being offered that was very different to the insights first offered in Stephen Hymer’s 1961 PhD thesis.
certain meanings derived from their capacity to describe the prevailing pattern of IDI. In the 1950’s and 1960’s, post-war IDI was understood and defined by economic theorists of the time so that those patterns and determinants were assumed to be generative of universal and general postulates. The conceptual simplex of capital, competition and internationalisation will be used to help explain how IDI theory made something that was historically contingent appear as constitutive of universal theoretical tenets.

By the late-1960’s, a coherent theoretical agenda had been established, and models of IDI were being offered as general theories of IDI, which could explain the patterns and determinants of all future IDI. No one then realised that these apparently universal models were based on a quite particular pattern of IDI. In retrospect it is now clear that in attempting to abstract theoretically from transitory facts the theoretical agenda was limited and going to be vulnerable to later change. While not evident at the time, the conceptual agenda of IDI theory had been locked into categories that were specific largely to the facts of 1950’s and 1960’s IDI.

After exploring the ‘new’ stylised facts of post-war IDI, the chapter explains how those facts became constituted into a new conceptual agenda of IDI theory. The chapter then proceeds to introduce the models of IDI that were developed to explain post-war IDI. While these models were not uniform, and debates occurred between them, they were unified by the conceptual framework of the new theory. The categories of competition, capital and internationalisation, developed in the last chapter, are applied here to establish the point that the post-war patterns were not ‘new’ in any fundamental sense, and hence not the basis of a new general theory. The 1950’s and 1960’s simply established a different pattern of IDI, a pattern that will be shown in subsequent chapters was itself subject to historical evolution.

3.2 THE ‘STYLISED FACTS’ OF POST-WAR IDI

The pattern of early post-war IDI represents what Mark Casson, borrowing from Nicholas Kaldor, termed the ‘stylised facts’ of IDI theory\(^4\). The requirement of explaining these generally recognised stylised facts was critical in establishing the conceptual agenda of post-war IDI theory\(^5\).

Several general characteristics of early post-war IDI were especially important for the formation and development of post-war theory of IDI, and the explanation of each of these characteristics helped to impart on IDI theory a particular analytical focus. There were also other facts which were not at the time seen as critical to the development of the agenda of IDI theory, but which would later become significant and require modification of the original conceptual categories. It is to the stylised facts that the chapter now turns.

\(^4\) Casson suggested that, “the need to explain these facts has guided the development of theory throughout, and has conferred on the theory its major strength relative to other branches of economics, namely its immediate practical relevance” (1987).

\(^5\) While debate occurred between proponents of the various models of IDI, that debate was constructed around the requirement of explaining these generally recognised stylised facts.
3.2.1 Rapid Growth of IDI

The growth of IDI in the 1950’s and 1960’s was spectacular, and that growth was significant historically and when compared with other contemporary measures of international activity. Figure 3.1 shows the growth in the global accumulated stocks of IDI in the 1950’s and 1960’s. What it reveals is the particularly strong growth of IDI during the 1950’s and 1960’s, especially when compared to IDI growth in the pre-war period. In contrast with the pre-war association of international capital with portfolio investment and loans, post-war period international capital came increasingly to be associated with IDI. It was this growth most of all which created the notion of the 1950’s as the beginning of a new era of international capital⁶.

Figure 3.1 Growth in the Stock of Accumulated International Direct Investment, 1914 - 1971 (US$ Billion)


3.2.2 Corporate Form of IDI

Arising from the growth in 1950’s and 1960’s IDI, came a further critical differential feature of post-war international capital from its pre-war ancestor: the increasing association of international capital with the international activities of firms. This was to mean that the analytical explanation of international firms - known variously as TNCs - became central to the new theory.

One measure of this association between IDI and the TNC was the acceleration in the rate of growth in the number of new international subsidiaries established or acquired by firms. Compared to the pre-war period, there was a rapid growth in both IDI and the rate of establishment of subsidiaries abroad by investing companies.

⁶ Arndt (1951), called it a new form of international borrowing.
Table 3.1 shows the rate of new ‘foreign’ subsidiaries established or acquired in various periods during the early post-war period.

<table>
<thead>
<tr>
<th>Period</th>
<th>Number of Foreign Subsidiaries Established or Acquired in period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946-1952</td>
<td>719</td>
</tr>
<tr>
<td>1953-1955</td>
<td>360</td>
</tr>
<tr>
<td>1956-1958</td>
<td>679</td>
</tr>
<tr>
<td>1959-1961</td>
<td>1510</td>
</tr>
<tr>
<td>1962-1964</td>
<td>1507</td>
</tr>
<tr>
<td>1965-1967</td>
<td>1880</td>
</tr>
<tr>
<td>1968-1970</td>
<td>1968</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8623</strong></td>
</tr>
</tbody>
</table>

Notes: Data on subsidiaries of 47 UK, 85 Continental European, and 67 Japanese-based firms were collected for all parent firms on the 1971 Fortune ‘200’ list of non-US industrial enterprises, as well as for a few financial holding companies and family groups that had more than $400 million sales in 1970 coming from manufacturing operations. Data on subsidiaries of US-based parents were collected for 187 US firms on the 1968 Fortune ‘500’ list with an equity interest of at least 25% in manufacturing subsidiaries in at least six foreign countries as of January 1, 1968. Some 50 of these US firms were smaller than the non-US companies surveyed. About 50 non-US firms did not manufacture in six or more foreign countries. Data incomparabilities thus exist. They do not, however, seem to alter critically the orders of magnitude indicated by the above comparisons. For a fuller explanation of the data in the Comparative Multinational Enterprise Data Bank, see Vaupel and Curburn (1974).

Source: Franko 1976, p 10

This institutional feature of IDI became a critical criterion for distinguishing between direct and portfolio investment, especially in national Balance of Payments accounting terms. It has been noted by Charles Jones, for instance, that the criteria for distinguishing between IDI and international portfolio investment were devised “by post-war economists for whom the paradigm of direct foreign investment was the wholly-owned overseas subsidiary” (1987, p 18).

The growth in IDI and its association with the increased rate of establishment of foreign subsidiaries was not only historically significant in itself. IDI also became a more significant feature of the economic activity of once domestic firms, especially of firms from the US (a point taken up in Section 3.4).

Figure 3.2 presents US data showing that the value of IDI by all firms in the US as a percentage of their total assets grew by more than 50% in the 1950’s and 1960’s (from 2.08% in 1950 to 3.19% in 1970). For non-financial corporations, IDI climbed from 4.22% to 6.79% of total non-financial corporate assets. IDI represented a much
higher proportion of the total assets of the largest international direct investors (or ‘multinationals’).

Taken together, the rapid growth in IDI, and its association with the TNC helped to give the impression that IDI was a uniquely post-war phenomenon, or at least had become a characteristic feature of it. The rapid post-war growth of IDI was therefore critical to the nature of post-war IDI theory.

![Figure 3.2 Value of US Direct Investment Abroad as Percentage of Assets of US Corporations](image)

Source: Lipsey 1988, p 489.

### 3.2.2 Concentration of IDI by the US

Apart from strong growth in post-war IDI and its association with the new corporate form of its transmission, perhaps the most significant feature of the early post-war period was the concentration by the US as the global source of IDI. Whereas in the pre-war period, the UK accounted for the largest stock of outward investment, including IDI, in the post-war period the US became the largest source of international investment, most of it in the form of IDI.\(^7\)

Up until the mid-1960’s for instance, the US accounted for about 70 per cent of the accumulated stock of post-war IDI and 85 per cent of all IDI transactions since 1945 (Dunning 1990)\(^8\). In the second half of the 1960’s, outward IDI by a few European countries began to assume more significance, but it was not until the 1970’s that this development challenged the nexus between IDI and the US.

---

\(^7\) This structural feature of the US economy predated the post-Second World War period, but became much more internationally significant in the context of the rapidly growing significance of IDI within international investment.

\(^8\) In that period, the stock of US IDI abroad increased from $US12 billion to $US55 billion (Vaupel and Curhan, cited in Dunning 1983; Reed 1983).
Figure 3.3 New Foreign Affiliates Established Per Year by the 180 Largest US Parent Firms, 1946-1971

(a) for 187 parent firms

Source: Lipsey 1988, p 489.

As Table 3.2 shows, 60% of the new subsidiaries established abroad between 1946 and 1961, were established by US-based MNCs.

<table>
<thead>
<tr>
<th></th>
<th>US-Based MNEs</th>
<th>UK-based MNEs</th>
<th>Continental MNEs</th>
<th>Japanese-based MNEs</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1946-52</td>
<td>2009</td>
<td>684</td>
<td>609</td>
<td>65</td>
<td>3367</td>
</tr>
<tr>
<td>1951-55</td>
<td>60%</td>
<td>20.4%</td>
<td>18.1%</td>
<td>1.9%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Dunning 1984, p93.

It was in this context that IDI was often described at the time as the ‘US model’ of international capital. Similarly, the multinational firm was thought of as virtually synonymous with companies from the United States (Penrose 1956; Arndt 1957; Servan-Schreiber 1968; Bergsten, Horst and Moran 1978; Jones and Schrotter 1993). This, as shall be seen shortly, served to exaggerate the importance of particular national characteristics in the determination of IDI. The concentration of early post-war IDI by the US (and the later growth of IDI from the UK and a few European countries) suggested that IDI was related to processes and characteristics of its country of origin.
Hence as will be seen below, IDI theory started to extrapolate from certain characteristics of US IDI. Suffice it here to provide some data on the pattern of US IDI. Between 1950 and 1965, for instance, outward IDI from the US increased fivefold, and until the mid-1960's the US accounted for 85 percent of all new IDI and around 70 percent of the accumulated stock of global IDI. The annual outflow of IDI from the US grew at an exponential rate from the late 1940's through the 1950’s and 1960’s. In 1946, outward IDI for that year amounted to $230 million. By 1960, the outflow figure had climbed to $1,670 million, and by the end of the 1960’s annual IDI outflow was running at $4,400 million (Bergsten, Horst and Moran 1978, p 150).

Table 3.3 Value of United States foreign direct investment as percentage of assets of United States corporations, 1950-1971

<table>
<thead>
<tr>
<th>Year</th>
<th>All Corporations</th>
<th>Non-Financial Corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>BEA (g) and FRB (h)</td>
<td>IRS (g)</td>
</tr>
<tr>
<td>1950</td>
<td>2.08</td>
<td>1.97</td>
</tr>
<tr>
<td>1952</td>
<td>2.12</td>
<td>2.00</td>
</tr>
<tr>
<td>1955</td>
<td>2.39</td>
<td>2.18</td>
</tr>
<tr>
<td>1957</td>
<td>2.76</td>
<td>2.55</td>
</tr>
<tr>
<td>1960</td>
<td>2.90</td>
<td>2.64</td>
</tr>
<tr>
<td>1962</td>
<td>2.97</td>
<td>2.69</td>
</tr>
<tr>
<td>1965</td>
<td>3.11</td>
<td>2.87</td>
</tr>
<tr>
<td>1967</td>
<td>3.05</td>
<td>2.81</td>
</tr>
<tr>
<td>1970</td>
<td>3.19</td>
<td>2.86</td>
</tr>
</tbody>
</table>

a) Bureau of Economic Analysis  
b) Federal Reserve Board  
c) Internal Revenue Service  


Whereas the book value of IDI from the US stood at $7.2 billion in 1946, it had increased more than three-fold by 1956. By 1960 the stock of IDI had reached $34.7 billion and by the end of the 1960's the stock of US IDI abroad had grown to $78.2 billion, representing an eleven-fold increase in a decade and a half.

3.2.3 Industrial Composition of IDI

Post-war IDI growth was closely identified as a process of international expansion of manufacturing industries. In the pre-war period, a trend toward manufacturing IDI had already become established and by the 1920’s, the manufacturing sector had become the largest sector of IDI investment. Nevertheless, a significant proportion of IDI remained in public utilities and in the mining/extractive industries, especially in oil and gas. In the 1950’s, IDI became particularly associated with the relocation of mass production industries from the United States. By the late-1950’s and early 1960’s, the stock of IDI was overwhelmingly dominated by investment in
manufacturing and oil and gas industries. Petroleum-based IDI has a long history and was a key strategic feature of post-war US foreign policy, and was therefore less likely to enter into the new general theories of IDI (except perhaps in radical company-based models focussing on the links between US foreign policy and the big oil companies). It was manufacturing IDI which became the basis of the new general theory. This reinforced the association between the post-war consolidation of the US as the hegemonic industrial nation, as well as factors such as firm size (or market structure) and the possession of advantages in technology and marketing, issues developed later in the chapter.

Table 3.4 shows the changing industrial distribution of IDI by US firms. The key area of outward IDI growth from the US in the 1950’s but especially in the 1960’s was in manufacturing, which grew from $US 3.83 billion in 1950 to $US32 billion in 1970. The petroleum sector also remained a significant sector of outward investment, growing from $US3.39 billion in 1950 to $US21.71 billion in 1970. Together with the petroleum sector, the manufacturing sector accounted for almost three-quarters of IDI stocks of outward IDI from the US at the end of the 1960’s. IDI it was therefore thought was to be explained by the particular nature of the productive and market structure as found in US manufacturing.
Table 3.4 Stock of US Direct Foreign Investment by Industry and Location, 1950, 1960 And 1970
(Book Value in USS Billion)

<table>
<thead>
<tr>
<th>Country or region</th>
<th>(1) Total</th>
<th>(2) Manufacturing</th>
<th>(3) Trade</th>
<th>(4) Trade</th>
<th>(5) Mining</th>
<th>(6) Public utilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>17.2</td>
<td>6.9</td>
<td>24.52</td>
<td>.93</td>
<td>3.80</td>
<td>13.71</td>
</tr>
<tr>
<td>Canada</td>
<td>1.55</td>
<td>1.16</td>
<td>22.79</td>
<td>1.90</td>
<td>4.83</td>
<td>10.06</td>
</tr>
<tr>
<td>Latin America</td>
<td>4.56</td>
<td>8.32</td>
<td>15.75</td>
<td>.78</td>
<td>1.52</td>
<td>4.62</td>
</tr>
<tr>
<td>Asia</td>
<td>1.60</td>
<td>2.48</td>
<td>5.38</td>
<td>.06</td>
<td>.29</td>
<td>1.52</td>
</tr>
<tr>
<td>Africa</td>
<td>29</td>
<td>1.07</td>
<td>3.44</td>
<td>.06</td>
<td>.12</td>
<td>.54</td>
</tr>
<tr>
<td>Oceania</td>
<td>26</td>
<td>1.01</td>
<td>3.39</td>
<td>.01</td>
<td>.49</td>
<td>1.81</td>
</tr>
<tr>
<td>TOTAL</td>
<td>11.79</td>
<td>3.82</td>
<td>7.81</td>
<td>3.83</td>
<td>11.05</td>
<td>32.26</td>
</tr>
</tbody>
</table>

1 Total is the sum of columns 2-6 plus miscellaneous investments
2 Including smelting
3 Includes transportation
4 Preliminary figures (revised figures could not be located)
5 Includes European and former European dependencies
6 Practically all in the Philippines
7 Less than $5 million
8 $1 million or less
9 Includes unallocated international

Figure 3.4 United States: Stocks of Foreign Direct Investment, 1950-1970
(Millions of US dollars)
All Industries

Note: The data is not exactly comparable, because of changes in survey definitions.

3.2.4 Geographic Pattern of IDI

Related to the growing concentration of IDI in manufacturing was also a growing geographic concentration in the direction of IDI to other advanced industrial countries. Whereas in 1914, around two-thirds of the global stock of IDI was accounted for by IDI in developing countries, by 1938, the developing countries' proportion of global IDI had fallen to 55 per cent. In the post-war period, most of the growth in new IDI occurred between the advanced capitalist countries, so that by 1960 the proportion of the global IDI stock in developing countries had fallen to around 40 percent, and by the end of the 1960’s it had fallen to around one-third (Dunning 1983). Hence, in the post-war period, growing IDI was accompanied by the increasing concentration of IDI between the advanced industrial countries (Table 3.5)
Table 3.5 Number of New Foreign Affiliates Established or Acquired by the One Hundred and Eighty Largest United States-based Transnational Manufacturing Corporations: 1951-1970

(Number of affiliates established or acquired)

<table>
<thead>
<tr>
<th>Host country group</th>
<th>1951-60</th>
<th>1961-65</th>
<th>1966-70</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total, all areas</strong></td>
<td>295</td>
<td>645</td>
<td>877</td>
</tr>
<tr>
<td>Developed market economies</td>
<td>181</td>
<td>444</td>
<td>618</td>
</tr>
<tr>
<td>Developing countries, <strong>Total</strong></td>
<td><strong>114</strong></td>
<td><strong>201</strong></td>
<td><strong>161</strong></td>
</tr>
<tr>
<td>Latin America</td>
<td>86</td>
<td>139</td>
<td>16</td>
</tr>
<tr>
<td>North Africa and Middle East</td>
<td>8</td>
<td>12</td>
<td>28</td>
</tr>
<tr>
<td>Other Africa</td>
<td>6</td>
<td>18</td>
<td>28</td>
</tr>
<tr>
<td>Asia</td>
<td>13</td>
<td>32</td>
<td>53</td>
</tr>
</tbody>
</table>

Source: UNCTC (1978, p 223)

Statistics on US IDI illustrate the concentration towards other industrialised countries, especially Canada, the UK and the main European countries and Australia. Whereas in 1950 the largest single location of US IDI was in Canada, a large share of the stock of outward investment was in Latin America (much of it related to petroleum investment, and public utilities), with Europe accounting for a significant but much smaller share of the total outward IDI. Table 3.6 shows that by 1960, around 25 percent of the stock of outward IDI was in Canada, a further one quarter in the EEC and less than one third in developing countries. By the end of the 1960’s, this pattern had altered quite significantly: more than one quarter of the accumulated stock of outward IDI in the European countries and only 30 percent in developing countries.
<table>
<thead>
<tr>
<th></th>
<th>1914</th>
<th></th>
<th>1938</th>
<th></th>
<th>1960</th>
<th></th>
<th>1971</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$m</td>
<td>%</td>
<td>$m</td>
<td>%</td>
<td>$m</td>
<td>%</td>
<td>$m</td>
<td>%</td>
</tr>
<tr>
<td>Developed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>countries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USA</td>
<td>1450</td>
<td>10.3</td>
<td>1800</td>
<td>7.4</td>
<td>7.6</td>
<td>13.9</td>
<td>13.9</td>
<td>8.4</td>
</tr>
<tr>
<td>Canada</td>
<td>800</td>
<td>5.7</td>
<td>2296</td>
<td>9.4</td>
<td>12.9</td>
<td>23.7</td>
<td>27.9</td>
<td>16.8</td>
</tr>
<tr>
<td>Europe</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Western Europe</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of which UK</td>
<td>(200)</td>
<td>(1.4)</td>
<td>(700)</td>
<td>(2.9)</td>
<td>(5.0)</td>
<td>(9.2)</td>
<td>(13.4)</td>
<td>(8.1)</td>
</tr>
<tr>
<td>Other European</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of which Russia</td>
<td>(1000)</td>
<td>(7.1)</td>
<td>400</td>
<td>1.6</td>
<td>neg</td>
<td>neg</td>
<td>neg</td>
<td>neg</td>
</tr>
<tr>
<td>Australasia and</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>450</td>
<td>3.2</td>
<td>1950</td>
<td>8.0</td>
<td>3.6</td>
<td>6.6</td>
<td>16.7</td>
<td>10.0</td>
</tr>
<tr>
<td>Japan</td>
<td>35</td>
<td>0.2</td>
<td>100</td>
<td>0.4</td>
<td>0.1</td>
<td>0.2</td>
<td>2.5</td>
<td>1.5</td>
</tr>
<tr>
<td>Developing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Countries</td>
<td>8850</td>
<td>62.8</td>
<td>15969</td>
<td>65.7</td>
<td>17.6</td>
<td>32.3</td>
<td>51.4</td>
<td>30.9</td>
</tr>
<tr>
<td>Latin America</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Africa</td>
<td>4600</td>
<td>32.7</td>
<td>7481</td>
<td>30.8</td>
<td>8.5</td>
<td>15.6</td>
<td>29.6</td>
<td>17.8</td>
</tr>
<tr>
<td>Asia</td>
<td>900</td>
<td>6.4</td>
<td>1799</td>
<td>7.4</td>
<td>3.0</td>
<td>5.5</td>
<td>8.8</td>
<td>5.3</td>
</tr>
<tr>
<td>of which: China</td>
<td>(1100)</td>
<td>(7.8)</td>
<td>(1400)</td>
<td>(5.8)</td>
<td>(neg)</td>
<td>(neg)</td>
<td>(neg)</td>
<td>(neg)</td>
</tr>
<tr>
<td>India and Ceylon</td>
<td>(450)</td>
<td>(3.2)</td>
<td>(1359)</td>
<td>(5.6)</td>
<td>(1.1)</td>
<td>(2.0)</td>
<td>(1.5)</td>
<td>(0.9)</td>
</tr>
<tr>
<td>Southern Europe</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle East</td>
<td>400</td>
<td>2.8</td>
<td>621</td>
<td>2.6</td>
<td>0.5</td>
<td>0.9</td>
<td>1.7</td>
<td>1.0</td>
</tr>
<tr>
<td>International and Unallocated</td>
<td>neg</td>
<td>neg</td>
<td>n.a</td>
<td>n.a</td>
<td>n.a</td>
<td>n.a</td>
<td>6.5</td>
<td>3.9</td>
</tr>
<tr>
<td>TOTAL</td>
<td>14085</td>
<td>100.0</td>
<td>24315</td>
<td>100.0</td>
<td>54.5</td>
<td>100.0</td>
<td>166.3</td>
<td>100.0</td>
</tr>
</tbody>
</table>


### 3.2.5 Trade and IDI

In the 1950's and 1960's both IDI and international trade grew rapidly, but their locational patterns were quite different. This evidence suggested that IDI could not be explained in terms conventionally used to explain trade between nations. Not only was the growth of IDI difficult to explain as simply a derivative form of trade, IDI and trade were behaving quite differently, suggesting that they had distinct determining influences.

Contrary to the thesis of IDI as a derivative process of trade, was evidence suggesting that trade was becomingly increasingly associated with the international activities of firms. This did not mean that trade regimes and their differences did

---

1 Some researchers even began to suggest that trade was following investment.
not form the basis of any explanation of why companies invested abroad, but rather that trade theory was forced to treat IDI as a derivative process, and that other determinants were clearly involved in post-war IDI.

In the case of the international activities of US-based firms for instance, there was a steady growth in the degree to which many national firms were engaging in international production by affiliates and subsidiaries rather than exporting from home, despite little if any increase in barrier protection. Indeed, despite the claims of contemporary globalisation theorists about the newness of the internationalisation of firms, by the early 1960’s, production by US affiliates abroad already exceeded the value of exports from the US by more than a factor of two,. By the late-1960s, this had increased to around three times the level of US exports (Encarnation 1993). This structural feature of post-war internationalisation was not a phenomenon unique only to the US, and Table 3.7 shows that by 1970 production and sales of subsidiaries abroad by companies of several nations were approaching or had already exceeded exports from their nation of origin.

**Table 3.7 Exports of Major Home Countries Compared to Estimated Foreign Production of the Multinationals Based in Each, 1971**

<table>
<thead>
<tr>
<th>Home country</th>
<th>Exports in millions of dollars</th>
<th>Estimated foreign production</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>In millions of dollars*</td>
</tr>
<tr>
<td>United States</td>
<td>43,492</td>
<td>172,000</td>
</tr>
<tr>
<td>Switzerland</td>
<td>5,728</td>
<td>13,500</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>22,367</td>
<td>48,000</td>
</tr>
<tr>
<td>France</td>
<td>20,420</td>
<td>19,100</td>
</tr>
<tr>
<td>Sweden</td>
<td>7,465</td>
<td>6,900</td>
</tr>
<tr>
<td>Canada</td>
<td>17,582</td>
<td>11,900</td>
</tr>
<tr>
<td>Belgium</td>
<td>12,392</td>
<td>6,500</td>
</tr>
<tr>
<td>Netherlands</td>
<td>13,927</td>
<td>7,200</td>
</tr>
<tr>
<td>Italy</td>
<td>15,111</td>
<td>6,700</td>
</tr>
<tr>
<td>Japan</td>
<td>24,019</td>
<td>9,000</td>
</tr>
<tr>
<td>Germany</td>
<td>39,040</td>
<td>14,600</td>
</tr>
</tbody>
</table>

Source: Bergsten, Horst and Moran 1978,p34.
Table 3.8 Sales of US manufacturing subsidiaries in the EC compared to exports from the US to the EC 1957-1972

<table>
<thead>
<tr>
<th></th>
<th>(1) Sales $mn</th>
<th>(2) Exports $mn</th>
<th>(3) Total $mn</th>
<th>(4) % of (1) to (3)</th>
<th>(5) Ratio of (1) to (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1957</td>
<td>2525</td>
<td>1240</td>
<td>3765</td>
<td>67.1</td>
<td>2.04</td>
</tr>
<tr>
<td>1962</td>
<td>5770</td>
<td>2097</td>
<td>7867</td>
<td>73.3</td>
<td>2.75</td>
</tr>
<tr>
<td>1967</td>
<td>12220</td>
<td>3442</td>
<td>15662</td>
<td>78.0</td>
<td>3.55</td>
</tr>
<tr>
<td>1972</td>
<td>35143</td>
<td>6584</td>
<td>41727</td>
<td>84.2</td>
<td>5.34</td>
</tr>
</tbody>
</table>

Source: Dunning 1993, p 173.

3.3 EXPLAINING ‘THE STYLISTED FACTS’ - THE DEVELOPMENT OF THE KEY CONCEPTS OF POST-WAR IDI THEORY

3.3.1 Introduction

Pre-war international investment theory had been based on a paradigm of portfolio capital, with investment flowing down a hierarchy of nations in response to differences in relative national capital abundance (and reflected in international interest-rate differentials). Within portfolio theory, post-war IDI growth was not anticipated, and nor could the characteristics of that growth be explained adequately. The theory of IDI began, therefore, as a lagging attempt to explain a process that seemed to be a distinctive and new feature of the international economy in the immediate post-war period, and emerged in the context of problems faced by existing portfolio theory. The empirical critique of the explanation offered by existing international portfolio theory of early post-war IDI therefore played a formative role in the development of the conceptual agenda of modern IDI theory. It was in the context of this critique that researchers began to develop other concepts for explaining the particular logic which made the observed pattern of IDI profitable.

The purpose of the current section is to outline how the explanation of the ‘stylised facts’ of early post-war IDI became constitutive of the modern theory of IDI. It was contended in the previous chapter that the development of IDI theory could be understood through the development of three unifying concepts (of capital, competition and internationalisation) that were themselves derived from attempts to explain the stylised facts of post-war IDI. While several contending models of IDI emerged and debate occurred between proponents of them, debate was constructed around the requirement of explaining these generally recognised stylised facts, and occurred on the basis of a shared conceptual agenda. Using those concepts, this section will show how those categories were themselves constituted by the stylised facts of the 1950’s and 1960’s IDI. The categories will be developed separately and in turn, but the implications of each category for the others is indicated and the categories build upon each other.
3.3.2 IDI and the Concept of Capital

The new theory of post-war IDI was developed through a distinctive notion of capital. In pre-war international investment theory, capital was understood in terms of a financial flow between nations. This was a notion of international capital as a loan or portfolio investment flowing from nations relatively well endowed with capital to those nations with a relative scarcity. In the post-war period, IDI grew much more quickly than portfolio investment, and one of the most distinctive features of IDI growth was its association with the institutional (corporate) form of IDI, the transnational corporation (TNC). With the growth of post-war direct investment, the TNC became an important form in which resources were being mobilised internationally, and this underscored the need to develop theoretically the differences between direct and portfolio investment so as to explain the emerging pre-eminence of IDI. The realisation of the incompatibility of this stylised fact of post-war IDI with the paradigm of portfolio investment theory, as much as any other, initiated the perception that a new theory of IDI was needed.

In developing an alternative concept of capital, the metaphor for international capital flows was transformed from the rentier (or money capitalist) allocating portfolio investment across the globe in search of the highest dividends or interest-rates, to the industrial firm (or industrial capitalist) seeking to utilise skills and abilities in international markets and to thereby maximise profits and the growth of the firm. Theories of IDI thus became associated with the study of the international industrial firm (for more discussion of industrial organisation markets of IDI see Appendix 3.3). In so doing, models of IDI were able to explain one of the important changes in the structure of international capital flows, the development (and growth) of investment transactions between countries with similar economic characteristics. In the early post-war period, the growth of US was characterised as the flow of IDI to developed countries, it was also characterised as a cross-flow of investment. A problem had been that these ‘cross-flows’ were also predominantly between nations with similar relative capital endowment.

The association of the concept of capital in IDI theory with the institution of the TNC is now such a commonplace identity that it hardly seems controversial. At the time, however, this concept flew in the face of much orthodox international economic theory. The development of this concept of capital was therefore an important analytical breakthrough and represented perhaps the critical rupture with portfolio capital theory. The new concept of capital also helped to establish a framework for the development of alternative concepts of internationalisation and competition of the new theory.

---

2 As will be shown below, the metaphor is sometimes more appropriately one of commercial than industrial capital, because many of the explanations focused on the role of firms in the sphere of circulation (exchange and distribution). Indeed, an ongoing problem for theories of IDI has been its conceptualisation of the way firms integrate the spheres of circulation and production (Jenkins 1975).

3 Post-war international capital flows were occurring between countries where there was not enough difference in interest rates prevailing in the two countries to account for the growth of international investment in arbitrage terms, IDI and portfolio investment were occurring as a cross-flow between countries.

4 There was an obvious reluctance to concede the need for a new concept of capital and early post-war explanations of IDI within portfolio and trade theory. Instead, these theories mostly responded to IDI through a relaxation in the concept of (perfect) competition.
In trade and portfolio capital theory, the explanation of international investment had been understood largely in derivative terms (and as an arbitrage or stock adjustment process). The incorporation of a concept of capital that focused analytical attention on the long-term international activities of individual corporations therefore required the relaxation of some key assumptions of those models. The new distinction between IDI and portfolio investment was based on a model of portfolio investment as a short-term capital flow involving either loans or the purchase of equity on the host country stockmarket. Portfolio investment was thus a model of lending from one country to governments or firms in another country; or individual investors from one nation adjusting their international portfolio to changes in international interest rates. IDI, on the other hand, was defined as a long-term movement of capital, involved in the establishment or expansion of a wholly-owned subsidiary, with the funds supplied by the head office. This definition established a distinction between IDI and portfolio investment. The divergent pattern of IDI and portfolio investment in the post-war period led researchers to suggest that IDI and portfolio investment may be ‘two different things’ (Hymer 1961). Unlike portfolio investment, IDI therefore came to be associated with the internationalisation of control and production by TNCs.

Whereas portfolio theory focussed analytical attention on the movement of investment, it was not an explanation of long term capital flows, and nor was it an explanation of the ownership and control over production abroad. A related issue was that the stylised facts of post-war IDI challenged the whole paradigm of IDI as a capital flow. The TNC was not necessarily associated with the process of capital flow at all. A growing proportion of the funding of the subsidiaries of TNCs was being derived within the host country itself, from retained earnings and from local capital markets. The international development of the operations of companies as significant features of the world economy in the 1950’s and 1960’s led to a growing support for the contention that explaining the stylised facts of post-war IDI required not just a sharper distinction between direct and portfolio investment, it required different explanatory concepts. It will be shown below in consideration of post-war models of IDI, such as Aliber’s Currency Area model (in Appendix 3.1) and later with Product Cycle model (in Chapter 4), that while some models continued to explain IDI through existing concepts of capital derived from trade and portfolio theory\(^5\), there was a growing consensus that a different concept of capital was required to explain postwar IDI.

The new focus on the firm as the critical unit of IDI helped to give rise to a strong institutional tradition in IDI research, and this established a space for both orthodox industrial organisation models of IDI as well as for radical monopoly models within IDI theory. At the time, orthodox (neoclassical) economics provided little or no analytical attention to firms as the institutional form of capital. The representative firm was assumed to be a small and relatively insignificant, so that the internal operations of firms could be treated as a ‘black box’. This was a concept of capital that was in part derived by the assumption of perfect competition. The assumption of perfect competition helped to both provide neoclassical economics with one of its core principles and to give internal consistency to the structure of the theory (Baumol

\(^5\) Referring to the case of post-war IDI flows into Australia for instance, Arndt (1957), called this development a ‘new form of overseas borrowing’.
1968; Barreto 1989). The beneficial aspects of this theoretical construction came at a price, one of which was the theory’s increasing inability to explain the paradoxical growth of large oligopolistic firms, except as an indicator of increasing market failure. In the post-war period, the TNC posed special difficulties for such an assumption, since TNCs were such a conspicuous part of the process of IDI.

Kindleberger captured the terms of the transformation in the concept of capital that began to occur in post-war IDI research when he said that “Direct investment belongs more to the theory of industrial organisation than to that of international capital movements” (quoted in Aliber 1972, p19). TNCs were still conceived of as creatures of national units, (so that IDI was associated with firms ‘spilling over’ from their nation of origin), but direct investment came increasingly to be defined within the new theory as a long-term capital flow associated with the international operations of firms (Hymer 1961, p 31).  

One of the most important insights that this conceptual re-evaluation offered, derived from industrial and institutional economics, was the explicit recognition that it was corporations not nations *per se* that invest. That is, IDI was an institutional expression of relations between and within firms rather than relations between nations. The beginning of the recognition of this point can be traced to the work of Stephen Hymer in the early 1960’s. Hymer concluded that whatever the motivation for IDI, it could not be explained through cross-national interest rate differentials. He suggested that the issue of control was critical to the IDI process (Hymer 1961, 23, 26).

Explanatory focus for IDI was thus shifted away from issues of cross national interest-rate arbitrage of portfolio theory toward issues of explaining the individual investment and production decisions of firms in a way that established systematic patterns. This was achieved by introducing concepts that permitted discussion of activities occurring *within* and *between* firms. IDI theory shifted analytical focus from capital market theory (where interest-rate differentials are crucial) to industrial organisation theory (where profits and the behaviour of individual firms is crucial). In this way, the explanation of the institutional form of capital became a critical and distinctive feature of IDI theory. In the 1950’s and 1960’s, when the TNC appeared to be a relatively rare occurrence linked to the particular attributes of the firm or market structure, orthodox industrial organisation models of IDI focussed on TNCs in terms of their monopoly position, or in terms of the particular ownership advantages that permitted monopoly rents to be earned by TNCs.

There was a similar institutional development in the concept of capital within radical monopoly models of IDI which were developing in the late 1950’s and particularly

---

6 Hymer also proposed that “The theory of international operations is part of the theory of the firm. It is concerned with the various relationships between enterprises in one country and enterprises in another” (1971, p 28).
7 Hymer’s 1960 PhD thesis was not published until the mid 1970’s, but was popularised in the 1960’s by Charles Kindleberger and others.
8 The introduction of a different concept of the firm into international investment theory was paralleled in several other branches of economics, apart from industrial economics. By the 1960’s, the development of the large-scale firm had become a problem not just for theories of IDI. The Marshallian concept of the firm of early twentieth century had become increasingly inadequate as a description of economic processes. See for instance Baumol (1961); and Barreto (1984).
in the 1960’s (discussed in more detail in Appendix 3.3.3). The analytical role of the TNC within monopoly capital models (as advanced by Baran and Sweezy for example) of IDI was critically important for at least two reasons. Firstly, for monopoly capital models the TNC was seen as the distinctive feature of capital in the post-war international era, and the growth of TNCs was understood in a way that gave the era its major motive force. In contrast to the laissez-faire period of capitalism in the nineteenth (and early twentieth) century, characterised by perfect competition among many relatively small firms, the post-war period was understood as the entrenchment of the period of international ‘monopoly’ capitalism. In the era of monopoly capitalism, a relatively few large oligopolistic firms (rather than many small firms) dictate the nature of competition and market structure. The international extension of this form of market structure through the TNC thus gave the post-war economy its unique character.

Secondly, the TNC, when combined with the new role for the US as the leading industrial, political and financial nation, also structured the whole post-war international order. Initially, monopoly capital-type models gave rise to the contention that through the entry and expansion of US-based TNCs, host nations were being incorporated into a new political and economic order of US ‘corporate’ imperialism. Later changes in the institutional structure of TNCs along with the growth of TNCs from other nations in the 1970’s forced some modification in the conclusions of monopoly capital models. It was increasingly concluded on the basis of monopoly capital models that TNCs themselves rather than just US TNCs were a challenge to the independence of nation-states. Both the imperialist edge of the monopoly capital analysis, and its institutional notion of capital were blunted by these developments.

In a similar way, changes in the 1970’s and 1980’s forced orthodox industrial organisation models of IDI to modify its concept of capital. The notion of IDI as limited to the wholly-owned subsidiary of a TNC became seen as too prescriptive. It was increasingly recognised that this corporate form and ownership structure was not the critical elements of the IDI process, and many forms of cross-border control were possible and practiced.

What is critical from the perspective of the development of IDI theory, however, is that the theory emerged from the 1950’s and 1960’s with a new and distinct concept of capital, and the incorporation of the TNC within that concept of capital appeared to be one of its major advances over earlier portfolio and trade theories.

3.3.3 IDI and the ‘New’ Form of Internationalisation

The new concept of internationalisation that developed within IDI theory was similarly binding. Pre-war international investment theory was premised on the nation-state as the basic unit of the world economy. Conditioned by the structuring of the international political/economic order by colonialism, international investment theory was based on a logic of investment flowing from a surplus to deficit countries. In the post-war period by contrast, IDI as the ‘new’ form of international investment

---

9 In fact, these firms are understood in monopoly capital models to operate in a way that negates competition.
was associated with the emergence of the US as the major industrial nation in a period characterised by a process of de-colonisation. This produced a pattern of IDI quite different to the 'trickle down' flow predicted by portfolio theory.

Unlike the predictions of portfolio theory, post-war IDI from the world's major creditor nation, the US, was increasingly directed to other advanced industrial countries (Cantwell 1991).

The US started the post-war period with technological and financial advantages over other industrial nations. The emergence of US hegemony in the post-war period was in part a natural historical consequence of the technological advances that were developed in the US prior to, and especially during the war, and the fact that the US emerged least affected by the depredations of war. The US also emerged from the war as the world's largest creditor nation and with the international monetary regime based around the US dollar. The MNE, were then regarded as virtually synonymous with 'American' IDI and 'American' MNEs (Jones and Schroter 1993; Vernon 1994). IDI was believed to be a distinctly 'American' form of investment, associated with the international relocation of mass production by firms (Harman 1991).

Post-war US hegemony was established in a period also characterised by decolonisation, and with a change in the dominant form of international capital. On its own, the dominance of US as the major source of early post-war IDI was a development that could be explained within the prevailing international trade and portfolio investment models on the basis that the US had become the world's major creditor country. Outward IDI from the US could therefore be explained as simply a shift in the principal capital surplus country, without undermining the metaphor of a hierarchical flow from capital surplus to capital deficit countries. Of course, the characteristics of the new (US) form of international capital created greater difficulties.  

Explaining internationalisation by reference to the investment characteristics of US IDI was a central element of almost all post-war models of IDI. The economic historian, D K Fieldhouse, observed that the original developments in IDI theory,

"related very specifically to the characteristic US corporation of the later 1950's: that is, its overseas activities were an extension of its domestic functions and its decision-making centre remained at home. It was not therefore conceived as firm whose home base was merely the source of financial investment in one or more overseas

---

10 The empirical fact which was much more difficult to explain within the existing concept of internationalisation of portfolio theory, however, was not so much the concentration of IDI growth from the US, but rather the nature of that growth. More problematic for portfolio theory were the facts that: IDI was occurring as part of a process of cross flows of investment between the US and other countries, that IDI from the US was being directed increasingly to other developed countries; that IDI was sometimes related to the takeover of existing activities rather than simply the establishment of new activities; and that IDI was often funded by capital raising in local markets and out of retained earnings of the subsidiaries rather than by an actual cross border transfer of capital."
enterprises, still less as one engaged in portfolio investment...”\textsuperscript{11} (Fieldhouse 1984).

Taken together with the development of a new concept of capital, the explanation of these features of post-war international investment was inconsistent with the pre-war concept of internationalisation. Although it did not occur spontaneously, a gradual change occurred in the concept of ‘internationalisation’ in IDI theory.

The characteristics of IDI growth were therefore quite different to those of portfolio investment, and the national characteristics leading to IDI seemed to be different to those of portfolio capital. This difference was underscored by the fact that IDI and international portfolio investment were occurring as a cross-flow of investment between countries, so that in the case of the US, for instance, it was still ‘importing’ portfolio investment while at the same time becoming the major source of IDI\textsuperscript{12}.

Nevertheless, the requirements of explaining the pattern of post-war IDI broke with the centrality of the nation per se as the unit of investment. IDI was increasingly understood not as a capital flow between nations, but in terms of the activities of corporations. Although corporations were thought of in national terms with national characteristics, the important point is that it was the activities and attributes of corporations, not nations per se which required explanation. Within IDI theory, internationalisation could not therefore be (only) about nations and the national characteristics of IDI\textsuperscript{13}.

Both orthodox and radical models of IDI developed a concept of internationalisation that helped to explain the stylised facts of US dominance of IDI. For orthodox models of IDI, the new concept of internationalisation changed the way international processes were understood. The concept of internationalisation incorporated into IDI theory was premised on two assumptions. The first, an extension of the earlier portfolio theory, was that investment (and invest by firms) was inherently national in character. IDI therefore required some special ‘advantage’ to make this form of international activity profitable. In a parallel way to radical models, the new form of international capital also helped to shift analytical emphasis from IDI as a capital flow toward IDI a measure of foreign ownership and control. This reinforced the changing notion of ‘internationalisation’ and was associated with institutional ‘foreignness’ of the TNC. For many orthodox IDI researchers, IDI also then became a question of national sovereignty, where ‘foreign’ institutions were making important decisions that affected host countries (Vernon 1969). The second assumption that was incorporated into the new concept of internationalisation was that the advantages leading to IDI were likely to be structured along national lines.

\textsuperscript{11} Fieldhouse went on to note that in order to respond to changing patterns of IDI the concept was changed and “the later extension of the concept to include virtually any form of overseas investment still under home control involved serious dilution” (Fieldhouse 1984).\textsuperscript{9}

\textsuperscript{12} These cross-flows of investment were also occurring mostly between the advanced capitalist countries, that is, countries with similar ‘relative factor endowments’. Stephen Hymer had also concluded in his seminal 1960 PhD thesis that “The existence of cross-movements may indicate that the interest-rate theory cannot itself explain the movements of direct investment” (1976, p 16).

\textsuperscript{13} The problem was that a large proportion of IDI, like international trade, was occurring between countries with similar national factor endowments. National versus ‘macroeconomic’ theories found it difficult to account for the existence of IDI among developed economies simply in national terms. IDI therefore appeared to respond to factors additional to the nationally-specific determinants of international trade theory (Gray 1982).
The global concentration of outward IDI growth by the US suggested that the advantages allowing some firms to engage in international operations were derived from characteristics of the US itself. The question which divided models of IDI research was over which characteristics. As Hymer noted,

"The problem of advantage [allowing firms to operate internationally] becomes interesting only when the distribution of advantages is systematically unequal between countries. Then we can analyse why some countries have more international operations than others" (1976,p73).

For the radical theorists of IDI, the emergence of US hegemony occurring in the context of a new form of international political order, helped to produce an analysis of post-war (and post-colonial) capital flows that was not based on the old imperial system. Instead, the domination of the US was constructed around a free-market based imperialism, in which the state was critical in opening and sustaining access to other national markets for international investment. This new concept of internationalisation, combined with the new (institutional) concept of capital, helped to make the issue of national sovereignty especially important within radical analysis. National sovereignty became the basis of the radical emphasis on the foreign corporation rather than on IDI as a foreign financial flow per se. And as will be seen in the next section, the reason for the potential loss of sovereignty was said to come from the particular form of competition. Specifically, the erosion of national sovereignty was located in the growing power of foreign monopoly corporations.

This national focus was consistent with the concurrent focus of other branches of economics, notably macroeconomics with its Keynesian concept of the nation-state, and the statistical construction of national accounting as the form of data construction. IDI theory was in fact premised on an acceptance of national accounting data and categories. The development of IDI theory was therefore based on an acceptance of the then generally accepted concepts and categories of the nation-state. Models of IDI were required to conform (to ‘fit in’) with this general concept of post-war economics, and this adds another specifically 1950’s and 1960’s dimension to the development of IDI theory.

---

14 The requirement that this new concept of internationalisation fit in with the then prevailing notions of internationalisation was explicitly recognised by the leading IDI theorist Richard Caves (1971). He suggested that there were two alternative approaches to integrating the pattern IDI and the TNC into the new theory: either to jettison the nation’s boundaries as the (outer) geographic limits of a market and recognise the potential for economic processes to (potentially) span the globe, or to continue to accept the national market as the basic unit of analysis and modify the standard concepts to allow for the fact that some market players (actually or potentially) are multinational. In the former approach the MNE and trade would be understood in global terms, whereas in the latter approach the nation is retained as the unit of analysis, and IDI and the MNE are understood as ‘leakages’. Caves, writing in the era of Keynesian national policy, suggested that while the latter approach lacked generality it was at least operationally efficient, and was consistent with prevailing economic theory. The decision to retain the national market as the (‘approximate’) unit of analysis, albeit one with leakages, served to enforce the analytical integrity of the nation. It was an analytical starting point that would become increasingly difficult to sustain in the face of the growing scale of those ‘leakages’ in the 1970’s and 1980’s. It bears noting that the erosion in this concept of internationalisation of IDI theory occurred concurrently with the decline of Keynesian Macroeconomics.
As explained in Chapter 6, by the mid-to-late 1980’s and early 1990’s, quite different concepts of internationalisation were being proposed to explain prevailing international patterns of IDI. In a similar way to the concept of capital, the critical point here is that the new theory of IDI emerged from the 1950’s and 1960’s with a distinct concept of internationalisation, and that concept derived much of its inspiration from the explanatory capacity it offered for early post-war IDI.

3.3.4 IDI and the Concept of Competition

The concept of competition in IDI theory acquired a new meaning in the context of changes in both the institutional form of capital and the nature of internationalisation. The focus on the (large) corporation as the institutional form of international capital and on the changed national patterns of international capital both helped to give rise to new insights into the competitive processes, which, gave rise to IDI. The concept of competition implicit in the model of pre-war international portfolio investment was one of perfect markets, with imperfection understood as an aberration and an exception. Pre-war international capital markets were conceptualised as a fluid price-equilibrating mechanisms within the sphere of international circulation and exchange. The modern theory of IDI was forged through a twin institutional focus on firms and nations - in an attempt to explain the involvement of national firms in international production, and one which required those firms to have particular ‘advantages’ over other firms.

The concepts of internationalisation and of capital that became incorporated into IDI theory this created a logical problem for the analysis of post-war IDI. A key assumption of portfolio theory was that a firm operating across national borders incurs additional costs of operating compared to host-country firms\(^\text{15}\). International firms could not, it had been presumed, exist in a world of perfectly competitive markets. In such a world all firms would be homogenous and no firms would be able to incur the additional costs associated with IDI. Large firms operating across national borders and engaging in IDI therefore violated the assumption of perfect competition inherent in portfolio capital theory. It was in this context that the multinational enterprise (and therefore IDI) came to be increasingly understood as a “creature of market imperfections” (Dunning and Rugman 1985, p 229). The concept of competition in IDI theory was at least in part therefore derivative of the development of new concepts of capital and internationalisation\(^\text{16}\).

The stylised facts of post-war IDI (particularly its concentration from the US, the evidence that the IDI was associated with large oligopolistic firms\(^\text{17}\) and that some IDI was even occurring through cross-border takeover activity) seemed to confirm

\(^{15}\) The extra costs were understood to include: acquiring market information; operating from a distance; discrimination from governments, consumers and suppliers in those markets; and exchange-rate risk.

\(^{16}\) The concept of competition in IDI theory was also itself (at least in part) ‘institutionalised’ in the sense that competition came to be defined in terms of market structures that seemed to give rise to IDI.

\(^{17}\) Hymer suggested that the relationship between IDI and oligopoly had at least two implications. The relationship introduced a degree of indeterminacy to the extent of international operations; and also suggested that international firms were earning monopoly rents that might be subject to national taxation.
that IDI violated the requirements of perfect competition. The new concept of internationalisation made it necessary to explain why it was that US firms operating abroad were able to compete with (and out-compete) firms in host countries, despite the (assumed) inherent competitive disadvantages of operating abroad.

A range of possible competitive ‘advantages’ or market failures/imperfections were proposed to explain how those inherent disadvantages were overcome. Models of IDI can be differentiated on the basis of the particular form of competitive advantage or market failure used to explain IDI. Some early models of IDI (such as the oligopolistic and the radical monopoly capital models) incorporated a concept of imperfect competition based on the evidence that IDI was linked to firms in industries with oligopolistic market structures. Other models (such as the product cycle model) became established on the basis of an assumed need for firms to possess certain advantages, such as new technology or unique and differentiated products. Later models, such as internalisation models, were developed through less binding notions of market imperfection. Much of the history of IDI research has therefore involved the search for, and debate over, the critical competitive advantage/s possessed, or market circumstances faced by firms engaging in IDI.

Post-war IDI theory incorporated a concept of imperfect competition/monopoly, both because of the evidence that IDI was associated with industries that were not structured by perfect market competition, and because of the emphasis of pre-war international portfolio capital theory on perfectly competitive markets. Reed (1983, p 234), for instance, suggested that in the context of these formative factors “it is not surprising that the principal reason for foreign direct investment [initially identified by IDI theory] was monopoly power”. Despite many changes in the pattern and structure of IDI that occurred after the 1950’s and 1960’s, the explanation of IDI through the concept of imperfect competition and monopoly has remained a central feature of IDI research.

For orthodox international economists, TNCs were initially understood as an institutional response to imperfections in market structures or as a consequence of the unequal distribution of advantages between firms (known as ownership advantages such as technology, management and marketing). The market imperfections that generated IDI-type advantages were understood as arising through competitive processes which were initially thought to be quite rare. In later formulations, orthodox models of IDI introduced the distinction between structural

---

18 Hymer stated the logical case quite clearly, when he concluded that “None of the reasons explained above [for IDI growth] would exist were the markets perfect” (1990, p 229).
19 The inherent disadvantages of organising international activities included those of administration, communication and transport.
20 Hymer suggested that “There is also a presumption that the kinds of abilities which lead to international operations will most often be possessed by only a few firms” (Hymer 1976, p 87). He also felt that IDI was a phenomenon likely to occur only under special conditions linked to particular qualities of firms or markets (1976, p 91).
21 As Thomas Parry observed in the late-1970’s, IDI and the MNE were by then treated within the framework or concept of imperfect competition. “Indeed, it is possible to explain the major groups of international investment theories in terms of various market imperfections and restrictions, both national and international” (1977).
22 The calculations of the costs and benefits of IDI occurred in terms of their effects on the investing or recipient country’s balance of payments.
23 Where the particular advantages of US firms arose was another matter.
and endemic market failure to identify that IDI was not necessarily produced only by structural failure (ie market closing). Rather, the market imperfections leading to IDI (such as reducing transaction costs for exchanging intermediate products) allowed potentially any firm to engage in IDI, and thus helped to provide a framework for explaining the growing number of firms that were engaging in IDI.

For radical theorists, on the other hand, the critical competitive factor generating early post-war IDI was monopoly power, particularly of US firms. These US firms were backed by the power of the US state, which protected access to markets abroad for those firms through control of international financial and military institutions. That view was predicated on a particular concept of competition, combined with a particular concept of internationalisation. The new notion of competition therefore generated a strong critique of IDI from radical theorists in terms of both the national effects of these transnational monopoly firms and the politicised role of the US state. For many radicals, the joining of monopoly capital and state power amounted to a new ‘US-style’ of imperialism.

What both the radical and the orthodox theories of IDI shared was the common focus on monopoly/imperfect competition as an explanatory category\(^\text{24}\), and this shared conceptual approach to competition has had some important consequences for IDI theory\(^\text{25}\). For instance, one of the keys to understanding the limitations of both orthodox and radical theories of IDI to explaining IDI in the 1980’s and 1990’s lies in problems associated with the concept of competition, because the 1950’s and 1960’s concept of competition created IDI as an exceptional form of corporate and market organisation\(^\text{26}\). Yet in the 1980’s, as IDI outflow from most countries and most industries became commonplace, models of IDI predicated of the competitive exceptionalism of IDI were forced to interpret a process which is now generally understood in terms of the growth of international competition as its opposite - as a growth of market failure and monopoly power. Paul Krugman, a leading international economist, could still confidently assert in the 1980’s that IDI and the MNE, “must be a response to market failure” (Krugman 1983).

3.3.5 Summary

In the current section it has been contended that the stylised facts of IDI in the early post-war period were critical in the formation of the new conceptual ensemble of the IDI theory. The formation of the new IDI theory emerged on the basis of the explanation of the stylised facts of 1950’s and 1960’s IDI. The ability of the new theory to provide insights into these facts appeared to be a major advance over the offered by explanation earlier portfolio theory. The development of IDI theory has been pursued here through three concepts which have been critical to the structuring

\(^\text{24}\) It is this common approach that made it possible for the leading IDI theorist, Mark Casson, to suggest a link existed between the radical and orthodox theories of IDI. He noted in relation to one of Stephen Hymer’s rediscovered works, that “despite his radical emphasis on market structure and distribution of income, Hymer’s analytical [ie conceptual:MR] approach is distinctly neoclassical”(1990, p 5).

\(^\text{25}\) The identification is not new (Blake 1939; Clifton 1977; Semmier 1982; Wheelock 1982; Bryan 1986).

\(^\text{26}\) The shared (neoclassical) concept of competition is also one of the important clues to the capacity of orthodox IDI theory to effect a ‘reabsorption’ of many of the insights of radical models of IDI and perhaps also to the latent conservatism of many radical theories of IDI.
of IDI theory; those of capital, internationalisation and competition. These concepts provide a framework for both understanding the development of IDI theory out of trade and portfolio theory, and for the later evolution of IDI theory itself.

It is also a proposition of the thesis that these 1950’s and 1960’s derived concepts were always going to be vulnerable to subsequent change. In retrospect it is now clear that the ‘new’ theory of IDI became locked into a conceptual agenda based on the stylised facts of IDI of a particular period as if this were applicable to IDI for all times. It will be shown in subsequent chapters how the changing stylised facts of IDI required modifications in these concepts. But what was critical from the perspective of the new theory was that it emerged from the 1950’s and 1960’s as a new and distinct theory of international capital, which could provide powerful insights into post-war IDI. The capacity for the new theory to explain IDI in the 1950’s and 1960’s encouraged IDI theorists to believe that the new theory would be powerful enough to explain all future IDI as well.

The shared theoretical discourse of IDI theory did not prevent considerable debate about the nature and welfare effects, of IDI. A range of models of IDI were developed under the general rubric of the new theory, and it is through these models that the evolution of IDI theory can be explored in more detail.

### 3.4 Conclusion and Summary

The chapter has shown that the 1950’s and 1960’s were the formative period of modern IDI theory, and the explanation of the stylised facts of 1950’s and 1960’s IDI were critical in establishing the conceptual agenda of IDI theory. The explanation of post-war IDI produced a range of models of IDI, but all shared some general characteristics, which have been developed in terms of the concepts of competition, capital and internationalisation. The theory of IDI emerged from the 1960’s as a general theory, which practitioners at the time thought was going to be applicable to the explanation of all future IDI. The evolution of IDI theory was not completed in the 1960’s, but its conceptual framework was established in terms of the explanation of IDI in that period.

In the next chapter, the changing stylised facts of 1970’s IDI are explored. The 1970’s was marked by continued growth in IDI, along with several important transformations in the pattern and structure of that growth. These features consolidated the importance of IDI theory and provided both a stimulus and challenge to IDI existing research. The chapter also discusses important developments in IDI theory and research, especially the product cycle model, the popularisation of transaction cost/internalisation models into industrial organisation models of IDI, as well as the development of an explicitly eclectic model of IDI.

At the close of the 1960’s then, IDI theory had become established as a distinct field of international economics, and the study of all subsequent IDI has been based largely on the conceptual agenda established in the 1950’s and 1960’s. The various models of IDI were formed in terms of explaining the generally recognised stylised facts of post-war IDI, and this gave to IDI theory both coherence and empirical
support. The chapter has shown how the categories of capital, competition and internationalisation, helped to illuminate that shared coherence. The next chapter also shows how the 1970’s both reinforced aspects of that agenda, but also began to erode the overall coherence of many of those apparently universal categories.
APPENDIX 3.1 PORTFOLIO INVESTMENT AND EXCHANGE-RATE MODELS OF IDI - THE CURRENCY AREA MODEL

Although the traditional portfolio theory of international investment pre-dated the 1950’s, it was the initial basis upon which post-war explanations of IDI were based. The early post-war growth of IDI from the US in the 1950’s was therefore understood as a new form of international ‘lending’ (Arndt 1957) 1. It has already been shown that post-war IDI theory moved towards a new theory of international investment, associated with different concepts of competition, capital and internationalisation. One way that the old pre-war portfolio theory was able to live on as an explanation of post-war IDI was through the Currency-Area (CA) model, associated particularly with Robert Aliber (1969).

The C-A model was not the first post-war model of IDI, nor indeed was it the most significant model of IDI. Nevertheless, the C-A model is significant here for at least two reasons. Firstly, because the CA model attempted to explain IDI within the orthodox (portfolio) theory of international investment, it provided continuity with pre-war approaches. This was achieved by introducing a concept of imperfect competition into the earlier theory, without conceding the necessity of introducing a concept to explain the new institutional (corporate) form of transmitting that investment, or of the new concept of internationalisation. The C-A model is also important because in the 1980’s and early-1990’s, with the breakdown of many mainstream models of IDI, some researchers returned to portfolio capital theory in an attempt to explain the more diverse and fluid nature of IDI in that period.

The C-A model is a modified interest-rate arbitrage model of IDI, based on the international movement of capital as a mechanism for equalising cross-national interest rates. The C-A model began with an assumption common to other post-war models of IDI, that the growth in IDI from the US required that firms from the US possess some ‘compensating advantage’ over firms in the host market 2. The C-A model rejected the contention of other models of IDI that employed the institutional concept of capital, focussing on the advantages of the investing firms themselves, or the market structure of the investing firm. The pattern of early post-war IDI was overwhelmingly dominated by firms from the US and the C-A model was based on the presumption that the advantages of US firms therefore had to have a largely national dimension (Aliber 1969). The C-A model concentrated its explanatory focus on imperfections in international capital markets associated with national currency differentials as the source of post-war IDI growth from the US 3.

---

1 The early commentators on post war IDI had attempted to understand it through existing concepts. Arndt (1957), for instance referred to the growth of post-war IDI as a “new form of overseas borrowing”. This description was overtaken with the beginning of industrial organisation models of IDI.

2 The idea of a compensating advantage related to the assumption that firms were inherently national in character, and IDI involved additional costs of transacting business across national borders. Firms were therefore required to possess some compensating advantage to overcome these extra costs.

3 The C-A model developed a suggestion of Kindleberger (1969) that one of the possible advantages that could compensate for the additional costs of operating abroad was differential access to capital markets.
In the C-A model, IDI was defined as the acquisition of plant and equipment in a currency or custom area (normally a nation-state) other than that in which the firm was domiciled (Aliber 1970). The existence of separate currency areas meant that interest-rates on similar assets denominated in different currencies would differ because of market assessment about the exchange-rate risk of the borrower's currency. The existence of such areas and differentials arising from them, opened the possibility that there may be a systematic bias in market assessment of currency exchange-rate risk, favouring firms from strong currency areas against those from weak currency areas. Capital market assessment was imperfect and that imperfection existed largely along national lines. The relative strength of a currency was said to therefore explain much about whether a country is a source country or host country for IDI. In a multiple currency world, firms with equities denominated in hard currencies (such as the US$), possessed an advantage in capital markets over those denominated in soft currencies, because lower risk premiums were applied by lenders. This advantage was sufficient to give firms from hard-currency countries a competitive advantage over those in soft-currency countries in the soft-currency market (Aliber 1972).

The C-A model explained IDI in terms of capital flows associated with imperfections in international capital markets (and in particular through the existence of systematic differences in currency exchange-rate risk). Currency risk imperfections created differential access to investment funds (the 'compensating advantage') for firms of different nationalities (or 'currency areas'). Capital markets were said to consider that lending to US firms entailed a lower currency risk than lending to firms of other nationalities. Accordingly, Aliber hypothesised that the post-war strength of the US-dollar (and the related characteristic of its low exchange-rate risk) meant that firms from the US had access to capital at lower rates of interest than firms from other currency areas. The currency-area phenomenon was therefore said to explain the advantages of US firms in foreign markets that made IDI profitable.

According to the C-A model, the post-war domination of IDI by firms from the US was related to the fact that US-based firms were identified with US dollar equities, and this gave them an advantage in world capital markets, because investors were willing to pay more for an income stream denominated in US dollar than the same income stream denominated in non-US dollars. As a result, US firms could outbid non-US firms, or launch takeovers of non-US firms and realise an immediate profit. By a roundabout way, the model's predictions were similar to the earlier arbitrage model - IDI would occur from those countries with lower interest-rates and move toward those nations with higher interest-rates (Aliber 1977, p 251).4

An illustration of the currency area model was given by Kindleberger (1972). According to the currency area model, a factory in Belgium owned by a Belgian company is considered by the capital market as a 'Belgian-franc' asset, whereas if the factory is bought by an American company, for the capital market at least, it becomes an 'American-dollar' asset. An American firm acquiring the factory in

---

4 Aliber also suggested that the currency area model was not simply a financial phenomenon. He also attempted to link the model to other factors such as the relative size of host-country markets, the value of patents and the height of tariff barriers, the costs of international operations and the dispersion of capitalisation rates across countries and industries.
Belgium is likely to value the assets higher because that firm can obtain funds to acquire the assets at lower cost (as an 'American' currency area firm). The fact that the post-war world economy was divided into national currency and customs areas was argued to have the greatest explanatory power for understanding post-war international capital flows. The model also predicted that IDI would not be uniform across industries. IDI would be more pronounced in capital-intensive industries than in labour intensive industries, since the disadvantage of host-country firms would more pronounced the larger the concentration of capital required (Aliber 1972).

The attraction of the currency area model was that it offered a ready integration of IDI back into portfolio international capital theory. That is, it was a theory of international interest-rate equalisation, via exchange-rate arbitrage. The model was, however, faced with several important problems. One of the most important problems of the portfolio model was that it was not a model of long-term IDI, but rather more of a model of a short-term stock adjustment process. The C-A model predicted that IDI flows would gradually eliminate the effects of the currency area over time, making capital markets less segmented. This was not therefore a long-term theory of IDI growth. The model was also based on the assumption not just that capital markets were segmented, but that types of capital markets were segmented. It assumed for instance, that portfolio investors were myopic to the effects of IDI.

Nor could the C-A model account for the fact that IDI was not flowing from the US to the developing world, but from the US to other industrial economies. Portfolio theory had predicted that most investment would flow largely in one direction from capital-rich to capital poor countries, yet almost three-quarters of post-war IDI was directed to other industrial (capital rich) countries. As Hufbauer noted, "This idea paralleled the Heckscher-Ohlin notion that capital rich countries should export capital-intensive goods" (1975, p2 59). Not surprisingly, therefore, the currency-area model confronted similar problems as the earlier interest-rate arbitrage theory of international investment in explaining post-war IDI. It could not explain either the fact that IDI flows were moving mainly from the US to other industrial countries, nor the cross-hauling of investment between developed countries. Aliber (1971) suggested that cross-hauling had not become a pervasive phenomenon until the late-1960's, and in any case most of it was accounted for by only a few firms. Furthermore, some cross-hauling could be explained as products of different historical periods of currency development. The US had been the strongest currency area in the 1950's and the first half of the 1960's, but in the second half of the 1960's the UK and West Germany had become strong currency areas. Aliber also suggested that cross-hauling might be more akin to a form of portfolio diversification (risk spreading) by firms.

Another significant problem for the currency-area model (of cheap capital in the home country) was that it rested on a dubious starting point.

---

5 This currency-area model operated in terms of the capitalisation rate applied to equity in different countries, so that source-country firms could raise capital at lower cost than host country firms or have their shares valued more highly for possession of the same assets (Aliber 1971). IDI can thus be seen as reflecting investor pricing of exchange-rate risk.
"The difficulties with the cheap capital thesis goes beyond issues of measurement. The multinational corporation phenomenon is probably not an outgrowth of capital abundance. Multinational corporations do not necessarily specialise in capital intensive sectors, just as British and United States exports are not particularly concentrated in capital intensive goods. Nor is there an observable connection between multinational corporation expansion, cost of capital, and average earnings on investment abroad" (Hufbauer 1975).

The explanation of IDI as portfolio diversification could not account for why IDI, which involves international control as well as ownership, would be preferred over portfolio investment. Nor could it be explained why IDI was associated with industrial corporations, while portfolio investment was associated with individuals and financial institutions. Finally, the existing theory could not account for the fact that firms engaging in IDI were not diversifying across industries as well as across countries. It was increasingly accepted that whatever the formal differences between IDI and portfolio capital they were, to paraphrase Stephen Hymcr, two different things.

Even more challenging to portfolio theory was the evidence that IDI did not necessarily involve capital flows at all. The importance of retained earnings of the subsidiary and host country capital raising in the funding of post-war IDI had been recognised quite early in the study of post-war IDI. Arndt (1957), for instance noted that some early post-war IDI in Australia by US firms was being funded from local capital raising and retained earnings. Hennart (1982) cited the results several researchers that had found that during the 1950’s and 1960’s only a small proportion (between 13 and 20 percent) of outward IDI from the US constituted an actual cross-border capital flow from the US firm to its subsidiary. This was a feature of IDI that prompted Kindleberger to conclude that whatever we know about IDI, it was not simply a capital flow.
APPENDIX 3.2 TRADE MODELS OF IDI

While portfolio capital theory was a theory of limited international capital flows, as an arbitrage process, it was international trade theory that provided the principal theory of pre-war international exchange. Trade theory was a model of limited international capital mobility, reflected in key assumptions of orthodox (Heckscher-Ohlin) trade theory, where 'factors of production' - such as capital and labour - were held to be mobile within nations, but immobile between them. The concept of capital in trade theory was also linked to its concept of internationalisation. For trade theory, national borders constituted a coherent economic space (an 'economy') in terms of factor mobility. Given the assumption of factor immobility, trade theory therefore proposed that the relative endowments of factors between nations constituted the basis of international exchange (trade). International investment was therefore understood in trade theory largely in derivative terms as an adjunct to commodity import and export.

The increased post-war international mobility of capital, and evidence that companies rather than nations were the critical units of that investment, undermined the coherence of trade theory, as a general theory of international resource transfer. There were several notable attempts to integrate capital mobility into international trade theory (such as Ohlin 1939; Mundell 1957). These models were useful in explaining some forms of international capital flow, but tended to treat trade and investment in similar terms (as complementary or alternative forms of international exchange).

These models, in a similar way to the Currency-Area model did for portfolio theory, attempted to explain IDI within existing trade theory. These models also developed by relaxing the assumption of perfect competition of trade theory, but resisted the examination of the institutional form of capital. In trade theory, international investment was understood through the concept of imperfect competition/market failure, that is, as a response to imperfections in trade markets (such as tariff barriers). This was a model of international investment as an aberration to the normal process of international exchange in the form of trade. The 1950's and 1960's reformulation of trade theory therefore, at least until the product-cycle model in the late-1960's, did not constitute IDI as a separate object of analysis6. The question posed by re-formulated trade theory in the face of increased capital mobility tended to be about the trade effects of growing international investment and thus also reflected this derivative conception of international capital.

Orthodox trade theory was based on the assumption that trade was conducted between private citizens of two nations at arm's length. By the early 1970's, intra-firm trade by MNEs already accounted for a large and growing proportion of

---

6 There was of course a growing concern by economists (and government policy makers) about the balance of payments effects of IDI. These investigations also centred mainly on the trade (and employment) effects of IDI. The section is concerned with how IDI was explained theoretically (for the US discussion, see US Dept. Of Commerce 1960, Hufbauer and Adler 1968; for the UK, see Dunning 1968; Reddaway 1971, for Europe see Layton 1967, Servan-Schreiber 1969; for Australia, see Arndt 1966, MacDougall 1968; and for Canada, see Penner 1966, Reuber and Roseman 1969).
international trade (Lall 1973), and thus created additional empirical problems for trade theory as a general theory of international exchange. By the mid-1970's, it had become widely held by trade theorists that the concepts of capital and internationalisation of trade theory could not adequately explain the increasingly explicit role of international firms in both IDI and trade\(^7\).

Research by Helleiner and Lavergne for instance, suggested that international trade was conforming less and less to the orthodox model of trade and was "increasingly managed by multinational corporations as part of their system of international production and distribution" (1979)\(^8\). Instead of trade theory, researchers began to introduce concepts from other theoretical traditions model to provide the basis for analysing the relationship between MNEs and the growth of intra-firm trade. This was the basis upon which in the late-1960's a product-cycle model of IDI and trade was proposed by Vernon. Since the product cycle model reached its most widespread use in the 1970's, it will be discussed in the next chapter.

In a similar way to the exchange-rate models, early post-war trade models relaxed the assumption that international markets could be understood with the assumption that markets were perfectly structured, but they could not introduce a different concept of capital or of internationalisation without undermining the overall viability of trade theory itself. The relaxation of the concept of perfect competition helped to preserve much of the theoretical consistency of trade theory, but at the expense of explanatory power. Trade models still assumed, for instance, that domestic residents exclusively owned all productive activities. Further, the concept of internationalisation in trade theory was still as a cross-border resource (trade) flow.

The problem for trade theory was that IDI was still being conceptualised largely in derivative terms, as a minor alternative to trade, based on particular market imperfections. The evidence that production abroad by 'national' firms was being conducted on a larger scale by firms than cross-border trade between countries (and that the characteristics of post-war IDI were quite different to those of post-war trade) therefore remained outside the explanatory range of trade models\(^9\).

---

\(^7\) Despite pointing to some of the problems with trade theory, Lall concluded that firms may simply be responding to market imperfections (barrier controls on both trade and capital flows), and so did not challenge the trade theory agenda. He thus felt that post-war developments may not necessarily impair either the explanatory capacity of trade models, or of policies based on them.

\(^8\) By the mid-1970's, they estimated that MNEs accounted about one-third of world trade.

\(^9\) It could be argued that, in the face of evidence that international production was much greater than trade, cross-border trade was simply a preliminary to international production. With product-cycle theory, this is in fact what developed.
APPENDIX 3.3 INDUSTRIAL ORGANISATION MODELS OF IDI

3.3.1 Introduction

It was noted above that the critical issue for the development of post-war IDI theory occurred on the basis of an alternative concept of capital (especially concepts derived from institutional and industrial economics). The introduction of an alternative concept of capital, more than any other single conceptual transformation, was critical in separating the modern theory of IDI from international (portfolio) investment theory. This was also the context that prompted Charles Kindleberger, one of the leading figures in post-war IDI theory, to conclude that, “direct investment belongs more to the theory of industrial organisation than to that of international capital movements” (quoted in Aliber 1972, p19). The focus on the institutional form of capital helped to transform the metaphor of international investment from the rentier allocating portfolio investment across the globe in search of higher dividends to the industrial firm expanding production abroad to maximise profits. Stephen Hymer, one of the first to introduce concepts of industrial organisation models of IDI contended that:

“The motivation for the [direct] investment is not the higher interest-rate abroad, but the profits that are derived from controlling the foreign enterprise” (1960, p 26).

The incorporation of concepts from industrial organisation into IDI theory was critical in establishing IDI as a distinct paradigm. Some of the leading figures of IDI theory have suggested that “It was only when the advantages of firms were integrated into the analysis [of IDI] that a distinct theory of international production emerged” (Dunning, Cantwell and Corley 1986). With the incorporation of this new concept of capital into IDI theory, international investment flows became explained through the investment and production activities of the international firm. By shifting the explanatory focus for IDI away from cross-national interest-rate arbitrage, industrial organisation models of IDI came to focus on the capital flows and management activities of firms. In so doing, IDI theory was able to account for one of the major features of post-war IDI, that IDI did not seem to necessarily involve an actual capital flow from the home to host country.

Whereas existing neoclassical economics had treated the firm largely as a ‘black box’, firms were significant in IDI, and the international firm posed special difficulties for IDI research. As Hymer again observed, “The important theoretical shortcoming of the interest-rate theory is that it does not explain control [by firms in one country over firms in another]...If we wish to explain direct investment we must explain control” (1960, p 23). This was the basis of a transformation of the concept of capital (and the corporation) in post-war IDI theory.

---

10 IDI was a capital movement “associated with the international operation of firms” (1971, p 3).
11 It will be recalled that one of the key stylised facts of post-war IDI was that a significant and growing proportion of IDI was being funded in the host country itself, from retained earnings of the subsidiary, the subsidiaries were also borrowing funds in host country capital markets.
Industrial organisation models of IDI transformed the metaphor of IDI, and so analysis of IDI shifted analytic focus from the nation-state as a coherent unit of exchange within international economics, to the activities of firms. Firms (and investment) were still understood to be inherently national in orientation, and so firms engaging in IDI were therefore thought to require some unique ‘advantage’ that could compensate for the additional costs of operating across national borders (or to overcome the inherent benefits of national organisation). IDI was therefore the result of national firms spreading out from their ‘home’, because of some unique advantage/s.

The issue of the internationalisation of investment and production had not been central to industrial economics, since it was implicitly assumed that industries and markets were nationally structured. This was compatible with the concept of internationalisation of trade and portfolio theory, that capital was nationally structured. This had two implications for industrial organisation models of IDI. Firstly, it meant that industrial organisation models were compatible with the requirement of explaining the observed national patterns of IDI, especially the dominance of the US as a source of IDI.

It also meant that firms could still be assumed to be inherently national in character, or at least that the nationality of firms was still critical. Hymer, for instance, stressed that the nationality of firms was of the “utmost importance, for it affects the way they behave and the treatment they receive” (1976, p 28). There were a number of aspects to corporate nationality: legal nationality of the parent company (country of incorporation and taxation); national residence of the major shareholders; and the nationality of the managers of the corporation. Each aspect of nationality was found to be relevant to explain different aspects of the international operation of firms. But as noted above, the overwhelming reason that nationality became significant in post-war IDI theory related to the empirical fact that some nations (the US in particular) were producing more international firms than others.

The emphasis on the nationality of firms was important for another reason, because it allowed researchers to point to the weakness of existing theories of portfolio investment, but at the same time to stay within the general paradigm that had produced it. In other words, early models of IDI retained the nation as a major explanatory category. This is quite evident in the case of the issue of corporate nationality because it was suggested that IDI was a product of advantages of particular national firms. In terms of orthodox international economics, IDI could be explained in terms of a new way that a country’s comparative advantages were being expressed. It is perhaps not surprising then that advantages sufficient to initiate and sustain IDI were even compared to factors of production (Hymer 1976, p 81).

Industrial organisation models also developed an explanation that incorporated the concept of imperfect markets. IDI was incompatible with the assumption of perfect market competition of portfolio and trade theory. Industrial organisation models was based on the explicit proposition that IDI was a response to imperfect

---

12 Hymer concluded that “None of the reasons... [for the growth of IDI] would exist were the markets perfect” (1990, p 229).
competition and market failure. Similarly, the international firm was explained as a “creature of market imperfections”(Dunning and Rugman 1985, p 229).

No single coherent industrial organisation models emerged to explain IDI. Rather a range of such models developed, although early industrial organisation models of IDI can be classified largely under the rubric of advantage-type models. The models were based on the recognition that IDI contravened the perfect market hypothesis of conventional international capital theory. The starting point of these models was that more and more firms were engaging in operations across national borders, and that it was no longer possible to see IDI and the international firms as an exception to trade or portfolio capital. IDI and the TNC had become a structural feature of the world economy. Kindleberger concluded in this regard that just as the large national firm had developed in the nineteenth century, “the twentieth century had given way to the multinational firm” (quoted in Hufbauer 1975).

3.3.2 The Elaboration of Industrial Organisation Models

In order to compensate for the additional costs of organising operations at a distance it was logically recognised that, firms engaging in IDI required some ‘advantage’ over firms in host countries. Firms engaging in IDI became known as multinational (or transnational) firms were defined or described through these models as firms with some advantage/s that permitted it to control operations in more than one country. The shared general paradigm did not preclude intense debate about which advantage or advantages were the most significant for explaining patterns of IDI, and about whether the growth of IDI and international firms were producing gains for nation-states either the host or home country. The early writings of IDI began as a critique of existing investment and trade models on a number of counts. In general, it is possible to see how each industrial organisation model of IDI began as a unitary model focussing on one form or set of ‘advantages’, and then proposed as a general model of IDI. While there were many advantage-type models proposed, the current chapter deals only with the most significant examples.

3.3.3. Monopoly Advantage Models

The industrial composition of post-war IDI was concentrated in industries with oligopolistic market structures in their home countries. This emphasised the limitations of portfolio theory that assumed perfect market competition. Hymer

---

Kendleberger (1969) again bridged both developments. After popularising Hymers’s critique in the late 1960’s, he also suggested that US firms possessed one of at least four advantages or assets over their foreign rivals. Each was characterised by its departure from the assumption of perfect competition. These were: imperfect competition in commodity markets, including product differentiation, marketing skills or administered pricing; imperfections in factor markets, such as patented or proprietary technology, access to capital markets, and labour skills (especially management skills); the third related to the existence of internal and external economies of scale, including economies of vertical integration; and finally, market imperfections arising from government intervention, such as output restrictions or barriers to entry.
suggested that, “monopoly problems pervade any discussion of international operations and direct investment” (1976, p 85). Many models of IDI and the MNC were conceived as an international extension of oligopolistic markets - where firms with concentrated selling or buying power in home markets were replacing cross border transactions between independent firms with transactions between branches of the same firm.

It was suggested that firms engaged in IDI (and replace the market transaction) do so to remove or prevent competition from other firms (or to ‘close’ a market)\textsuperscript{14}. The early evidence indeed suggested that IDI was coming from large firms in industries that were characteristically oligopolistic in structure, with high levels of industry concentration and significant barriers to entry. In the context of the prevailing assumption of perfect competition in existing investment theory, and the characteristics of early post-war IDI, it was perhaps not surprising, as Reed (1983, p 234) noted, “that the principal reason [found] for foreign direct investment was monopoly power”. Much of the research by orthodox economists in this area drew on the insights oligopolistic market structure from industrial economics (Bain 1956,1971), while others drew on strands of radical and Marxist theory.

One of the key determinants of early models of IDI was thought to be firm size. Horst (1972), for instance, found evidence from IDI growth from the US in the 1950’s and 1960’s to suggest that once inter-industry differences were set aside, the only significant factor that had explanatory potential for observed patterns of IDI was the size of the firm. Most advantage model explanations still argued that the key feature of MNEs was the possession of some unique intangible asset, such as the ability to create new knowledge or the ability to close a market (Magee 1977). Finally, research in this model of IDI also suggested that much IDI was proceeding through merger and acquisition in host countries, and much of it was ‘parallel’ in nature (ie the acquisition of similar operations abroad) Adams (1975). The association between IDI and merger and acquisition activity, would become a more critical issue in the 1980’s.

3.3.4 Oligopolistic Behavioural Models

A slightly different, but closely related attempt was made to model IDI in terms of the behaviour of firms in oligopolistic terms. Caves (1971, 1974) stimulated a number of studies that were based on the proposition that many possible advantages that cause IDI, such as superior management and technology, do not explain why international control and production is chosen ahead of either exports or licensing. Instead he suggested that the most convincing explanatory model for the higher rents of IDI was through product differentiation. International production was therefore best explained as a way that firms extend their capacity to differentiate a product. The critical advantage that permitted firms from one national market to produce in another was the possession of a differentiated product. That ability could be exploited either by differentiating the same product across different regions or a wide range of products to the tastes of a region (Buckley and Casson 1976).

\textsuperscript{14} Hymer claimed that “if entry is not difficult, there is not much point in trying to control the market” (1976, p 38).
While the product differentiation model stayed narrowly within the industrial organisation paradigm, it did stimulate a range of other models of oligopolistic behaviour. During the 1960's, there was growing evidence that the industrial distribution of IDI was showing not just concentration in oligoplistic industries, but that firms in those industries tended to begin investing abroad at similar periods. The car industry in the US was a highly concentrated industry, and in the post-war period firms from that industry were investing on a large scale in overseas operations in countries at similar times. Developing the proposition first advanced by Lamfalussy (1961), researchers using new data bases on IDI (such as the Harvard University's MNE Study) found that IDI into markets by firms in particular industries tended to be 'bunched' together. The timing of investment seemed to be determined by follow-the-leader behaviour. Knickerbocker (1973) suggested that there was a close relationship between what was termed 'oligopolistic reaction' and industry structure. It was found that the greater the degree of seller concentration, the more closely related was the timing of IDI entry into one market by the 'leader' matched by rivals. The oligopolistic rivalry (or behaviour) model also added another novel insight. Far from IDI being a largely predatory phenomenon of rent-seeking monopolists, IDI was often motivated by quite 'defensive' reasons.

After the first wave of US-dominated IDI in the 1950's and early 1960's, growth of IDI from other countries, particularly from several European countries, began to become more significant. An important feature of growth of IDI from the 'new wave' of countries was that much of that activity was occurring as IDI into US (cross-investment) in the same or similar industries as outward IDI from the US (intra-industry IDI). The oligopolistic rivalry model to explain the cross-flow of intra-industry IDI between the US and Europe on the basis that IDI into Europe by US MNEs had induced IDI into the US by European firms as a defensive measure (Graham 1978). While it was observed that rivalry on an international scale may actually increase competition in national markets, over time rivalry may give way to international collusion15.

Other researchers suggested that once firms have established international production, a firm may be compelled to maximise sales and profits of the corporate group. Hufbauer (1975) for instance concluded that that "These considerations almost compel the multinational corporation to adopt a global strategy rather than the profit-centre philosophy"(1975, p 28)16. Other researchers (such as Lall 1973), countered that transfer pricing may simply be motivated by the desire to overcome restrictions on capital movements or to conceal profits from the gaze of nationalist governments (with excessive taxation regimes) or from trade unions.

The oligopolistic behavioural model helped to shed the monopoly-advantage models of many of its restrictive assumptions, and introduced a dynamic element. By the late 1960's, the oligopolistic behavioural models had become popular explanatory models, but even here these models began to be challenged in the 1970's by the development of IDI in non-oligopolistic industries, and the insights of the

15 A point made earlier by Hymer and Rowthorn (1970).
16 Leckraw (1985) suggested that intra-firm trade by MNEs had encouraged firms to adopt a global strategy of pricing and tax minimisation. It gave MNEs greater scope to engage in non-market transfer pricing. One consequence of the greater scope was an increased capacity of MNEs to evade national taxation measures.
behavioural models were increasingly incorporated into other models of IDI, particularly internalisation models.

### 3.3.5 Monopoly Capital Models

The concepts of competition, capital and internationalisation used to explain post-war IDI were not limited to developments within orthodox theory. These concepts can also be used to understand the development of models of IDI by many radicals and Marxists. These models incorporated the concepts, along with elements of underconsumption theory, institutional economics and Marxian notions of ‘international’ exploitation to provide a critique of capitalism on an international scale, and of US international hegemony in particular. These were therefore not models only of IDI per se, but, because IDI and the TNC were ubiquitous features of the post-war period all these models offered explanations of IDI as one of their central features.

There were several radical models of the post-war period and they were themselves quite diverse. No attempt is made to represent them all, or to suggest that they were all the same. Inasmuch as they were both more than a model of IDI, but engaged with IDI theory, it is absolutely necessary to discuss a representative of the radical theory of IDI here. The model discussed here is associated with the Monopoly Capital (or Monthly Review\(^{17}\)) School, while dependency models are discussed in the next chapter.

The monopoly capital model attempted to provide an explanation of the main features of the post-war phase of international capitalism. It did so by extending the work of pre-war theorists such as Hilferding, Lenin, Kalecki, Hobson and others. The monopoly capital model therefore attempted to account for international relations between the advanced and underdeveloped countries as well as relations between the advanced nations; and to explain economic tendencies within capitalist nations, especially those relating to the activities of TNCs.

Insofar as monopoly capital was a model of IDI and the TNC, it both drew on, and contributed to, the new theory of IDI. The monopoly capital model employed a concept of competition both as a characterisation of the era derived from Lenin and as form of competition contributing to IDI from the new IDI theory. Lenin’s concept of monopoly was used to distinguish between two phases in the history of capitalist competition\(^{18}\). The early (nineteenth century) history of capitalism is associated with the ‘competitive’ phase of capitalism, characterised by the existence of industries with many small firms, where the output of individual firms was small relative to total production, and only normal profits were possible. In this phase, there was either little need or capacity for firms to invest outside of ‘their’ industry and their ‘home’ nation. The individual firm could only grow by reducing costs, and to do so this required that a firm invest in expanding capacity and undercutting other firms.

---

\(^{17}\) After the journal *Monthly Review*, in which much of the research was published.

\(^{18}\) Lenin claimed that “Half a century ago... free competition appeared to be overwhelming majority of economists to be a 'natural law'... [but] free competition gives rise to the concentration of production, which in turn, at a certain stage of development, leads to monopoly” (1951, p 28).
As firms grew in size in order to meet this competition, they tended to drive out smaller firms and industries gradually began to take on the characteristics of oligopoly. In so doing, the competitive phase gives way to the monopolistic phase. Increasing firm size also results in oligopolistic firms expanding out from their home markets, and eventually from their home nation. The main advantage of the multinational firm over its competitors abroad therefore relate mainly to the size and strength of the large firm. While for the monopoly capital school, size is partly related to the economies of large-scale production, it is suggested that “the decisive advantages of the giant corporation lie elsewhere than in production” (Baran and Sweezy 1968)\textsuperscript{19}. It is thus in the sphere of circulation that the advantages of multinational firms are present in the monopoly capital model\textsuperscript{20}. This establishes another point of similarity between the monopoly capital school with other models of IDI. In both the concept of imperfect competition is not only a key category, but the source of imperfect competition is located mainly in the sphere of circulation. This has clear implications for what might be termed the welfare effects of monopoly capital. Because firms do not secure monopolistic markets in the sphere of production, but in the sphere of circulation, the source of monopoly profits does not come from economies of scale, but from market power\textsuperscript{21}.

In the monopolistic phase, a number of additional tendencies also manifest themselves. In particular, borrowing from the underconsumption theories of Hobson, Kalecki and Steindl, the monopoly capital school identified a long-run tendency for capitalism toward stagnation created by a lack of effective demand. Monopoly profits make possible an acceleration in the rate of growth of large firms, and this helps to generate an inherent tendency in the monopolistic phase for productive capacity to expand at a faster rate than does consumption (effective demand). Eventually, monopolists are required to regulate and control markets, rather than to continually expand them. These circumstances result in the creation of surplus funds which cannot be invested in the monopolist’s industry, and this in turn establishes a long-run tendency for capitalism toward stagnation (in the absence of some external factor/s).

In order to stem the tendency toward stagnation, the state is impelled to resort to ‘wasteful’ consumption (such as armaments spending) as a way of absorbing the surplus capacity in monopoly industries. The other way of negating this tendency is for firms to find an ‘outlet’ for their surplus investment funds. These must be invested elsewhere, in new industries and especially in new markets abroad (Sweezy 1969b). The expansion of firms across industries creates conglomerate firms, the expansion of firms across national markets, creates multinational corporations. The growth of IDI and the multinational firm in the post-war period is one of the key developments in this process, and therefore one of the key features of the monopolistic phase.

---

\textsuperscript{19} Following Kindleberger in some respects, these are identified as access to large amounts of capital on favourable terms, managerial talent, and research and development.

\textsuperscript{20} The role of circulation is said to include the role of the state (particularly in the case of US IDI) in securing the conditions for profitable investment and trade.

\textsuperscript{21} This focus on exchange and distribution is what Jenkins termed a ‘circulationist’ theory of IDI (1984).
The monopoly capital school, thus, turned Hobson’s surplus capital thesis on its head. The surplus funds invested abroad allows the firm to continue to expand, and because of the monopoly structure of that investment, that international expansion can run counter to the expectation of orthodox economic theory. The monopoly capital school therefore suggested that “firms undertake overseas investment so as to relieve their profitability pressures” (Pitelis 1991, p 200)\(^2\).

Gradually, the same tendency that created a monopolistic market and surplus capital in the original industry becomes manifested in these new markets, and this requires a continuing search for new markets or new industries if surplus capital is not to be generated. In this phase of monopoly capital “foreign investment far from being an outlet for domestically generated surplus, is a most efficient device for transferring surplus generated abroad [back] to the investing country” [to maintain parent firm profitability: MR] (Hufbauer 1966, pp 107-8). For this reason, foreign investment in the monopoly capital model, which began as an outlet for surplus capital, actually generates a surplus in its own right. For this reason the monopoly capital model of IDI has been called the ‘suction-pump’ theory of IDI (Hufbauer 1975)\(^3\).

There were other similarities between the monopoly capital model and other models of IDI, apart from similarities in the concept of competition. For instance, echoing the concept of internationalisation of orthodox theory, Baran and Sweezy defined corporate nationality in terms of the nationality of the owners/controllers of the TNC. They suggested that while the multinational corporation was international in the sense that it invested in operations in a number of countries, “in all other decisive respects we are dealing with national corporations”(1969a, p 3). This is critical for the monopoly capital school because it forges an identity of interest between the firm and the state.

Ownership and control of TNCs is understood to be divided mainly along national lines\(^4\). Even where ownership and control structures exhibited more complex cross-national structures (such as in the cases of joint control of Royal Dutch Shell and Unilever or with the growing numbers of joint ventures), the net result was usually to give effective control to one nation’s capital over another. The nationality of capital in monopoly capital models therefore occupied a critical place. The power and profitability of capital were seen to be a function not only of firm size, but also of other characteristics, “among which nationality occupies an extremely important position” (Sweezy 1969a,9)\(^5\). In the post-war period, the identification of monopoly capital as an extension of national firms, with US international hegemony also provided the basis for characterising this as the distinctive feature of a new form of imperialism. The TNC was therefore a challenge to the national sovereignty of host

---

\(^2\) Baran and Sweezy suggested that, “Foreign investment, it seems, far from being a means of developing underdeveloped countries, is a most efficient device for transferring wealth from poorer to richer countries while at the same time enabling the richer to expand their control over the economies of the poorer” (1966a, pp 24-5).

\(^3\) Hufbauer also claimed that “the suction-pump thesis is merely a Marxist attempt to draw policy guidance from balance-of-payments statistics...[and these statistics] as used by Marxist advocates, are quite inadequate to the problem” (1975, p 302). It will be suggested in later chapters that Balance of Payments statistics are not only problematic for policy-making on the basis of radical and Marxist accounts of IDI.

\(^4\) Baran and Sweezy define corporate nationality not in terms of the location of the firm, but in terms of “the people who control it” (1969a).

\(^5\) They also add that “For reasons that reach far back into the origins of capitalism, the deepest and most durable divisions within the global capitalist class have been along national lines” (1969a, 9).
countries because ‘foreign’ institutions were making important decisions in, and extracting monopoly profits from, host countries.

The monopoly capital model also incorporated a concept of capital which blended two elements: the institutional concept of capital of IDI theory, and capital as a process of exploitation and accumulation. Firstly, as a process of exploitation, the concept of capital was understood as a relationship of exploitation between a class of capitalists and the working class. In the post-war period, the rise of the growth of monopolistic corporations had produced a new capitalist class of owners and corporate executives which now constituted “the leading echelon of the ruling class” (1966). Capital was also a process of accumulation (self-expansion), which in the post-war period was exemplified by the growth of large monopoly firms (especially the TNC). The institutional concept of capital provides the link with the institutional concept of capital developed in orthodox models of IDI. In the monopoly era, the self expansion of capital is associated with the growth of firms which cannot be contained within their own national industries. It is the international expansion of these large monopoly firms (TNCs) that provided the dynamic force for multinational growth.
IDI IN THE 1970’S

The highwatermark of IDI theory

and beginnings of

a breakdown in the general theory
4.1 INTRODUCTION

The stylised facts of IDI in the 1950's and 1960's were generally perceived as part of a new era of international investment, and the previous chapter has shown how the characteristics of the particular form and pattern of international investment in that period were constituted as a benchmark for a new theory of international capital. The chapter also explained how, through the categories of capital, competition and internationalisation, the new post-war IDI theory emerged out of what Dunning and Rugman (1986) called the “straightjacket of neo-classical-type trade and financial theory” with a distinct conceptual agenda of its own. The concepts were invested with particular meanings in the new theory of IDI, derived from their capacity to explain the stylised facts of 1950's and 1960's IDI. The categories were also employed to help show both the underlying unity of IDI theory as well as divisions within the general theory. The chapter's central proposition was that the widely held conception of a new era served to confuse the particular characteristics of IDI in the 1950's and 1960's with universal theoretical postulates about the nature and motives of IDI for all times.

The stylised facts of 1970's IDI were therefore one of the first ‘tests’ for the new theory. It was natural that the explanation of 1970's IDI was pursued in terms of the newly developed general theory. Indeed, the stylised facts of 1970's IDI shared many similarities with those of the 1950's and 1960's, and this evidence of continuity reinforced both the conception of a new era of international investment and that a general theory of IDI had been developed to understand one key feature of that era. Although there was by now a growing number of competing models of IDI, and quite active and vigorous debate between them, the models operated mostly within a shared conceptual framework and on the basis that a general theory (or model) of IDI had or was being developed. At one level then, the 1970's seemed to provide support for both the importance of a theory of IDI, and for the concepts that had underpinned and unified post-war IDI theory.

This chapter shows, however, that just as the general theory was reaching its highest point of acceptance, the concepts underpinning that general theory were already starting to unravel in the face of the changing stylised facts of 1970's IDI. In the 1970's, the international pattern of IDI underwent some important and (from the point of view of the new theory of IDI) quite unexpected transformations. The current chapter explores how the general and universal categories of the new theory began to be modified in the face of these changing stylised facts.

Both the fact of change, and many of the individual changes themselves, were confronting to the new theory of IDI. One astute observer noted that the changing stylised facts of 1970's IDI had “emphasised the unique characteristics of the international economy in the 1950's and 1960's that have colored our view of the direct investment process”(McClain 1983: emphasis added). The problem for IDI theory, was that it was precisely those ‘unique characteristics’ which were the ones upon which the analytic foundations of the new and seemingly general theory of IDI had been based.
Ongoing growth and change in IDI during the 1970's assured that research into IDI remained very active, but that research also began to raise conceptual questions in terms of how the apparently universal concepts of IDI theory (based on the 'unique' characteristics of 1950's and 1960's IDI) would respond to the changing circumstances of 1970's IDI. The chapter will show how IDI analysis sought to absorb many of these 'unexpected' changes in 1970's IDI by way of a modification to some of the 1950's and 1960's-derived concepts. In this regard, the 1970's was more a period of transition between IDI of the long boom and IDI in the context of a globalisation of economic activity. Before exploring the way IDI theory was modified to deal with the changing stylised facts of 1970's IDI, it is necessary to outline how those facts changed in the 1970's. The stylised facts of 1970's IDI and the way models of IDI explained the changed pattern are now considered in turn.

4.2 STYLISED FACTS OF 1970'S IDI

4.2.1 Introduction

Although 1970's IDI shared many of the similar features with 1950's and 1960's IDI, there were also many differences. These changes, discussed in more detail shortly, included growth of IDI from a much wider national and industrial origin, the emergence of the US as a major destination for IDI, a growing intra-industry pattern of IDI, changing patterns of ownership and control, and changes in the funding of IDI. Those patterns are elaborated below, but it needs emphasising here that a growing particularity began to enter notions of IDI, and that explaining the changes forced modifications in the conceptual categories of the new theory.

4.2.2 Growth Of Outward IDI from a wider range of Source Countries

During the 1950's, and for much of the 1960's, US hegemony in the international economy was at its peak, and one expression of that dominance was that the US was the largest source of outward IDI. Until the mid-1960's, for instance, the US was estimated to have accounted for more than three-quarters of all new post-war IDI. While it was noted in the Chapter 3 that IDI was never exclusively a US phenomenon, post-war IDI theory was constructed largely on the basis of explaining the particular characteristics of US IDI.

By the late-1970's, the growth of significant levels of outward IDI from a much wider range of nations, meant that the notion of analysing IDI solely by reference to

---

1 Without pre-empting the analysis, models of IDI explained 1970's changes in two broad ways. The first was to shift explanatory focus away from an emphasis on national characteristics of IDI and to shift explanatory focus towards the characteristics of firms. The other response was to introduce insights from other models or from other areas of economic theory.

2 It will be recalled that for many researchers IDI was regarded as a peculiarly 'US' form of investment (or lending), and the MNE as a peculiarly 'US' form of business organisation. It has been shown how this perception was related to the fact that during the formative period of development of modern IDI theory, researchers were required to explain the patterns of IDI largely in terms of the particular patterns of early post-war IDI outflow from the US (Vernon 1992).
the characteristics of US IDI had ceased to be a source of credible explanation. It was during the 1970's that US economic hegemony began to be challenged, as the post-war reconstruction of Europe and Japan reduced (but did not entirely eliminate) differences in the industrial structures of the developed countries (Maddison 1987). As Table 4.1 shows, one aspect of that convergence was the rapid growth of 'non-US IDI' and 'non-US based TNCs'. During the 1970's, the US remained the major IDI source country, but by the end of the 1970's, the share of total international IDI accounted for by the US had fallen to 40 percent.

There was also even evidence in the 1970’s that IDI growth was occurring from developing countries (Wells 1979, Lall 1979). By the late-1970’s, it was no longer tenable to regard IDI and TNCs either as a peculiarly US phenomenon, or even a phenomenon of developed countries. It will be shown below that this conclusion required modifications in IDI theory.

Table 4.1 Stocks of Outward foreign direct investment by major home countries and regions 1967-1980 - (billions of US dollars)

<table>
<thead>
<tr>
<th>Countries/Regions</th>
<th>1967</th>
<th>% of GDP</th>
<th>1973</th>
<th>% of GDP</th>
<th>1980</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value</td>
<td>% of total</td>
<td>Value</td>
<td>% of total</td>
<td>Value</td>
<td>% of total</td>
</tr>
<tr>
<td>Developed Market</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Economies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>109.3</td>
<td>97.3</td>
<td>205.0</td>
<td>97.1</td>
<td>503.6</td>
<td>97.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>66.6</td>
<td>50.4</td>
<td>101.3</td>
<td>48.0</td>
<td>220.2</td>
<td>40.0</td>
</tr>
<tr>
<td>Japan</td>
<td>15.8</td>
<td>14.1</td>
<td>27.5</td>
<td>13.0</td>
<td>79.2</td>
<td>14.8</td>
</tr>
<tr>
<td>Germany (GDR)</td>
<td>1.5</td>
<td>0.9</td>
<td>10.3</td>
<td>4.9</td>
<td>19.6</td>
<td>3.6</td>
</tr>
<tr>
<td>Switzerland</td>
<td>3.0</td>
<td>2.7</td>
<td>11.9</td>
<td>5.6</td>
<td>43.1</td>
<td>7.8</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.3</td>
<td>2.2</td>
<td>7.1</td>
<td>3.4</td>
<td>22.4</td>
<td>7.0</td>
</tr>
<tr>
<td>Canada</td>
<td>11.0</td>
<td>9.8</td>
<td>15.8</td>
<td>7.5</td>
<td>42.4</td>
<td>7.6</td>
</tr>
<tr>
<td>France</td>
<td>3.7</td>
<td>3.2</td>
<td>7.8</td>
<td>3.7</td>
<td>21.6</td>
<td>3.9</td>
</tr>
<tr>
<td>Italy</td>
<td>7.0</td>
<td>5.5</td>
<td>8.8</td>
<td>4.2</td>
<td>20.8</td>
<td>3.8</td>
</tr>
<tr>
<td>Sweden</td>
<td>2.1</td>
<td>1.9</td>
<td>3.2</td>
<td>1.5</td>
<td>7.4</td>
<td>1.3</td>
</tr>
<tr>
<td>Other*</td>
<td>1.7</td>
<td>1.5</td>
<td>3.0</td>
<td>1.4</td>
<td>7.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Developing countries</td>
<td>5.4</td>
<td>4.8</td>
<td>20.0</td>
<td>9.5</td>
<td>15.4</td>
<td>2.7</td>
</tr>
<tr>
<td>TOTAL</td>
<td>112.3</td>
<td>100.0</td>
<td>211.1</td>
<td>100.0</td>
<td>516.9</td>
<td>100.0</td>
</tr>
</tbody>
</table>

* Australia, Austria, Belgium, Denmark, Finland, Greece, Ireland, New Zealand, Norway, Portugal, South Africa, Spain.

Source: Dunning, 1993.

---

3 Two changes in the pattern of IDI flows emphasise the changing national patterns of IDI. In the 1970’s, the proportion of the stock of inward IDI sourced from the US began to fall (from around 76 percent in 1962 and to around 62 percent by 1974). Even more significantly perhaps, the rapid growth of outward IDI from the UK to the US meant that by the mid-1970’s, the UK had become a 'net-exporter' of direct investment to North America (Panico 1989).
4.2.3 Growing Concentration of IDI flows towards the Developed Countries

During the 1970’s, developed countries were increasingly the major destinations of IDI flows. Table 4.2 shows that the developed country share of global IDI inflow increased from just under 70 percent in the late 1960’s, to almost 80 percent at the end of the 1970’s.

Table 4.2 Stocks of Inward Foreign Direct Investment, by major host countries and regions 1967-1980, (billions of dollars)

<table>
<thead>
<tr>
<th>Regions</th>
<th>1967</th>
<th>1973</th>
<th>1980</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value</td>
<td>% of</td>
<td>Value</td>
</tr>
<tr>
<td></td>
<td>total</td>
<td>GDP</td>
<td>total</td>
</tr>
<tr>
<td>Developed Market</td>
<td>73.2</td>
<td>69.4</td>
<td>153.7</td>
</tr>
<tr>
<td>Economies</td>
<td>3.2</td>
<td></td>
<td>3.8</td>
</tr>
<tr>
<td>Developing countries</td>
<td>32.3</td>
<td>30.6</td>
<td>54.4</td>
</tr>
<tr>
<td>TOTAL</td>
<td>105.5</td>
<td>100.0</td>
<td>208.1</td>
</tr>
<tr>
<td></td>
<td>3.8</td>
<td></td>
<td>4.1</td>
</tr>
</tbody>
</table>

Source: John H Dunning, (1992)

Another prominent feature of IDI flows was that the US became the largest destination for IDI transactions. Whereas at the end of the 1960’s, the US was the destination for around 10 percent of international IDI, by the close of the 1970’s, the proportion had risen to more than thirty percent of total global IDI, and almost half of IDI located in the developed countries. Figures 4.1 and 4.2 shows that one consequence of the rapid growth of inward IDI into the US during the 1970’s was that whereas the proportion of inward to outward IDI had been falling during the 1950’s and 1960’s, during the 1970’s that trend was dramatically reversed. By the close of the 1970’s, the US was both the major national source and the major national destination of IDI.
Figure 4.1 Stock (Book Value) of Foreign Direct Investment in the United States as Percentage of US Direct Investment Abroad

Source: Lipsey (1988)

Figure 4.2 Net US Capital Outflow (-) or Inflow (+) Annual Averages (billions of dollars, current prices)

Source: Lipsey (1988)
4.2.4 Changing Industry Pattern of IDI

The concentration of IDI in mining, but particularly in the manufacturing sector was a distinctive feature of 1950’s and 1960’s IDI. This concentration helped to inform the concepts of capital and competition of post-war IDI theory. IDI was increasingly associated with the internationalisation of industrial (manufacturing) production. By the late-1960’s, the distinctiveness of the association between IDI and manufacturing had already begun to diminish. As Table 4.3 shows, 1970’s IDI growth was spread across most industries, and especially from growth in tertiary industry IDI. By the end of the 1970’s, variations in the industrial distribution of IDI remained. Manufacturing was still the major sector of IDI activity, but differences in IDI activity between sectors became one of degree rather than of structure. This fact too was to have ramifications for IDI theory.
Table 4.3 Sectoral distribution of foreign-direct-investment stock for the largest developed home countries and largest
developed and developing host countries 1970-1980

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Billions of dollars</td>
<td>Average annual growth rate in per cent</td>
<td>Share in percentage</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A  Outward stock</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed countries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary</td>
<td>29</td>
<td>58</td>
<td>88</td>
<td>14.0</td>
<td>8.7</td>
<td>22.7</td>
<td>25.3</td>
<td>18.5</td>
</tr>
<tr>
<td>Secondary</td>
<td>58</td>
<td>103</td>
<td>208</td>
<td>11.7</td>
<td>15.1</td>
<td>45.2</td>
<td>45.0</td>
<td>43.8</td>
</tr>
<tr>
<td>Tertiary</td>
<td>41</td>
<td>68</td>
<td>179</td>
<td>10.4</td>
<td>21.4</td>
<td>31.4</td>
<td>27.7</td>
<td>37.7</td>
</tr>
<tr>
<td>Total</td>
<td>129</td>
<td>229</td>
<td>475</td>
<td>11.7</td>
<td>15.7</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>B  Inward Stock</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed countries</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary</td>
<td>12</td>
<td>17</td>
<td>18</td>
<td>4.7</td>
<td>5.9</td>
<td>16.2</td>
<td>12.1</td>
<td>6.7</td>
</tr>
<tr>
<td>Secondary</td>
<td>44</td>
<td>79</td>
<td>148</td>
<td>10.7</td>
<td>13.4</td>
<td>60.2</td>
<td>56.5</td>
<td>55.2</td>
</tr>
<tr>
<td>Tertiary</td>
<td>17</td>
<td>44</td>
<td>102</td>
<td>16.5</td>
<td>18.3</td>
<td>23.7</td>
<td>31.4</td>
<td>38.1</td>
</tr>
<tr>
<td>Total</td>
<td>73</td>
<td>140</td>
<td>268</td>
<td>11.3</td>
<td>13.9</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Developing countries/ economies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary</td>
<td>..</td>
<td>7</td>
<td>17</td>
<td>..</td>
<td>19.4</td>
<td>..</td>
<td>20.6</td>
<td>22.7</td>
</tr>
<tr>
<td>Secondary</td>
<td>..</td>
<td>19</td>
<td>41</td>
<td>..</td>
<td>16.6</td>
<td>..</td>
<td>55.9</td>
<td>54.6</td>
</tr>
<tr>
<td>Tertiary</td>
<td>..</td>
<td>8</td>
<td>17</td>
<td>..</td>
<td>16.3</td>
<td>..</td>
<td>23.5</td>
<td>22.7</td>
</tr>
<tr>
<td>Total</td>
<td>..</td>
<td>34</td>
<td>75</td>
<td>..</td>
<td>17.1</td>
<td>..</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.2.5 Changing Institutional forms of International Organisation associated with IDI

The development of post-war IDI theory was based on its association with a particular institutional form of capital - the establishment or expansion of wholly-owned subsidiaries, not mediated through the stock market. In the 1950’s and 1960’s, IDI was understood and defined in a way that gave prominence to this prevailing institutional form, and the theory of IDI was very much informed by this development. During the 1970’s, however, the expansion of TNCs was undertaken in more diverse ways. IDI growth in the 1970’s was thus also accompanied by a growing diversity in the corporate forms of subsidiary production. Table 4.4 shows that the wholly-owned subsidiary was never the only way that IDI was undertaken in the 1950’s and 1960’s, but that even in the 1970’s it remained the principal form of IDI. The table also shows that the growth of minority owned subsidiaries became another important form of IDI. The growing diversity of forms of expansion of IDI required changes in the definition of IDI in terms of the level of ownership deemed to confer control. In general, there was a strong general trend in the 1970’s toward a reduction in the ownership threshold used to distinguish between direct and portfolio investment, and this development too had implications for the new theory of IDI (Jones 1986).
### Table 4.4 Distribution of ownership patterns a/ of 1,276 manufacturing affiliates b/ of 391 transnational corporations established in developing countries, by period of establishment, 1951-1975 (Percentage)

<table>
<thead>
<tr>
<th>Home country and type of ownership</th>
<th>Number of establishments as percentage of total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Affiliates of 180 United States-based corporations</strong></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
</tr>
<tr>
<td>Wholly-owned</td>
<td>58.4</td>
</tr>
<tr>
<td>Majority-owned</td>
<td>12.2</td>
</tr>
<tr>
<td>Co-owned</td>
<td>5.6</td>
</tr>
<tr>
<td>Minority-owned</td>
<td>11.2</td>
</tr>
<tr>
<td>Unknown</td>
<td>12.6</td>
</tr>
<tr>
<td><strong>Affiliates of 135 European and United Kingdom-based corporations</strong></td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
</tr>
<tr>
<td>Wholly-owned</td>
<td>39.1</td>
</tr>
<tr>
<td>Majority-owned</td>
<td>15.4</td>
</tr>
<tr>
<td>Co-owned</td>
<td>5.3</td>
</tr>
<tr>
<td>Minority-owned</td>
<td>9.8</td>
</tr>
<tr>
<td>Unknown</td>
<td>30.5</td>
</tr>
<tr>
<td><strong>Affiliates of 76 other transnational corporations</strong></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
</tr>
<tr>
<td>Wholly-owned</td>
<td>27.4</td>
</tr>
<tr>
<td>Majority-owned</td>
<td>8.2</td>
</tr>
<tr>
<td>Co-owned</td>
<td>12.3</td>
</tr>
<tr>
<td>Minority-owned</td>
<td>16.4</td>
</tr>
<tr>
<td>Unknown</td>
<td>35.6</td>
</tr>
</tbody>
</table>

Source: United Nations (1978)

### 4.2.6 IDI and the Growing Internationalisation of Firms

In the 1950’s and 1960’s, IDI growth was associated with the growth of a relatively small number of large TNCs. In the 1970’s, not only were firms from more nations and across a wide range of industry sectors engaging in IDI, the international activity of TNCs was becoming an increasingly important component of their overall activities. IDI growth in the 1970’s was thus associated with the increased proportion of total production, sales and assets held

---

1 By the mid-1970’s for instance, there were an estimated 10 thousand firms worldwide with international operations, and those firms held a stock of international assets valued at around $US670 billion (Dunning 1983; UN 1978).

2 Bergsten et al. (1978,p10) estimated that by the mid-1970’s the average earnings of all American multinationals from their affiliates abroad had grown to around one quarter of their total earnings, up from around 7 percent in the late 1950’s and early 1960’s.
by TNCs outside of their home country\textsuperscript{3}. By the late-1970's, for instance, eight of the top ten US companies in Fortune's industrial 500, were earning between 50 percent, and as much as 87 percent, of their total income from overseas affiliates (Bergsten, Horst and Moran 1978). Figure 4.4 shows that even by the late-1960's US TNCs were already selling around three times as much from production in Europe as from exports from the US. By the early 1970's, more than 80 percent of total export sales was being derived from activities abroad. Figure 4.4 and Table 4.5 shows that in terms of capital expenditure, and increasing proportion of the total was being directed to overseas activities.

Similarly, Figure 4.3 shows that the share of assets of UK corporations held abroad in the form of IDI, increased from around twenty percent to almost thirty percent in the early 1980's.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{chart.png}
\caption{United Kingdom, private foreign direct investment as percentage of assets of non-financial corporations, 1955-1982\textsuperscript{*}}
\end{figure}

\textsuperscript{*} excluding banks, property companies, and insurance


\footnote{Whereas in 1962 the largest 800 industrial firms had about 15 percent of their production abroad, by the early 1970's it had risen to 26 percent. By the late 1970's, the proportion of production located abroad had grown to more than one third (Dunning and Pearce 1985).}
Figure 4.4 Foreign Expenditure as a Share of Total Plant and Equipment Expenditure by American Corporations, 1970-1976

Plant and equipment expenditure (billions of dollars)\textsuperscript{a}

![Bar chart showing foreign expenditure as a share of total plant and equipment expenditure by American corporations from 1970 to 1976.]

\textsuperscript{a} Data on domestic and foreign expenditures are not precisely comparable, because (a) property expenditures are included in the foreign series but not the domestic series, and (b) foreign expenditures include only those by majority-owned foreign affiliates of American multinationals, ignoring altogether expenditures in enterprises where they are minority owners. The growth rates of the two series are thus more strictly comparable than their absolute magnitudes.

Source: Bergsten, Horst & Moran (1978)

Table 4.5 Value of US Direct Investment Abroad as Percentage of Assets of US Corporations

<table>
<thead>
<tr>
<th>Year</th>
<th>All Corporations</th>
<th>Nonfinancial Corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>3.13</td>
<td>n.a</td>
</tr>
<tr>
<td>1972</td>
<td>3.02</td>
<td>n.a</td>
</tr>
<tr>
<td>1973</td>
<td>3.08</td>
<td>n.a</td>
</tr>
<tr>
<td>1974</td>
<td>3.06</td>
<td>n.a</td>
</tr>
<tr>
<td>1975</td>
<td>3.11</td>
<td>n.a</td>
</tr>
<tr>
<td>1976</td>
<td>3.10</td>
<td>n.a</td>
</tr>
<tr>
<td>1977</td>
<td>2.97</td>
<td>5.82</td>
</tr>
<tr>
<td>1982</td>
<td>2.45</td>
<td>5.07</td>
</tr>
</tbody>
</table>

Source: Lipsey (1988)
4.2.4 Changing Sources of Financing of IDI

In the 1950's and 1960's it was increasingly recognised that IDI was not necessarily associated with a capital flow from the home to a host country. A growing proportion of funding for IDI was being derived from within the host country itself, from retained earnings and local capital raising. Table 4.6 shows that the majority of funding of the activities of TNCs from the US was increasingly being derived from outside of the US. This fact is reinforced by the figures in Table 4.7, which shows that reinvested earnings was an increasingly important source of financing of IDI for firms from the US. This underscored the conception of IDI as related more to the international activities of firms than to capital movements per se, but, combined with the increasing international orientation of TNC's, the developments began to force changes in the notion of internationalisation.

Table 4.6 Sources of Financing of American Affiliates (in billion of US dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital Expenditures by Majority-Owned Foreign Affiliates ($B)</th>
<th>Net US Capital Outflows to All Foreign Affiliates ($B)</th>
<th>Net Capital Outflows as a Proportion of Total Capital Expenditure (percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>20.5</td>
<td>3.2</td>
<td>17.1</td>
</tr>
<tr>
<td>1974</td>
<td>25.3</td>
<td>1.3</td>
<td>5.7</td>
</tr>
<tr>
<td>1975</td>
<td>26.8</td>
<td>6.2</td>
<td>23.1</td>
</tr>
<tr>
<td>1976</td>
<td>24.7</td>
<td>4.2</td>
<td>17.0</td>
</tr>
<tr>
<td>1977</td>
<td>27.5</td>
<td>5.6</td>
<td>20.4</td>
</tr>
<tr>
<td>1978</td>
<td>30.7</td>
<td>4.9</td>
<td>16.0</td>
</tr>
<tr>
<td>1979</td>
<td>38.4</td>
<td>5.0</td>
<td>13.0</td>
</tr>
</tbody>
</table>

Source: Hennart, (1982)

4 Apart from local capital raising, an additional element to financing 1970's IDI was the growing use of international capital markets such as the Eurocurrency markets. While this was embryonic in the 1970's, the link between capital raising on international capital markets was to become a highly significant in the 1980's.
Table 4.7 US Foreign direct investment (in millions of dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Equity and intercompany account outflows</th>
<th>Reinvested earnings of incorporated affiliates</th>
<th>Ratio of equity outflows to reinvested earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950</td>
<td>1,088</td>
<td>621</td>
<td>475</td>
<td>1.31</td>
</tr>
<tr>
<td>1965</td>
<td>4,995</td>
<td>3,468</td>
<td>1,542</td>
<td>2.25</td>
</tr>
<tr>
<td>1969</td>
<td>6,186</td>
<td>3,130</td>
<td>2,830</td>
<td>1.11</td>
</tr>
<tr>
<td>1970</td>
<td>7,387</td>
<td>4,413</td>
<td>3,176</td>
<td>1.39</td>
</tr>
<tr>
<td>1971</td>
<td>7,280</td>
<td>4,441</td>
<td>3,176</td>
<td>1.40</td>
</tr>
<tr>
<td>1972</td>
<td>7,118</td>
<td>3,2134</td>
<td>4,532</td>
<td>0.71</td>
</tr>
<tr>
<td>1973</td>
<td>11,435</td>
<td>3,195</td>
<td>8,158</td>
<td>0.39</td>
</tr>
<tr>
<td>1974</td>
<td>8,765</td>
<td>1,275</td>
<td>7,777</td>
<td>0.16</td>
</tr>
<tr>
<td>1975</td>
<td>13,971</td>
<td>6,196</td>
<td>8,048</td>
<td>0.77</td>
</tr>
<tr>
<td>1976</td>
<td>12,759</td>
<td>4,253</td>
<td>7,696</td>
<td>0.55</td>
</tr>
<tr>
<td>1977</td>
<td>13,039</td>
<td>5,612</td>
<td>7,286</td>
<td>0.77</td>
</tr>
<tr>
<td>1978</td>
<td>17,957</td>
<td>4,877</td>
<td>11,469</td>
<td>0.43</td>
</tr>
<tr>
<td>1979</td>
<td>24,844</td>
<td>5,904</td>
<td>18,414</td>
<td>0.32</td>
</tr>
</tbody>
</table>


4.2.7 Changing Relationship between International Direct Investment and Trade

It has already been noted that the internationalisation of firms in the form of TNCs in the 1970's meant that a growing proportion of the activities of firms was being conducted outside of their 'home' nation. While some researchers suggested that the internationalisation of firms challenged the notion of TNCs having a national identity, for others, the developments suggested something quite different. In terms of the growing importance of IDI and TNCs for national economies, some researchers challenged the idea that trade was any longer the indicator of international competitiveness. Figure 4.5 shows that while US exports represented a declining share of world exports in the 1970's, a calculation on the basis of US corporations (TNCs) generates a different picture. Lipsey has suggested that in terms of an ownership-based rather than a geographic-based definition of nationality, the US share of total world exports did not deteriorate during this time. Table 4.8 shows that this gap was made up by the international production of US firms. In the 1950's, the continuing facts of this development would begin to challenge the notion of internationalism of IDI theory.
Table 4.8 Share of World Exports of Manufacturers of US Majority-Owned Foreign Affiliates (percentage)

<table>
<thead>
<tr>
<th></th>
<th>In All Countries</th>
<th>In Developed Countries</th>
<th>In LDCs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1957</td>
<td>4.5</td>
<td>4.1</td>
<td>0.5</td>
</tr>
<tr>
<td>1966</td>
<td>6.8 (6.6)</td>
<td>6.3 (6.2)</td>
<td>0.5</td>
</tr>
<tr>
<td>1977</td>
<td>8.4</td>
<td>7.6</td>
<td>0.8</td>
</tr>
<tr>
<td>1982</td>
<td>8.3</td>
<td>7.3</td>
<td>1.0</td>
</tr>
</tbody>
</table>

*Comparable to 1957

Source: Lipsey (1988)

4.2.8 Summary

The stylised facts of IDI in the 1970’s continued many of the patterns and trends that were established in the 1950’s and 1960’s, and in this sense the 1970’s were part of a continuum of change. But there were also critical degrees of change, associated directly and indirectly with the responses of TNCs to a period of international recession, in contrast to the boom of the 1950’s and 1960’s. The growing importance of IDI as an international economic process, its association with the TNC and the funding of IDI from within the host nation, all seemed to reinforce the key characteristics identified by researchers in the 1950’s and 1960’s, that were important in establishing the conceptual basis of the new theory. There were also however, some important contrasts in the stylised facts of 1970’s

---

5 For accounts of the end of the long post-war boom, see Armstrong Glynn and Harrison (1991) and Glynn, Hughes, Lipietz and Singh (1990).
IDI, with those of the 1950’s and 1960’s. These included the growth of IDI from a much wider national and industrial origin, the changing industrial composition of IDI, more diverse ownership and organisational patterns and a growing international orientation of firms. Many of these developments were not anticipated by the new theory, and the next section will show that the explanation of this evidence of what Dunning (1993,p128) recently termed a more ‘pluralistic’ pattern of 1970’s IDI would force modifications in IDI theory.

At this point, it simply needs noting that the stylised facts of 1970’s IDI raised several problems for IDI research. The more diverse pattern of 1970’s IDI meant that there now appeared to be more than one type of IDI and more than one motive for firms to seek to control production abroad (Behrman 1972). It was increasingly recognised that while there were some key elements to IDI, no generally accepted comprehensive definition of IDI, or the MNE possible (Aharoni 1972, UNCTC 1974)⁶. These definitional problems also helped to raise the empirical question of how to measure IDI in the context of different and more complex patterns of ownership and organisation. As the next section will show, these developments were all to have important implications for the new general theory of IDI.

4.3 THE ANALYTICAL EXPLANATION OF THE STYLISTED FACTS OF 1970’s IDI

The previous chapter established how the explanation of the stylised facts of 1950’s and 1960’s IDI constituted the basis for a new and distinct theory of international capital. By the close of the 1960’s, the new theory had emerged as a distinct theoretical paradigm out of earlier theories of international trade and portfolio capital, where IDI had been understood largely in derivative terms. IDI growth in the 1970’s helped resolve some of the remaining doubts about the analytical importance of IDI as a form of international resource transfer, and settled the issue of whether 1950’s and 1960’s IDI was simply a one-off, stock adjustment process. The continuing growth of IDI thus helped to underline the importance of the new theory of IDI, and most of the research into 1970’s IDI was conducted on the basis that a general theory of IDI had been developed, or was at least possible.

The paradox of the 1970’s IDI was that just as the theory had emerged as a distinct body of analysis, changes in the stylised facts of 1970’s IDI, discussed above, were already forcing modifications in the new and seemingly universal concepts of IDI research. Initially, the changes seemed to relate only to empirical and definitional issues, such as the Balance of Payments definition of IDI, and the related problem of measuring IDI in terms of the changing definitions. As the 1970’s wore on, it began to be realised that the explanation of changing IDI was

⁶ It had become increasingly apparent that the particular definition of IDI employed depended on the purpose for which the definition was being employed.
forcing a modification in some of the key categories of IDI theory and that this was also challenging aspects of the general theory.

The 1970's was especially severe on some models of IDI, particularly those that emphasised national determinants of IDI (such as models based on trade and portfolio theory), or that predicted that IDI would be a relatively rare occurrence. Conversely, it seemed to heighten the insights offered by models of IDI that emphasised firm specific determinants, or market imperfections leading to their creation. As promising as they then seemed to be, even these models were undermined by the growing pessimism that any model could constitute the basis of a general theory of IDI. A characteristic feature of IDI analysis in the 1970's was that explanation of change occurred via a relaxation of assumptions and a loosening of the conceptual categories of IDI. During the greater part of the 1970's, the resort to eclecticism in the face of historical change was still presented in terms of a general theory of IDI. But by the end of the 1970's, IDI theory had reached something of a hiatus and the confidence in the general and universal nature of IDI theory had been impaired by the changing circumstances of 1970's IDI. The resort to eclecticism began to look more and more like an attempt to make a virtue of necessity, and IDI theory as a general and universal theory was no longer so secure. The remainder of the section considers how the explanation of 1970's IDI both stimulated the conception that 1950's and 1960's IDI theory was general and universal, but also began to force modifications in the underlying concepts of that theory.

4.3.1 Trade Theory and Locational Models of IDI in the 1970's

The development of IDI theory as a distinct body of analysis in the 1950's and 1960's had occurred partly on the basis of a recognition of the differences between trade and IDI - that post-war trade and IDI were behaving in quite different ways. It was increasingly recognised that trade and IDI were (to extend Hymer's point about IDI and portfolio capital) two different things, and that the explanation of post-war IDI required a different conceptual agenda7. The evolution of a different (and distinct) conceptual agenda did not, of course, prevent many international economists in the 1950's and 1960's from attempting to understand and explain IDI in terms of pre-war trade theory, or at least within a shared nationalist perspective. It was rather that models of IDI developed within this perspective became more and more limited in their explanatory range.

Similarly, while the growth and pattern of 1970's IDI reinforced the explanatory problems for trade theory, a number of important attempts were made to use trade-type models in the explanation of 1970's IDI. Two notable orthodox trade models of IDI, the Product Cycle (P-C) and Trade Enhancing (T-E) models, and the radical or dependency models of IDI, associated with Amin and Gunder-Frank, are considered here. More detailed consideration of dependency theory as a model of IDI, and of the P-C and T-E models are also contained as appendices to the chapter.

---

7 It will be recalled that the development of IDI theory occurred largely in terms of a critique of the limitations of trade theory in explaining post-war IDI.
Until the mid-1970's, trade models of IDI had retained the original concept of internationalisation of trade theory. It will be recalled that in trade theory, IDI was understood as a subsidiary flow to trade, and related to certain national attributes (or endowments). Although the continued growth of 1970's IDI, reinforced the incompatibility of trade theory's assumption of international factor immobility, the fact that the growing international mobility of capital did not eliminate observable national patterns of IDI helped to sustain attempts to explain patterns of IDI in terms of their national characteristics. Similarly, the fact that post-war IDI from the US was increasingly directed to other advanced economies (in the wrong direction to the predictions of trade theory), challenged the concept of investment internationalisation as a hierarchical flow (related to relative factor endowments).

The conception of internationalisation thereby turned into an area of both analytical and policy debate about the relationship between IDI and the host (and home) nation (Bergsten and Moran 1974; Reddaway 1971; US Senate 1969; Hufbauer and Adler 1968). As this issue remains a point of debate into the 1990's - in terms of what question to ask about international capital and the nation-state (vis. national sovereignty) - it is not surprising that analytical advances in the 1970's were limited by the concept of internationalisation that informed it. Nonetheless, given the significance of the issue for later developments, it is important to see how the question was being posed at its inception in the 1970's. In order to do this, it is first necessary to show how trade theory was also forced to modify the concept of capital that was employed to explain IDI.

In both the Product Cycle (P-C) and Trade Enhancing (T-E) models, national patterns of IDI continued to be used to develop analytical propositions about IDI. In the case of the P-C model, the post-war pattern of IDI from the US was constituted as the basis for an analytical relationship between trade and IDI. It was a relationship based on the observed post-war pattern of US trade and IDI and explained in terms of both the national technological propensities of the US and the life-cycle of new products. In the case of the T-E model, on the other hand, the

---

8 These developments eventually undermined the concept of internationalisation of trade theory, but the nation-state was such a central category of trade that capital mobility was explained largely in terms of a relaxation of the assumption of perfect market competition.

9 The continued analytical focus on IDI in terms of national characteristics was of course underscored by the fact that IDI was by definition a national creation (a category of Balance of Payments accounting).

10 The 1970's was a period not simply of interest in the relationship between trade and IDI at an analytical level. It was also of interest at the policy level, and many of the major studies of IDI employed trade theoretic approaches for policy analysis. Analytical debates about the relationship between trade and industry were reflected in national policy debates. The dominant policy question tended to be the over affects of IDI (whether inward or outward) on home country production, and especially on exports from that country. The results of such research tended to be quite ambiguous, or as one report concluded 'haphazard' (Bergsten et.al. 1978). Another review suggested that the nature of the relationship found between trade and IDI depended heavily on the assumptions made (Hufbauer and Adler 1968). At the beginning of the 1970's, that policy interest seemed to pertain mainly to the effects of US IDI (either on the host country or on the US economy). In the early 1970's, it was still possible for instance to view conflict between MNEs and the nation-state as a specifically 'American problem' (Francko 1974). By the close of the decade, the issue had become more one of the relationship between MNEs and nation-state in general, and has since been an area of ongoing (but largely unresolved) debate. Lipsey et.al. (1993) summarising the history of one aspect of this issue concluded that, "The effect of foreign production by a country’s firms on the home country’s exports continues to be a puzzle after many years of controversy and a considerable amount of empirical research".
pattern of late-1960’s and early-1970’s IDI from Japan was used as the basis of an analytical distinction between two national types of IDI (US- and Japan-type), determined in terms of their national trade effects.

In the P-C model, the concentration of post-war US IDI to other developed countries was explained in terms of the relocation of production to new markets, where the initial markets for new products were shown to need similar national characteristics (such as high standards of living) to the original innovating nation. Only later, when the product or technology had become standardised or a ‘commodity’ would production be relocated to developing countries. In the case of the T-E model, it was contended that while one national type of IDI was being directed largely to other developed countries (and acting as a substitute for trade), IDI of another national type was being directed to developing countries (to establish new export industries in those countries).

An important strand of post-war analysis of international trade and investment was also developed under the general rubric of dependency analysis. Although advanced mainly as an analysis of relations between the advanced capitalist countries (especially the U.S.), and the ‘developing’ countries (especially Latin American nations), dependency analysis was also used to explain wider international processes (including IDI flows). Dependency analysis was therefore an important strand of radical analysis of post-war IDI. Dependency analysis was developed as an explanation (and critique of) the fact that the actual process of international development were inconsistent with the benign view of orthodox trade theory. Instead of international trade and investment acting in a mutually beneficial way for all nations, dependency analysis was developed in terms of a systematic inequality between nations that structured international economic processes. Trade and investment between nations were not mutually beneficial and the development and prosperity of the advanced (or ‘core’) nations is based on (and indeed requires) the underdevelopment of the ‘periphery’. Unequal exchange is therefore at the heart of relations between core and periphery.

In terms of an analysis of post-war IDI, dependency analysis developed two basic propositions. Firstly, the accumulation of capital by firms in the ‘core’ nations is based upon the extraction of a ‘surplus’ from then periphery, which is then transferred back to the core. Second, the form of surplus extraction required the imposition of a narrow, raw material production orientation to the peripheral economies, that locked those economies into a dependent position vis-a-vis the core nations.

While dependency analysis was advanced in terms of a critique of orthodox trade theory, it developed much of that critique within orthodox trade theory. Thus its analysis is developed in terms of relations between nations as coherent economic units, in terms of exchange relations, and with a concept of competition assessed in terms of market structures rather than as a process. While dependency analysis has been subjected to much critique on this basis, perhaps the most decisive reasons for its demise as a general theory of international trade and investment was the fact that it could neither anticipate changing international patterns of trade and investment, especially in relation to the paradoxical process of peripheral
industrialisation in the 1970’s. In this sense, there was an inherently ahistorical methodology in dependency analysis, which like the P-C and T-E models, made it vulnerable to ongoing changes in post-war IDI.

For instance, a characteristic of 1970’s IDI that was difficult to explain in terms of trade theory was the growth in source countries. IDI growth in the 1970’s was being derived from an increasing number of industrial countries, and even from some ‘underdeveloped’ and ‘dependent’ countries. IDI began to exhibit a pattern of flow both in and out of the advanced industrial countries, which made it increasingly difficult to explain within models conceived in terms of the primacy of national processes and characteristics. Trade theory predicted that where capital flows occurred, it should flow from countries where capital was relatively abundant (or where certain national advantages existed) to those countries with relatively little capital (or where national advantages did not exist). The more diverse pattern of source country IDI in the 1970’s resisted easy explanation in terms of national comparative advantage, based on relative factor endowments or advantages. Furthermore, the pattern of that outward investment from many of the new IDI nations did not conform neatly with the notion of internationalisation found within models of IDI based around the early post-war ‘US model’ of IDI.

One response to the problems of changing patterns of IDI was to modify the concept of internationalisation. Although the nation-state was retained as the central explanatory category, the national attributes and their particular characteristics were modified. Another response, pace the industrial organisation models, was to shift more and more explanatory focus toward non-national determinations of IDI, such as the industry structure and firm characteristics leading to IDI.

In response to growth and greater generalisation of IDI flows, some models of IDI were developed on the basis of the proposition that the new source nations of IDI represented a change in the way national comparative advantage was being expressed. In this view, IDI continued to be understood as an extension of, or substitute for, trade-type comparative advantage. Expanded trade models attempted to explain IDI on the basis of a country’s comparative advantage (Markusen 1979). The other response to the growth of IDI (and the related growth of the large MNE) was presented as undermining the nation-state or national sovereignty.

Nevertheless, two models of IDI and trade which were significant in IDI research will be considered here - The Product-Cycle, and the Trade Enhancing (Kojima-Ozawa) models\(^\text{11}\). Paradoxically perhaps, these models of IDI involved a continuation of the attempt to explain IDI through a modified concept of internationalisation where the national patterns and attributes of IDI were deemed to be significant explanatory factors in IDI.

In the previous chapter, it was shown how trade-type models were forced to modify their concept of competition to explain early post-war IDI. Within trade

\[\text{11} \text{ There are other such attempts to synthesise trade and IDI theory, such as that associated with Markusen (1986, 1989, 1996). However, only the two investigated concentrate on IDI per se.}\]
theory, post-war IDI logically required either that some markets had become imperfect or that (US-based) firms had come into possession of advantages that compensated for the extra costs of operating abroad. In both cases, the market imperfections or attributes were specified in national terms. Until the 1970's, trade theory models had modified their concept of competition, but had made virtually no concession to the concept of capital that became a characteristic feature of industrial organisation-type models.

In an attempt to explain developments in IDI during the 1970's, trade models of IDI were forced to modify and eventually transform both their conception of competition and capital. The paradox for trade theory explanations of 1970's IDI was that the growth in IDI had to be explained either as a growth in national market failure, or a growth in the number of firms from a growing number of nations with 'unique' (and nationally-based) advantages. The resort to this type of explanation tended therefore to undermine the analytical significance (and explanatory power) of the 1950's and 1960's type-trade models. Responding to these changes, the P-C model introduced explicitly monopolistic elements into each of the three phases of the P-C model. In the T-E model, by contrast, the concept of monopolistic competition was incorporated as part of a characterisation of US-type or (trade destroying) IDI.

A related problem for trade models of IDI was that 1970's IDI was increasingly associated with a growth in the number and size of firms engaging in IDI. The development of firms across an ever-wider range of industries with an explicitly international scale of reproduction in terms of location of production, sales and investment challenged the notion of IDI as a minor 'leakage' from national economies, and of the TNC as derivative of the attributes of their nation-of-origin. In order to explain 1970's IDI, it became increasingly necessary to explain IDI in terms of the activities of those firms themselves rather than simply in terms of the common national characteristics of IDI. Trade theory models were therefore forced to incorporate a concept of capital similar to that of mainstream IDI theory. In so doing, trade models of IDI increasingly came to incorporate an institutional concept of capital, addressing the particular characteristics of TNCs which made them choose international investment over international trade.

The introduction of an institutional concept of capital also reinforced the need to modify the concept of internationalisation of trade theory. The growth of multinational firms from other countries in the 1970's initially made the direct association between MNEs and the predominant source nation (the US) more tenuous. Posed in terms of an institutional concept of capital, the international firm came to be seem independent of its nation-of-origin. By the late-1970's, the TNC was increasingly represented as a challenge the autonomy of the nation-state per se. Raymond Vernon, one of the leading trade theorists of IDI, concluded that, "As the decade has rolled on... it has grown increasingly clear that various restraints are limiting the extent to which nations can use MNEs as a passive conduit for promoting their national interests" (1977).

The growth of non-US IDI and particularly of non-US TNCs was increasingly viewed as a problem to the nation-state per se (Vernon 1974). For trade theory, it
was increasingly recognised that while TNCs were not ‘stateless’, the activities of TNCs were not simply an products of their home nations. In these terms, the TNC seemed to represent a ‘rival institution’ to the nation-state Vernon (1991).

In modifying the concept of internationalisation IDI theorists were conceding that there were clear limits to the ability of macroeconomic (ie nationally based) theories to contribute to the general understanding of IDI (Gray 1982). It began to appear that the concept of internationalisation inherent in such approaches were concealing as much as it revealed. Similarly, in introducing concepts of competition and capital from industrial organisation theory, trade models became more eclectic and more like the industrial organisation models that now formed the core of IDI theory.

4.3.2 Industrial Organisation Models - Internalisation and Transaction Cost Models

The previous chapter explored how some of the central categories that became incorporated into the theory of IDI were derived from industrial organisation theory and institutional economics, particularly in terms of an institutional concept of capital, and a concept of oligopolistic competition. It was through industrial organisation type-models of IDI that the paradigm of post-war IDI theory was shifted from the portfolio investor or trading firm to that of the manufacturing firm relocating (or extending control over) production abroad. Models of IDI based on these concepts helped to solve the analytical problem of explaining the association between IDI and the activities occurring within and between industrial firms. The evolution of industrial organisation models (and changes occurring within them) in the 1970’s were also representative of several of the major developments within IDI theory. While these are explored in more detail below, two of those developments are worth noting at the outset.

One change relates to the evolving concept of internationalisation in IDI theory. Mainstream IDI theory had developed on the basis of a critique of the concept of internationalisation derived from trade and portfolio theory, but this (pre-war) concept remained important for some models of IDI. In the 1970’s, this concept became even less tenable in the face of the growth of outward IDI from an increasing range of countries, and their increasing concentration within industrial countries. The concept of capital rather than internationalisation became the critical analytical category in IDI theory as it was increasingly recognised that TNCs rather than nations invest abroad. Within the new theory of IDI, the relationship between the nation-state and the TNC (as the institutional form of capital) remained an open issue, but as noted in the previous chapter, the new concept of capital dictated a particular understanding of competition and internationalisation.

In the 1970’s, one way that IDI theory responded to this change was by further reducing the nation-state as an explanatory category of IDI, with the concepts of

---

12 It will be recalled that unlike neoclassical trade and portfolio theory, IDI theory developed a particular interest in the international industrial firm or TNC as the form of international capital.
capital and competition becoming more critical. Hertner and Jones (1986) observed that mainstream IDI theory involved a gradual move away from a reliance on what they termed 'country-oriented' explanatory factors, towards a focus on 'firm-specific' factors. This transition did not however, occur without criticism from theorists who argued for the central place of 'country oriented' factors. It was claimed for instance that industrial models of IDI had, by rendering the concept of internationalisation a derivative category of the concept of capital, left the national patterns of IDI largely 'underdetermined'.

The other issue highlighted by industrial organisation models related to the evolution of the concept of capital (and the related concept of competition). Developments in the 1970’s did not simply reinforce the trajectory of 1950’s and 1960’s IDI theory, it also forced modifications in the new theory. In response to changing IDI, the concept of capital was also modified, and this was expressed most clearly by the introduction of developments from ‘new institutional economics’. IDI theory in the 1950’s and 1960’s was informed by a concept of capital characterised as firms becoming a TNC to exploit their ownership of unique assets or possession of special (monopoly-type) ‘advantages’. By contrast, 1970’s IDI theory was increasingly informed by a concept of capital where the TNC is understood as an institution for the centralised control of a range of interrelated activities. This development was expressed most clearly by the growing use and popularity of internalisation/transaction cost models of IDI (associated especially with the work of what became known as the ‘Reading School’). Although the existence of transaction costs was advanced as a possible explanation of IDI at the same time as monopoly/advantage models (Hymer 1960), its incorporation into the theory’s concept of capital began much later (from the early-to-mid-1970’s). Models of IDI based on internalisation or transaction cost analysis represent the most important development of IDI theory in the 1970’s, and help to illustrate the analytical shift away from a reliance on monopoly-type factors as a central explanatory category.

Associated with the evolution in the concept of capital during the 1970’s was a modification in the concept of competition. The original concept of competition of IDI theory was characterised by what became known as the Hymer, Kindleberger

---

13 More particularly, the concept of internationalisation became a subsidiary concept to that of capital and competition. Not all IDI researchers followed this path, however, and for them the national or locational distribution of IDI remained the critical analytical category. Aliber, for instance, contended that, “It may be that there are no geographic patterns [of IDI and the TNC: MR] - that the country mix of direct foreign investment is random; if so there is no need for a theory of foreign direct investment” (1983, p255). Partly on this basis, he concluded that the industrial organisation models were ill-equipped to explain the changing geographic patterns of IDI in the 1960’s and 1970’s. He suggested that they continued to look at IDI by attempting to identify the characteristics (advantages) of firms that invest abroad. “Consider how this theory might explain why British firms buy US firms - it is because British firms now are generating more firmspecific knowledge? This seems unlikely, since much of British investment in the United States is in standard industries, such as banking, retail, food chains, and hotels” (Aliber 1983).

14 Aliber (1983) for instance suggested that any model of IDI was required to explain three different features of post-war IDI: the growth of firms, the international re-location of production (and control) and different national ownership patterns. Hether claimed that the last feature was a critical requirement of IDI theory, and yet few industrial organisation models of IDI had the conceptual categories required to explain it. Instead, models of IDI employed concepts used to explain either the location of production, or firm growth to explain the international pattern of ownership. Aliber concluded that these models of IDI therefore had limited explanatory power for explaining the changing national patterns of 1970’s IDI.
and Caves-type monopoly advantage models was subject to growing criticism, related to its limited ability to explain the continued growth and change in 1970’s IDI. These models predicted that only a few firms engaging in IDI from a few industries would have the ownership advantages or control over markets that would permit profitable IDI. The growing number of firms from the same industry (intra-industry IDI) had to be explained within these models either by a growth range of possible ownership advantages that permitted IDI (patent technology, product differentiation, production systems, managerial know how and so on), or by conceding that the types of market failure permitting IDI had changed to allow more firms in the same industry to become TNCs. Models of IDI based on the first approach still retained some explanatory power, but since their were now acknowledged to be many potential advantages, models based on any one of them had to surrender any claim to have developed a general model of IDI.

It was the modification of the concept of competition (as imperfect competition rather than monopoly) that enabled industrial organisation models of IDI to explain the growing number of firms engaging in IDI. Dunning (1983) referred to this in terms of an historical transition away from explaining IDI through a firm’s possession of some unique intangible asset or monopoly position towards models based on the common control of interrelated activities (especially in imperfectly structured intermediate product markets).

A further problem for the early industrial organisation models was the evidence in the 1970’s that IDI was increasingly taking place through cross-border merger and takeover. The problem was that industrial organisation models were models mainly of product market characteristics, and “...a change in the production market is different from a change in the ownership market” (Aliber 1983,p256) 15. The use of transaction cost models offered the potential to explain merger and takeover activity in terms more encompassing than simply the ‘production market’.

Finally, the early industrial organisation models tended to develop into a critique of the welfare effects of IDI and TNCs. Monopolistic market structures, and the TNC as monopolist, were central to most of these models and meant that IDI was understood as a process likely to involve the undermining of competition, the restriction of supply, or monopoly rents. In combination with the concept of internationalisation that understood MNE’s in terms of ‘foreign-ness’, there was a strong critical tendency inherent in most early models of IDI, and this provided some common ground with radical models of IDI. Transaction cost models of IDI sidestepped the debate over the welfare effects of IDI, since many market imperfections leading to IDI were understood to be endemic to particular markets and IDI did not therefore necessarily close markets in monopoly-type way.. In

---

15 Aliber went on to suggest that while industrial organisation-type models, “...may explain the advantage of source-country firms, they cannot predict the country pattern of foreign investment or its industrial pattern. Nor can they explain adequately takeovers. These theories are not integrated with alternative ways - exporting and licensing - that source-country firms might exploit the market in the host country. Finally, these explanations derived from industrial organisation lack elements of 'foreignness' in the sense that explanatory variables do not include any of the factors that distinguish national economies...These theories of the growth of the firm applied to an international economy in much the same terms as a national economy” (1972,p20).
part then, the growing use of internalisation models was also stimulated by dissatisfaction over the welfare implications of monopoly advantage models\(^\text{16}\). Internalisation models promised to side-step the welfare debate and to provide an alternative to monopoly/advantage models, which assumed IDI would be conducted by only a limited range of large oligopolistic firms, and from only a few countries. Internalisation models quickly became a key explanatory model, so much so that by the late-1970's, research into IDI and the MNE were being pursued most commonly through internalisation models (Rugman 1978; Dunning 1979; Buckley and Casson 1982)\(^\text{17}\).

Researchers using internalisation models were critical of advantage models on a number of counts. Advantage models had identified many possible advantages, but rarely specified which advantages were the most important in practice. There was also criticism that there was little explanation about how the advantages themselves come about\(^\text{18}\). Firm-specific advantages could therefore appear to come about as one-off, windfall gains. These models also rarely specified how advantages are sustained and re-created on a long-term basis. Nor were the costs of generating the advantages considered in any systematic way. Advantage models were also said to be predisposed to consider IDI and the MNE in terms of a single innovation or patent, rather than a stream of innovations. It was claimed therefore that advantage models could not adequately explain the process of IDI that related to firms with the ability to innovate and therefore sustain and expand IDI, rather than merely possessing one or more innovations (Buckley and Casson 1976).

In contrast with monopoly-advantage models, the unit of analysis in internalisation models is the market transaction (rather than the structure of the market or the market power of the firm). Unlike Marshallian price theory, where market structure was assumed to be perfectly competitive and firms were not

\(^{16}\) It has been argued that “If the only role of transaction costs was to provide a more complete theory of collusion there would have been little controversy or debate surrounding it. The controversy has arisen because it is claimed that it is the quest for efficiency in the face of transactions costs rather than the exercise of market power which has been the main determinant of the forms of industrial organisation, including the transnational corporation” (Yamin 1991, p75).

\(^{17}\) Many of the models of IDI that stressed advantage or firm-specific factors, such as certain attributes of firms (that produce market power for the firm) also tended toward a critique of the IDI process. Advantages leading to IDI were almost always grasped as a means by which one firm increases market power over other firms. By contrast, internalisation models distinguished between ‘structural’ and ‘cognitive’ forms of market failure. Internalisation models provided a way of explaining the greater scale of IDI and sidestepping the debate about the welfare effects of IDI as a product of market failure (or imperfect competition).

Internalisation models tend to view IDI and the MNE in a benign way, and even suggest that the MNE could be seen in economising terms rather than market power (Williamson 1981, 1985). While market imperfections were at the very core of IDI, the welfare implications of internalisation models were very different. Whereas advantage models emphasised ‘structural’ market failure and tended to explain IDI by a focus on advantages specific to individual firms, internalisation models emphasised ‘cognitive’ market failure, and these market imperfections may be available to all firms of a certain nation (Buckley and Casson 1976). Firms engaging in IDI may not ‘close’ markets, but by internalising certain market exchanges may merely ‘supersede’ the market. In these models, “an MNE is created whenever markets are internalised across national boundaries” (Buckley and Casson 1976). Once a firm has ‘internalised’ a market, ownership advantages may arise, but there is an important conceptual difference between internalisation models and advantage models. Advantage models tend to lead to an exaggerated emphasis on the market power effects that lead to IDI, rather than considering the efficiency and economising possibilities of IDI (Teece 1985).

\(^{18}\) With the possible exception of advantages in the product-cycle model.
important (except as the representative firm), internalisation models introduce the institutional arrangements that govern the process of exchange. As Coase claimed, in Marshallian price theory the market and firm are present, “but they lack real substance” (Coase 1992). In the post-war period, IDI could not be explained without introducing some alternative concept of market imperfection as an explanation for the growth of the firm.

For internalisation models, a modified concept of competition is employed. The market is not understood not as a friction-less mechanism. In fact, it is argued that the neglect of the existence of costs (called transaction costs) in using the market mechanism is one reason that earlier neoclassical-type models left aspects of the market process unexplained (Coase 1968; Williamson 1975). Models of IDI based upon transaction costs or internalisation were instead based upon the existence of imperfections in the market mechanism, especially in intermediate product markets. Minimising these costs is the basis for the existence (and growth of) firms as alternative institutions of exchange. There are many cases where due to market imperfections (for instance in the market for knowledge), the costs of using the market are significant and can materially affect the working of markets. Transaction cost-type market imperfections can often be minimised by ‘internalising’ market transactions within a firm.

Firms are thus conceived in terms of an institution for minimising transaction costs, where firms ‘internalise’ market transactions within the firm by allocating resources through administration (or entrepreneurial decision) rather than through market exchange. Internalisation models suggested that the multinationality of firms was derivative of the internalisation of transactions across national borders. In these cases, firms internalising a market do not necessarily close that market, because internalising transactions may actually create or ‘make’ a market, as much as superseding a market. Whereas in monopoly/advantage models only one or at most a few firms can grow in each market, for transaction cost models, several firms can internalise the inherent market imperfection without closing the market to other firms19.

The internalisation (also called transaction cost) model therefore offered an alternative explanation for the growth of firms and for the increasing scale of resources transacted within firms (rather than through the formal market mechanism). Whereas earlier industrial capital models were based on the concept of control and market power, internalisation models were based on firms minimising transaction costs or ‘internalising’ market exchange. Orthodox industrial capital models of IDI are thus considered here to be incomplete models.

Applied to IDI and the MNE, internalisation models were able to offer a number of important insights. In particular, researchers using internalisation models helped to explain the growth of investment by firms in intermediate product markets (such as raw materials) prior to the Second World War and particularly for post-war IDI as a by-product of the internalisation of markets in knowledge, especially the significance of ‘technology’ in that process (Buckley and Casson

---

19 Casson argued that internalisation must be treated as a non-monopolistic advantage, since internalisation is, in principle, available to any firm. Firms internalise markets not the advantages themselves (1987).
1976). Internalisation models concentrated on explaining the growth of IDI in areas that had stretched the capacity of monopoly-advantage models. These included IDI in research intensive industries, intermediate products (semi-finished manufactures), as well as vertical integration of firms and growing cross-investment between the advanced capitalist countries where factors such as proprietary technology seemed to be significant and profitable. Importantly also, these models helped to offer a more robust explanation for the growing numbers of firms in the same industry engaging in IDI.

Internalisation models contended that whenever the transaction costs of exchange through the international market became greater than the cost of an internal market (within the firm), there will be a reason for IDI. Two basic types of imperfection were identified by internalisation models: exogenous government restrictions creating market imperfections, or ‘natural’ (non-government) market failure such as in proprietary knowledge and information (Rugman 1981).

By the late-1970’s, internalisation models were being offered as a general theory of the IDI and the MNC, and internalisation models had also become widely used by IDI researchers (Rugman 1981) and corporate economic historians (Nicholas 1983; Jones 1987).

Internalisation models were however, not without problems of their own. One of the attractions of internalisation models was that they offered a more comprehensive account than the monopoly-advantage models of the main features of IDI. It has already been noted that internalisation models were developed without straying very far from what Vernon called the ‘comfortable pastures of static general equilibrium theory’ (1985, p.30). The neo-classical heritage of internalisation models meant that they could no more resolve all the problems of explaining changing patterns of IDI than any other model of IDI. Internalisation models were therefore also challenged by the ongoing change in the pattern of IDI in the 1970’s.

By the late-1970’s, there was a growing recognition that internalisation models did not have any inherent dynamic, and so encountered similar difficulties in explaining change as their earlier industrial organisation counterparts (Krugman 1993; Nicholas 1983; Teece 1985). For instance, the growing generalisation of IDI and the MNE, including IDI in non-intermediate product markets (in horizontal or non-related conglomerate activities rather than vertical integration, and via merger rather than greenfield investment) suggested that IDI could not be grasped only in terms of minimisation transaction costs in intermediate product markets. As has Jones and Schroter noted, internalisation models were developed:

"to explain multinationals of the classic United States type, which predominated in the world economy between the 1950's and 1970's. These were very large firms, which had gone abroad after growing in size in their domestic market. Generally, their subsidiaries were wholly-

---

20 Casson (1987), for instance claimed that the emphasis on knowledge-based monopolistic advantages had tended to obscure the important role of vertical integration in the operations of many multinational enterprises.
owned and they were fully integrated. Their ownership advantages lay in proprietary know-how and specific managerial competencies, and their international expansion could be readily explained in terms of the internalization of knowledge. The problem was this was only one type of FDI. The models need adjustment and modification when faced with different time periods, and the experience of countries beyond the United States” (1993: emphasis added).

Internalisation models were able to explain many aspects of the growing diversity of IDI and the growing generalisation of the international firms, but only at the expense of a growing generality and vagueness of the concept of internalisation itself (Dunning 1991; Buckley 1982, 1983; Krugman 1985). In an analogous way to the monopoly-advantage models then, internalisation as a general theory faced the problem of specifying the actual market activities that were being internalised as a result of imperfections in international markets. The use of the concept of internalising trade in ‘intangible’ asset markets highlights the sorts of problems involved. And internalisation models were also challenged to explain why these market imperfections needed to be internalised within the firm rather than through other forms of involvement (Parry 1975, 1985). The growth of alternative forms of control (less than majority ownership and joint ventures) therefore posed analytic problems for internalisation models (Contractor 1981; Buckley 1983).

Internalisation models retained an inherent assumption that TNCs replacing international markets do so in the form of hierarchical control, where the costs of co-ordination were less than those of market transactions. This flew in the face of evidence that many ‘subsidiaries’ of TNCs were operating with considerable independence, including in research and development activity (Ronstadt 1977; Lall 1979). The evidence of the 1960’s and especially the 1970’s suggested that the nature of ‘subsidiary-independent’ behaviour was much more diverse than predicted on the basis of the assumption of hierarchical control. In part, this was solved by introducing an institutionalist perspective to understanding the variety of forms of exchange (Williamson 1975, 1981). The firm-market dichotomy was replaced with a less binding institutional approach, where all market institutions (open markets, agency contracts, franchising, licensing, and the firm) were analysed in terms of their ability to minimise transaction costs. While this helped to spread the concept of capital to capture other institutional forms, it provided no mechanism to explain the forces that govern the transition from one institutional form to another (Nicholas 1983). And the attempt to introduce a more dynamic element into such analysis often amounted to imposing little more than a stages-of-growth program onto internalisation models. Where more dynamic approaches were employed, engagement with non-neoclassical economic theory and its methodology was increasingly required (Jones 1987). While this sometimes led backwards to an atomisation of firms as a series of contracts, it nevertheless

---

21 In other areas of economics, there was an attempt to relax the assumption that the firm is a coherent institutional entity (Jensen 1976, 1983).
helped throw open the wider issue of the problem of prematurely institutionalising the concept of capital within IDI theory\textsuperscript{22}.

A related problem was that inherent in the concept of capital of internalisation models was a focus on the internal activities of firms rather than on the movement of capital. In so doing, there was a tendency to neglect issues relating to the competitive relations between individual firms. The new industrial organisation literature became seen as too obsessed with factors internal to firms (Graham 1986). Finally, while internalisation promised to analyse the ‘institutional structure of production’ (Coase 1992), they did so more in terms of TNCs as internal traders, than of industrial capital as such. The models tended to give analytical attention to the internalising of transactions, rather than of the growing scale and scope of production by firms.

During the 1970’s, the incorporation of concepts derived from institutional economics such as internalisation and transaction costs had helped to provide a way for the new theory of IDI to adapt to the changing circumstances and patterns of IDI, and preserve its claim to have developed a general theory of IDI for all times. Yet by the late 1970’s and early 1980’s, the notion of internalisation-type models as a general theory of IDI had itself been seriously weakened.

To make internalisation models operational as a general theory of IDI, several additional assumptions about transaction costs needed to be specified, and these additional assumptions often involved extending the models by introducing concepts from other branches of economics or insights from other models (such as country-specific factors) (Casson 1982)\textsuperscript{23}. The resultant models were thus extended to attempt to capture the ever widening range of forms of IDI, but this reinforced rather than averted a tendency toward excessive generality in internalisation models. By the beginning of the 1980’s, generality had become, to paraphrase one of its earlier proponents, not a source of strength, but a source of weakness. Internalisation had become a ‘concept in search of a theory’ (Buckley 1983, 1987), and internalisation models were now being offered as an explanation only of certain types of IDI and certain activities of international firms\textsuperscript{24}.

Using the concepts of capital, competition and internationalisation, the section has shown that despite the modification of IDI theory by way of internalisation and transaction cost economics, during the 1970’s there was the beginning of the breakdown of the 1950’s and 1960’s derived general theory of IDI theory. IDI theory had institutionalised concepts based on their ability to explain the stylised facts of IDI in a particular period. In the 1970’s, this theory, albeit in modified form, was still being presented as a general theory of IDI for all times. But by the

\textsuperscript{22} It was in this context that Murray for instance had concluded that IDI theory had “gone too far in lodging the laws with which they are concerned in firms as institutions, rather than treating the latter as forms through which the laws of the market are manifested” (cited in Jenkins 1979). This problem also came into focus within IDI theory itself. The recognition of IDI theory’s preoccupation with the institutional form of capital in IDI research lead Casson, for instance, to conclude that most models of IDI had been far too steeped in the special institutional forms of foreign involvement that prevailed in the early post-war period (1986).

\textsuperscript{23} As Rugman noted in this respect, a ‘close and intimate’ relationship developed between internalisation and the ‘eclectic model’ (1985), and both approaches were involved in what became known as the ‘Reading School’ of IDI theory.

\textsuperscript{24} Related especially to the internalisation of intermediate commodity markets and vertical integration.
late 1970's, and especially in the 1980's, the notion of a general theory was increasingly being questioned.

It was increasingly argued (even by theorists who had developed them) that Models of IDI were still being offered as a robust explanation for some IDI by TNCs, but less and less offered as a general theory of IDI (Buckley 1985; Dunning 1984, Parry 1985). That models of IDI were perhaps not (or no longer) a universal model of IDI had thus become an open issue, for which changes in the 1980’s proved to be the decisive and final break (Casson 1979; Rugman 1981).
4.4 **The Eclectic Model of IDI**

One of the central arguments developed in the current chapter is that the requirements of explaining the changing historical circumstances of IDI in the 1970's began to force unitary models of IDI to relax and modify many of their analytical categories. No single model of IDI was able to adequately explain the historical evidence of 1970's IDI. In order to respond to the explanatory challenge of 1970's IDI and preserve the claims to generality of IDI theory, researchers began to adopt a more descriptive or theoretically eclectic approach to IDI theory.

The changing circumstances of 1970's IDI had helped to produce both a growing range of different definitions of IDI and the MNE, and a recognition that the differences between various definitions were a reflection of differences in the actual forms of international of production and exchange\(^1\). In a similar way, it was increasingly accepted that the differences between models of IDI were a reflection of the fact that they were offering an explanation of different types of IDI. The chapter has shown the impact of these developments on IDI theory in terms of a relaxation and modification of the 1950's and 1960's-derived concepts of competition, capital and internationalisation within the prevailing models of IDI.

An explicitly eclectic model of IDI also emerged in the 1970's, most closely associated with the work of John Dunning (1976). Dunning, who had undertaken some of the pioneering empirical research into IDI in the 1960's, adopted a somewhat different theoretical starting point to the unitary models. The unitary models of IDI had been forced to resort to eclecticism to explain the 'facts' of 1970's IDI, because those facts no longer fitted any one theory. The Eclectic Model (EM), on the other hand, adopted theoretical eclecticism as its starting point. Through it, the EM came to embody the central categories of post-war IDI theory. Heterogeneity of forms of IDI had become important and the EM was a formalised attempt to incorporate that diversity in IDI theory. The EM was therefore based on an attempt to explicitly recognise that "a full explanation of the transnational activities of enterprises needs to draw upon several strands of economic theory" (Dunning 1988). The contrast between the EM and other models was therefore partly one of starting point. While some writers had resorted to eclecticism to explain the changing 'facts' of IDI because the facts didn't fit any one theory, the EM was motivated by a theoretical eclecticism from the outset.

The EM promised to resolve the weaknesses of the unitary models (their inability to explain more than a part of the IDI process or of IDI for a particular period) and it did so in a way that seemed to represent the most general model of IDI. The EM quickly became a widely used model of IDI research. Initially proposed as a general theory of IDI, the EM also represented an explicit recognition that because there were different types of IDI, no unitary model of IDI could provide a general explanation of all types of IDI. Furthermore, it will be shown that the EM, as much

\[^1\] Aharoni (1971) for instance suggested that the differences in definition were "not merely a question of semantics...there are several kinds of so-called multinational companies. The realization of heterogeneity of the field seems to be of the utmost importance".
as the unitary models, still left open the methodological issue of how change was to be understood within IDI theory.

The EM developed a framework that incorporated the key categories from several models of IDI into one overarching explanatory framework. The EM developed an explanation of IDI through three broad categories - ownership, location and internalisation. From trade models, it developed what were called the location advantages of particular nations that permitted its firms to engage in IDI. From the early industrial organisation models of IDI, it derived what were called the ownership advantages of particular firms that permitted them to engage in IDI. And from the later industrial organisation models, it obtained what were termed factors relating to the internalisation of inherent market imperfections. These elements were brought into the model through the three categories (ownership, location and internalisation, or OLI)².

Through this synthesis of elements from other models of IDI, the eclectic model was able to offer a much more robust and comprehensive set of categories for explaining IDI. Because it could unite the various models of IDI and rescue the claim of IDI theory to have developed a general model of IDI, it promised to be of use in almost all instances of IDI and the MNE.

Nevertheless, the question remained whether the eclectic model was more than the sum of its parts. Indeed, most of the problems of the individual models upon which the categories of OLI were derived, also existed for the eclectic model. A general point here related to how the problems facing models that formed the basis of the eclectic model were to be overcome by blending them together. A second point was that the eclectic model was largely static and had no inherent dynamic content. It too then was confronted by ongoing change in IDI. Despite the appearance that the EM offered a resolution of the problems of unitary models, the explanation of ongoing change therefore remained just as much a problem for the eclectic model as for other models of IDI. As has been noted already this problem of change also raised methodological issues for IDI theory in general.

The eclectic model also created additional difficulties of its own. The advantages offered by the eclectic model, in terms of breadth and comprehensiveness of coverage, came at a cost. One of the most important problems related to the question of how analytical coherence would be maintained in a model that blended several 'strands' of economic theory. A key issue here was that in incorporating insights and concepts from a range of models, the EM was based on an inconsistent ensemble of concepts. While these inconsistencies were recognised by other IDI theorists, they can also be shown through the way the EM deployed concepts of capital, competition and internationalisation³.

---

² These categories are not coincident with the categories of internationalisation, capital and competition, developed in this thesis, but there are obvious similarities.
³ For instance, Krugman raised two problems for the EM. The first was how were the elements of the eclectic model related, and how were they to be deployed systematically without degenerating into a sort of descriptive checklist. A related issue was that to the extent that the eclectic model moved towards a more explicitly descriptive approach, it ran the risk of becoming an explanation only of the effects of IDI (Krugman 1987). Finally, it was recognised even by Dunning himself that the EM did not resolve the issue of explaining change.
The ownership advantages permitting profitable IDI are based mainly on a concept of capital and competition of the Hymer-Kindlebereger-Caves type. In this sense, IDI is understood to be the more or less exclusive preserve of a relatively few firms in a narrow range of industries characterised by monopolistic market structures, or by firms with technological or marketing leadership. In these cases, IDI is market closing in nature. With internalisation factors on the other hand, the concept of capital and competition are cast rather differently. The internalisation factors, which are of the Buckley-Casson-Rugman-type, incorporate a concept of capital and competition where profitable IDI can be undertaken by a wide range of firms (when transaction costs are high or the potential to internalise an intermediate product markets exist). In this case, IDI does not necessarily close markets or require monopoly advantages. Both internalisation and ownership factors share a focus on a particular institutional concept of capital and on imperfect markets as a concept of competition. The concepts incorporated in ownership and internalisation are however both inconsistent with those involved in the locational advantages category. Locational advantages that permit IDI are based on a concept of internationalisation derived from trade theory. Here, national factors are understood as the major determinant of IDI, and IDI is understood as an extension of these national factors. In these terms, firms and markets are subsumed by and become derivative of the national factors that characterise IDI, and IDI becomes understood in terms of trade relations. The EM did not specify the relationship between the categories, nor how the categories were articulated.

In retrospect, but especially in terms of the conceptual categories that have been used to understand the development of the EM, it is possible to understand why the model would face problems dealing with both the relationship between the multiple forms of IDI, and with ongoing change in patterns of IDI. The limitations of the EM did not become acute until the 1980’s in the face of further transformations in the stylised facts of IDI in that decade. At the close of the 1970’s, the eclectic model seemed to offer a general and flexible model for IDI research. And the increasing resort to eclecticism in IDI theory can now be seen as a pre-cursor to explicitly eclectic (and descriptive) models of wider international economic processes in the 1980’s (Porter 1986). Even though the EM seemed to preserve the claims of IDI theory to being a general theory of IDI for all times, it did so in an environment where, to paraphrase D.K. Fieldhouse (1986), the earlier certainties of IDI theory were now under question. The explanation of the ‘stylised facts’ of 1980’s IDI would necessitate the addition of even more elements to the original eclectic model, and culminate in Dunning renouncing his claim of ever having propounded the EM as a general theory of IDI at all. Thus one of the effects of transformations in the 1980’s and 1990’s would be that while the EM remains perhaps the main model of IDI research, it is no longer presented as a general theory of IDI but as a descriptive research paradigm.

Nevertheless, by the close of the 1970’s, the issue of the clash of IDI theory and the history of IDI itself was resulting in a common resort to eclecticism.
4.5 **Summary and Conclusion**

In the 1970’s, IDI research based on the new general theory of IDI flourished in an environment of continued IDI growth, and theoretical interest in the phenomenon of IDI remained high. For most of the decade, researchers shared a generally optimistic outlook about both the importance of the IDI process and about the development of a general theory of IDI. During the 1970’s, there were however a number of important transformations in the pattern of IDI that were challenging to aspects of IDI theory, and researchers began to raise critical issues firstly about particular aspects of IDI theory. Within a few years, these doubts would be extended to the whole research paradigm of IDI theory. In the face of transformations of 1970’s IDI, some models of IDI were discarded, especially those that retained significant elements of pre-war international trade and finance theory. On the other hand, other models seemed to be better able to explain the changes in the 1970’s, and this provided researchers with a new burst of theoretical optimism. But in order to preserve claims to have developed a general theory in the face of changing patterns and characteristics of 1970’s IDI, researchers were forced to modify some of the original assumptions and concepts of post-war IDI theory.

Although it was now recognised that IDI was an important structural feature of the world economy, the nature of the IDI process was still undergoing considerable change. Those changes could be captured by the 1950’s and 1960’s derived theory, but only at the expense of introducing an increasingly eclectic and descriptive elements to the general theory. Several of the more perceptive IDI theorists began to raise doubts about some of the more exaggerated claims being made to have developed a general theory of IDI. By close of the 1970’s then, the ‘heroic age’ of IDI theory was over, and IDI theory had reached something of a hiatus.

The 1980’s was to prove a watershed in the post-war development of IDI theory. Whereas in the 1970’s, there had been a growing recognition that all models of IDI were encountering difficulties in explaining some aspect of the ongoing growth and change in the stylised facts of IDI, in the 1980’s, structural weaknesses had been identified as common to all theories (Casson 1986, Fieldhouse 1984). By the mid-to-late 1980’s, this had extended to a recognition that there was no really satisfactory general theory of the MNE (Casson 1986). Theoretical scepticism even extended to the conclusion that no such general theory was possible at all (Dunning 1987). The remaining chapters of the thesis will explore how the explanation of the stylised facts of 1980’s IDI turned a general uncertainty about how to reconcile ongoing change through the existing models of IDI, into a generalised crisis in IDI theory.

---

4 The reference to the end of the heroic age is a paraphrasing of Paul Krugman’s comments about problems being encountered in the 1970’s by exchange-rate theory.
APPENDIX 4.1 TRADE MODELS OF IDI

4.1.1 The Product-Cycle Model of Trade and IDI

One of the most influential attempts to explain post-war IDI within the broad tradition of trade theory became known as the Product-Cycle (P-C) model, and was closely associated with the work of Raymond Vernon (1966, 1967, 1971, 1974, 1979). Charles Kindleberger (1981) suggested that the P-C model was one of the most important non-industrial organisation models of IDI. The P-C model provided some new and important insights into the post-war growth of IDI from the US manufacturing industries, and also seemed to account for the early growth of IDI from many MNEs from Europe in the late 1960’s and early 1970’s.

The P-C model is also important for the thesis because it helps to show the evolving concept of competition in IDI theory. In this sense, the P-C model represented a bridge between 1950’s and 1960’s IDI models based on the concept of competition as monopoly/oligopoly and the less binding concepts of competition that began to be employed in the 1970’s. The evolution of the P-C model also shows how even trade-theoretic models of IDI were forced to concede the institutional concept of capital to explain developments in the stylised facts of IDI, a concession which also had implications for the concept of internationalisation. Although first propounded in the mid-1960’s, the P-C model became most popular as an explanatory model for IDI research in the late 1960’s and especially in the 1970’s. It will be considered here in some detail in the context of IDI in the 1970’s, focusing on how the concepts of competition, capital and internationalisation were developing (and adapting).

The P-C model was attractive to IDI researchers in the late 1960’s and early 1970’s for at least two reasons. Firstly, by providing a way of explaining IDI in terms that remained compatible with orthodox trade theory, the P-C model seemed to preserve (or restore) the credibility of the conceptual agenda of trade theory as a general theory of the international economy. This meant that initially at least the P-C model was articulated through trade theory’s concepts of internationalisation and capital, with only the concept of competition modified.

Secondly, and importantly for IDI theory, the P-C model offered a way of explaining and predicting change (in the stylised facts of IDI in the late 1960’s and early 1970’s) that had not been possible in either other trade or industrial organisation models. The previous chapter noted how the pattern of early post-war IDI became crystallised in the conceptual categories of IDI theory, and this made it seem as if the particular characteristics of that period were universal. Explaining changing IDI in the late-1960’s and early-1970’s therefore began to pose difficulties for most models IDI that had become based on concepts that were inherently ahistorical and static. The P-C model on the other hand suggested that there was a regular path (or life

---

5 Kindleberger termed it one of the most important ‘post-Hymerian’ models, meaning that it developed an analysis not suggested or anticipated in the writings of Stephen Hymer in the early 1960’s.

6 This applied especially in later attempts to use the P-C model as a vehicle for a synthesis between trade and industrial organisation-based models of IDI.
cycle) of change which affected the relationship between trade and international production over time. The P-C model therefore was based on the expectation of change and provided a way of modelling that change. The lack of dynamism of most other models of IDI made the P-C a very attractive way of dealing with changing IDI.

Like many trade-based models of IDI, the P-C model retained a focus on the differing national patterns of IDI and the national characteristics that gave rise to IDI. That is, the P-C model understood IDI in terms of a concept of internationalisation of trade and portfolio theory - as an outgrowth of national economic activity. The P-C model also located the reasons for IDI in terms of market imperfections, specifically in imperfect international markets for new technology-based products (and for the propensities to develop them), which were almost akin to the comparative advantage concept of factor endowments. According to Vernon, “In a world in which new products are constantly being launched in the marketplace, the trade patterns of any country may well be shaped by the innovative propensities of its businessmen, scientists and engineers. Some countries may be predisposed to develop one kind of product, some another, some not at all” (1972, p.97).

It was suggested within the P-C model that the post-war pattern of IDI was due to the fact that there was an unequal distribution (or endowment) of innovatory capacity between nations, and that there was a regularity in the innovations that emanate from one country to the next. This was the proximate cause of why manufacturing firms from the US were so prominent in IDI, why outward IDI from the US tended to be directed mainly to other developed countries, and why early post-war overseas manufacturing investment from the US was concentrated in research intensive industries. With some later modification, the P-C model also seemed to explain the early growth of outward IDI from European countries.

Post-war IDI from the US was explained by the P-C model in terms of linkages between the national patterns of new product innovation, trade and the international location of manufacturing. Vernon suggested that the rapid growth of IDI from the US was a result of the historic development of US industries as the innovatory leaders. This meant that IDI could continue to be grasped in terms of different national characteristics that was at the core of trade theory.

The P-C model thus began with the observation that in the post-war period the national distribution of innovations and the propensities to produce them were not randomly but unequally distributed in a systematic way between countries. In part this was thought to relate to the fact that innovation requires a body of trained engineers, and interested businessmen, and in part because it requires consumers with the capacity to purchase the new products. The patterns and behaviour of MNEs were assumed to be influenced by the nature of the national market (or country-specific factors) in which the MNE is based. “These factors seem to generate a certain regularity in the innovations that emanate from one country to the next” (1972, p.97). The post-war expansion of IDI (especially from the US to Europe) could be accounted for by the fact that US emerged from the Second World War with

---

7 The P-C model can taken as a bridge between the 1960's monopoly 'advantage' models and 1970's models of IDI that incorporated a concept of imperfect competition.
technological advantages in many industries. Through a more affluent consumer market, US firms had a market that could pay for the higher cost of new innovatory products, and through IDI, US firms were attempting to move from exporting to production in Europe. IDI thus enabled US firms to maximise technological rents internationally as the product life cycle evolved.

Vernon suggested that two inter-related features of post-war international investment indicated that a relationship existed between trade and investment. First, IDI was led by firms that were in industries that were leaders in technology or innovation in their home country. In trade terms, outward IDI was occurring from industries that seemed to embody the country’s ‘comparative advantage’, it was just that firms and industries were expressing comparative advantage by way of investment in production abroad. Furthermore the location of innovation was almost always based in the home nation of the parent company, because of a link between the location of innovation and the national characteristics that help to produce the innovations (countries with high incomes and high unit labour costs are more likely to produce innovations). Combined with the observed unequal distribution between firms and nations in the techniques of production and the capacity for innovation, Vernon suggested that the P-C model could be used to explain both the causes and patterns of both trade and IDI, especially the post-war dominance of global IDI growth from the US. Outward IDI from the US in the 1950’s and 1960’s seemed to be closely related to the fact that the US emerged from the Second World War as the leading industrial nation with a clear leadership in certain areas of technology. In turn, the process of post-war IDI helped to contribute to extending the lead of the US in the international economy\(^8\). The P-C model could also explain the stylised fact that much of the outward IDI from the US was going to other industrialised countries. In turn, the emergence of outward IDI from other industrialised countries in the late 1960’s and 1970’s was also compatible with the P-C model.

The P-C model proposed that national trade and investment patterns can be understood through the analogy of the life cycle of new products (in turn based on the biological analogy of organisms). Products and therefore industries as well go through a regular and definable life-cycle and in an international economy the life-cycle of products affects the pattern of trade and international location of production\(^9\). Three phases in the life cycle of a product were identified (innovation, maturity and senescence), and each phase carried with it implications for the location and pattern of cross border trade and investment. The first phase of the cycle - innovation - was concerned with the initial phase of new product development. Innovation tended to be concentrated in the most affluent and highly skilled countries, which could provide the skilled labour necessary for new product development and bear the extra costs of buying the new products. Consequently, it

---

\(^8\) According to Vernon “What is stressed therefore is the advantages of the US market that had historically given the US enterprises a lead in certain categories had been extended to provide an even larger lead...” (1971, p91-2).

\(^9\) According to Vernon, “Products commonly move through a cycle from birth to senescence. During the cycle, the demand for the product grows, the technology associated with its production is diffused and appropriated, and specifications defining the product become more standardised. As demand grows, the threat of new entrants tends to grow... When the threat of new entrants becomes acute, the established leaders in the industry sometimes try to distinguish their product from those of others [by advertising or other product differentiation: MR]. At other times, however, the leaders have sloughed off products as they have lost their distinctive characteristics and turned to the generation of new products”.
was proposed that production would be initially based in the country where the innovation is developed and where the initial market is located. In the second (maturing) phase, the market for the product has grown beyond the innovating country and is being exported to other countries. The question then becomes finding the factors that determine whether new markets will be met by production for export or production in the market itself (or some third location). Importantly, production for export and production in the market are now considered as alternatives (or substitutes) for each other.

The product cycle could thus be seen to lend implicit support to the criticism that much IDI was ‘trade substituting’. In the third (senescent) phase, the market demand continues to grow, but so too does the diffusion of technology associated with the product. The product becomes fairly standardised, and is therefore subject to competition from imitators and other competing products by new entrants. According to Vernon, “As demand grows, the threat of new entrants tends to grow... When the threat of new entrants becomes acute, the established leaders in the industry sometimes try to distinguish their product from those of others [by advertising or other product differentiation: MR]... At other times, however, the leaders have sloughed off products as they have lost their distinctive characteristics and turned to the generation of new products”.

In the 1970’s, even the evolving patterns of US IDI was increasingly inconsistent with the P-C model. These patterns increasingly suggested that the P-C model had both an outmoded notion of capital (of the firm as a technology producer) and internationalisation (the relocation of manufacturing production). IDI outflow was not necessarily based only in R&D intensive industries, and the nature of the national spread of the innovation process did not conform with the stages of the P-C model. Rather than innovation occurring initially for the market of its development and then the product transferred to another country by export or IDI, products were being developed and designed for international markets and the location of that development was also subject to international determination. International calculations of markets were becoming a continuous process, not occurring as a spillover when national markets were being exhausted. Further problems were identified for the P-C model in the 1970’s as IDI increasingly occurred in manufacturing industries at all stages of the ‘life-cycle’, and in many sectors that had no apparent innovation (or with relatively low levels of R&D). Perhaps more problematic still was the increasing prominence in IDI growth of firms in non-manufacturing industries, especially in tertiary industries, and that IDI was increasingly being undertaken via merger and takeover activity. This suggested that MNEs were becoming more than simply a mode of cross-border relocation of manufacturing over a life cycle from trade to production.

MNEs had been prominent in primary extractive industries in the nineteenth and early twentieth century, but IDI growth in the 1950’s and 1960’s was dominated by IDI in secondary industries. The P-C model provided little explanatory capacity for either IDI in non-technology-based manufacturing IDI or service industry IDI. It was found for instance that the P-C model was based on an assumed choice between

---

10 With these global products only being differentiated for local tastes.
exporting and production abroad and the progressive evolution from the former to
the latter. That model did not apply to many sectors because "...some services (and
indeed non-traded secondary industries: MR) require foreign direct investment or
alternative non-equity forms of international product from the very beginning, when
part of the product-delivery-use chain must be performed abroad" (Boddewyn et al.
1986)\textsuperscript{11}.

Apart from empirical problems, two methodological objections to the P-C model
were also raised. One objection related to the ability of the P-C model to explain
changing patterns of IDI. The P-C model's ability to inject dynamic content into the
explanation of post-war IDI seemed to be one of its major strengths over other
largely static IDI models. Change was embedded in the P-C model, but only by
imposing a deterministic and programmatic (life-cycle) methodology onto the theory
of IDI. In part, this life-cycle was informed by the concept of competition where IDI
was linked to monopolistic industries with unique advantages. As IDI emerged from
industries without identifiable uniqueness, the idea of life cycle was undermined.
Moreover, the whole methodology was itself based on the particular pattern of US
IDI in the 1950's and 1960's IDI, and was thus vulnerable to evolving patterns and
processes. The PC model also began to breakdown in the face of 1970's IDI, and
perhaps surprisingly (considering its more explicitly dynamic approach), its
breakdown was much more rapid and final when it did come.

A second and related methodological objection raised about the P-C model was that
it tended to treat different phases in the life-cycle (and decisions about product
development, method of servicing markets, and competitive rivalry between firms
made within the stages) as separate and distinct phases. It was suggested that this
tended to oversimplify and artificially separate the problems facing the international
firm and the inter-relatedness of decisions between phases (Buckley and Casson
1976; Giddly 1978; Buckley 1987). This problem can be understood in part in terms
of the P-C's concept of internationalisation, which attempted to identify TNCs (and
their new products) as spreading out from their 'home' nation in a regular and
predictable way. In the face of the increasingly explicit global orientation of firms,
this national identification of capital and the programmatic life-cycle was being
made obsolete.

Vernon responded to some of the criticisms by initially suggesting several
modifications to the P-C model. In doing so, Vernon was forced to concede more of
the conceptual agenda of IDI theory. Firstly, he introduced a more explicit
recognition of the concept of monopoly in the determination of IDI patterns.
According to Vernon, IDI was now becoming associated with oligopolistic, as well
as technological factors. He therefore introduced oligopolistic market behaviour as a
co-determinant of IDI, along with technological/innovatory factors. This was
achieved by changing the concept of competition by incorporating elements of

\textsuperscript{11} IDI in the financial services sector became a particularly active area of international investment in the 1970's
as banks began to establish subsidiaries abroad in the 1970's, as part of the internationalisation of both credit and
credit institutions. IDI in the financial services sector also raised the issue of the distinction between IDI and
international loans and portfolio investment. IDI was also occurring in industries such as hotel chains, soft drink
manufacture and brandname foodstuffs, that were not noted for research intensity, and an explanation that
pivoted on technological leadership was challenged by the broadening of IDI patterns, many of which seemed to
be only slightly related to investment patterns caused by product trade life-cycles (Huftonauer 1975).
oligopoly and market-power into each of the phases of the P-C model. Vernon also recognised that the institutional form of capital had become a conspicuous feature of IDI and had ramifications for the concept of capital and internationalisation. He suggested that with monopolistic market structures, the large MNE had emerged as a powerful institution, that had transcended its national base. In fact, the MNE was an institution that was coming to ‘rival’ the power of nation-states (1971, 1972, 1979). While recovering some of the explanatory power of the P-C model, the modifications meant that Vernon was “virtually admitting the redundancy of the simple [P-C] model” (Buckley 1987).

Despite these attempts to modify the P-C model, by the late 1970’s, the modified P-C model had lost much of its relevance even for explaining the major features of prevailing US manufacturing IDI (which it had been designed to explain), let alone service sector IDI and IDI from other countries. Giddy (1978) for instance suggested that the product cycle approach had become inconsistent with much of international trade and investment, and that the P-C model had only limited explanatory power for the behaviour of international business. This was conceded by Vernon (1979) at he close of the decade, when he observed that because of two critical changes in the pattern of IDI and the structure of TNCs, the explanatory power of the P-C model had been eroded.

The first change related to the concept of capital. The growing geographical reach of TNCs was undermining the notion of a product life-cycle. Because most new products were being developed by TNCs - firms that were already internationalised - the sequence between domestic innovation and production, export and the international relocation of production had become highly compressed. He concluded that there had been a basic change in the institutional structure of the MNCs concerned, which in turn affected the required notion of internationalisation. Many US firms had now developed global networks and were effectively being transformed from multinational to global firms. Secondly, the income gap between the US and other advanced industrial countries was being eroded and this weakened what Vernon conceded was a ‘critical assumption’ of the P-C model, that firms confronted markedly different conditions in their respective ‘home’ markets.

Vernon concluded that the P-C model still continued to retain some explanatory power for a certain category of IDI, but could no longer claim to be a general model of IDI for all US firms. The P-C model could still be a model of IDI for smaller US firms (i.e. those that had not yet acquired a capacity for global calculation), and for aspects of IDI by firms from some other countries. Thus, in a little over a decade after its first development, the P-C model had undergone its own ‘life-cycle’ from a general explanation of post-war trade and investment to an explanation of one aspect of IDI. As Richard Caves (1979) noted, with this auto-critique, the product cycle was effectively laid to rest by it progenitor. The only issue that remained was whether there were elements of the P-C model that could be retained in IDI theory, or whether the P-C model had been a cul-de-sac in IDI research. Some researchers suggested that the P-C model still retained value as one facet of a more general

---

12 Vernon cited evidence suggesting that whereas in the early 1950’s less than 10 percent of new products were transferred overseas within the first year of development, by the mid-1970’s the proportion of new product transfer occurring within one year had grown to 33.4 percent.
phenomenon (Giddly 1979), and others suggested that one of its central hypothesis still retained validity - that international investment is led by technological leaders (Cantwell 1995). Fieldhouse (1986) on the other hand, concluded that even though from the start it was recognised that it was a model restricted to explaining American post-war industrial experience, by the later 1970's it had lost much of its relevance even for the more advanced US industries. He concluded that in retrospect the P-C model as a general theory of IDI and the MNC was a 'sidestream concept' in which the concept of a monopoly rent was replaced by product life-cycle.\(^{13}\)

### 4.1.2 The 'Trade Enhancing' (Kojima-Ozawa) Model of IDI

One way that the concept of internationalisation of trade theory was preserved occurred in terms of using observable national differences in the patterns of IDI as the basis for characterising 'national types' of IDI. The Trade Enhancing (T-E) model of IDI is a useful example of this approach. The 'trade-enhancing' model of IDI was not an entirely empirically-based explanation of actual national patterns. Rather it was an attempt to demonstrate both empirically and theoretically that IDI outflow from Japan was different, and to suggest that these differences had important positive welfare effects for host nations.

The growth of outward IDI from a wider range of advanced industrial nations from the mid-to-late 1960's (noted in the stylised facts section) was in contrast with the early post-war growth of IDI dominated by the outflow from the US (which was one reason that IDI became known as the 'US model' of international investment). While there were many similarities between the observed characteristics US IDI and IDI from European countries, some significant differences were also found (Franko 1974). Even more significant differences were found between US IDI and outward IDI from countries such as Japan in the late 1960's and early 1970's. The different national characteristics of IDI from the newer IDI countries suggested that different explanatory models might be required, and the explanation of the distinctive nature of IDI from Japan was developed into an alternative model of IDI that became known as the Trade-Enhancing (T-E) model.\(^{14}\) Even though in many respects, the T-E and the P-C models share almost the same conceptual ensemble, the T-E model as an explanation of 1970's IDI from Japan stands in direct contrast to the P-C model of IDI as a model of 1950's and 1960's IDI from the US.

One of the distinguishing features of the T-E model of IDI was that it attempted to link the concept of capital and competition to the concept of internationalisation. Research into outward IDI from Japan revealed that there were several important

---

13 The P-C model and the promise it offered of synthesising trade and IDI theory and explaining national patterns of cross border exchange over time remained popular even through the 1980's. International economists suggested even in the late-1980's that the P-C model continued to have intuitive appeal and still offered important insights into the growth and diversification of IDI during the 1980's (Allen 1988, p13). Other researchers have used product and trade cycle-type models as a way of explaining changing national patterns of industrialisation and industrial leadership (eg. 'flying geese' and 'leapfrogging'). These were more a models of national industrialisation strategies than of trade and IDI. However, perhaps Vernon should have the last word. He concluded that whereas the nationality of firms seemed to be a significant factor affecting the behaviour of TNCs, models of IDI that draw on the national origins of TNCs as a major explanatory variable have been rapidly losing their value (Vernon 1992).

14 Also known as the Kojima-Ozawa model after its main authors.
differences between the national pattern and characteristics of early post-war US IDI and 1970’s IDI from Japan. Firms investing abroad from Japan shared the characteristic of MNEs from other countries in being larger on average than the typical domestic firm in the home country. But unlike MNEs from the US, those from Japan were not significantly different from large Japanese non-MNEs in terms of R&D, marketing and diversification strategy. One of the most distinctive features of early outward IDI from Japan was that whereas most US (and European) IDI was directed to other industrial countries, outward IDI from Japan seemed to be concentrated in developing countries in Asia.

In particular, overseas production by Japanese-based subsidiaries was concentrated in industrialising (or developing) countries in Asia and Latin America. In the early 1970’s, half of the subsidiaries of Japanese MNEs were located in Asia and a further 20 percent were in Latin America (Yoshihara 1979). It was also found that the institutional form of capital from Japan was different in that the wholly-owned subsidiary was not the usual way way of transmitting IDI. Approximately two-thirds of establishments by MNEs from Japan in the early 1970’s were in the form of minority-owned or joint ventures\(^\text{15}\). This compared to subsidiaries of US MNEs of which nearly two-thirds were wholly-owned and subsidiaries of European MNEs where the use of the wholly-owned subsidiary was more common than by Japanese MNEs, but not as common as by MNEs from the US (Yoshihara 1984).

It was hypothesised that just as there were identifiably national patterns of trade, there were also distinctly national patterns of IDI. Furthermore, those distinctly national patterns of IDI (and national patterns of TNCs) could be differentiated on the basis of their trade effects. Kojima and Ozawa suggested that two types of IDI could be identified. IDI from the US and some ‘older’ investing countries were directed mostly to other developed countries, suffered from problems such as monopoly power and tended to occur in place of production for export from the home nation (i.e. had ‘trade-replacing’ effects). This they termed ‘US-type’ or ‘trade destroying’ IDI. By contrast, IDI from other countries, notably from Japan, could be characterised as being ‘trade-enhancing’. It tended to be directed mostly to developing countries, was derived from industries that had lost ‘comparative advantage’ in the home country, and did not suffer from problems of monopoly power.

The two types of IDI were also differentiated in terms of the national type of competition. American type IDI was characterised as investment that was motivated by the attempt to extend market power from the leading industries (i.e. monopoly industries which embodied US comparative advantage)\(^\text{16}\) in the home country to the host market, and was therefore directed mostly by way of wholly-owned subsidiaries to the major markets in other developed countries. As a consequence, the

---

\(^{15}\) The location of the subsidiary was an influential factor in determining the nature of the ownership/control, so that subsidiaries in developing countries were mostly minority-owned, whereas only about one-third of subsidiaries in developed countries were majority-owned.

\(^{16}\) Kojima used concepts from the product-cycle model to suggest that ’American-type’ IDI takes place at the top of the product cycle where firms relocate to the export market in an attempt to preserve their oligopolistic positions in those markets. As a consequence, American-type IDI substituted exports from the home market for production in the host market. By contrast, ’Japanese-type’ IDI seemed to run counter to the product cycle and was taking place much earlier in the product cycle and therefore more ’trade-oriented’. 
international relocation of production either was unrelated to trade or more commonly substituted for trade. This underscored American type IDI as a ‘trade replacing’ type of IDI.

It was suggested that outward IDI from Japan (or ‘Japanese type’), on the other hand, was a different model of competition. Outward IDI from Japan was identified with the international relocation of industries in which Japan had lost comparative advantage to developing countries which could form the basis of a comparative advantage in the developing country. IDI from Japan was also investment released from comparatively disadvantageous industries, often conducted through joint ventures and minority-owned affiliates to countries that lacked the capital, technology or management skills. That investment ‘harmoniously’ promoted an upgrading of industrial structure on both sides and thus speeds up the extension of trade between the two countries. Kojima argued that ‘Japanese-type’ IDI was therefore trade-oriented and “plays the role of initiator and tutor in industrialisation of less developed countries countries” (1978, p17)17.

Even by the time the trade-enhancing model of IDI had been developed, many of the suggested differences between IDI from Japan and elsewhere had either disappeared or were already beginning to break down, forcing modification in the concepts underpinning it. Outward IDI from Japan during the 1970’s moved increasingly toward other developed countries, and was especially directed to the US and Europe, where most of the subsidiaries were of a majority and even wholly-owned type18.

One way the T-E model was modified to account for these developments was the proposition that Japanese cross-investment was motivated by different factors - the attempt to overcome trade barriers. The problem here was that these trade barriers (market imperfections) had already been found inadequate as an explanation of post-war IDI from other countries. It was observed for instance that trade barriers were of limited importance in the growth of international manufacturing from the US (Franko 1976). Kojima also suggested that Japanese investment in the US actually remained trade creating, because the much of it was occurring in service industries, such as the establishment of subsidiaries of trading companies and banks, and these firms played a role in reducing the international transaction costs of trade (1979, p173). This approach increasingly looked like emphasising particular patterns rather than a new model. A high proportion of outward IDI from Japan was also going into industrial production in Europe and the US aimed not at re-export, but to service those markets. The T-E model was also criticised even on its alleged developing country benefits. It was pointed out that to the extent that outward IDI from Japan was directed to developing countries, it was not full-scale IDI, but rather largely confined to assembly operations, as part of a relocation to low labour-cost areas.

---

17 In that sense, this was a model of once-off, not of ongoing the IDI growth. A logical conclusion of the model would be that the growth of ‘Japanese-type’ IDI to developing countries might be fairly short lived and would abate and even decline once those countries accumulate their own capital and technology. This was conceded by Kojima who suggested that once “the foreign firm has completed its job as a tutor, it should transfer ownership by stages to the host country” (1982).

18 It was also pointed out that the claim that minority-ownership was characteristic of Japanese MNEs is mediated by the fact that many minority-owned subsidiaries and joint ventures were joint-ventures with other Japanese firms, especially Japanese trading companies.
Whatever the later empirical problems with the T-E model, it had been developed on the basis of attempting to generalise from the pattern of IDI from one country and over a relatively brief period (the late 1960’s and early 1970’s). It was not in that sense a model claiming to represent a general theory of IDI, and even by the late 1970’s, the changing pattern of IDI from Japan had undermined the explanatory capacity of model even in relation to Japan. Developments during the 1980’s were to provide even more substantial empirical problems for the model.

In retrospect, the main theoretical significance of the T-E model was that it challenged the universality of all existing (and perhaps future) models of IDI (Giddy and Young 1982). Implicit in the T-E model was the proposition that no one model could adequately capture the different national patterns of IDI (even the later rejection of the T-E model suggested that no nationally-based model could explain even patterns of any one nation over time). That different national models of IDI could be observed - was an indication that IDI researchers were beginning to concede conceptually that modern theories of IDI, based on the post-war growth of IDI from the US, were no longer capable of providing a general explanation of all forms of IDI. The other implication of the model - that national T-E models of IDI could be superseded over time raised the wider question (echoing Vernon’s autocritique of the P-C model) of the conceptual power of explanations of IDI that hinged on the nation-state.

While there was an ongoing attempt to understand the national effects of IDI and explain IDI through national categories of trade and balance of payments, there was a growing switch of emphasis toward explaining international production through the characteristics of firms and markets. During the 1970’s, trade-type models were actively used for IDI research, but by the end of the 1970’s trade theory and its conceptual framework, had been largely surpassed by the use of industrial organisation theory as the central framework of IDI theory (despite the development of some new models for explaining IDI discussed above). To paraphrase Dunning, the study of IDI increasingly became the study of the MNE (Dunning 1984).

4.1.3 Dependency Analysis as a Model of IDI

An important strand of analysis of post-war international capital was developed under the rubric of dependency analysis. While dependency analysis was developed largely in relation to the analysis of the investment and trade relations between the US and the nations of Latin America 19, dependency analysis was also used to explain IDI in advanced capitalist countries, such as Australia and Canada. In this way, dependency analysis became an influential strand of radical analysis of IDI.

Dependency analysis is drawn from a variety of intellectual traditions, but in some areas at least, it is nevertheless possible to identify a shared conceptual discourse and a common methodology. This framework makes it is possible to define dependency analyses as a cohesive body of work (Brenner 1977; Palma 1978; and Cypher 1979). It must be noted at the outset that dependency analysis was in many respects

19 The origins of dependency analysis is usually traced to Paul Baran, who it will be recalled from Chapter 3, was also a critical figure in the Monopoly Capital model of IDI.
developed to explain different processes than just post-war IDI, and thus much dependency analysis is beyond the range of this thesis and its propositions. Yet it will be shown here that part of the cohesiveness of dependency analysis, at least as it claims to provide an explanation of IDI, can be identified in terms of several shared conceptual co-ordinates with other models of IDI. The current section establishes these in terms of the concepts of competition, capital and internationalisation.

Before locating the conceptual agenda of dependency analysis, it is first necessary to summarise the basic propositions advanced by dependency analysis\textsuperscript{20}. Within dependency analysis, the roots of underdevelopment and dependency are located within the process of capitalist development itself. As Palma (1978) noted, for dependency analysis, the development of the ‘core’ capitalist nations necessarily requires the underdevelopment of the ‘periphery’. European nations and later core nations developed because they were able to ensure the underdevelopment of other nations. In this international system, dependent nations were tied to an international system of (unequal) exchange in which they were obligated to specialise in commodities and resource extraction for the purpose of export\textsuperscript{21}. The surplus arising from such exchange was not reinvested locally beyond the point where the maximum rate of return could be extracted. Instead, the surplus was circulated back to the core nations or to some other peripheral region. Hence, the development of the periphery had no ‘self-reliant’ or ‘autonomous’ status, and once this basic pattern was established the roles of core-periphery were permanently established and structurally embedded in the international system of exchange.

Dependency analysis developed a critique of both the actual process of international development and an explanation of it. In developing this critique, dependency analysis actually reproduced the much of the conceptual agenda of orthodox theory, by simply inverting many of the concepts of orthodox theory\textsuperscript{22}. Orthodox international economic theory, it will be recalled, was based on a concept of internationalisation as a process of mutually beneficial exchange between different but equal nations. Implicit in the orthodox approach was the Smithian proposition that growing international exchange would lead to the growing industrialisation and growing prosperity of developing countries made possible by the increasing division of labour\textsuperscript{23}. International economic theory was also premised on a concept of competition developed on the basis of perfect competition in the sphere of international exchange. Inasmuch as this was a theory of international capital mobility, international capital was understood in terms of a hierarchical flow from nations with relatively abundant capital to those nations with a relative shortage of capital. Trade theory thus made the nation-state the central unit of analysis, and the more advanced nations represented the model for the future development of new

\textsuperscript{20} The following summary is taken from Cypher (1979).
\textsuperscript{21} As Frank stated “One and the same historical process of expansion and development of capitalism throughout the world has simultaneously generated - and continues to generate - both economic development and structural underdevelopment” (cited in Brenner 1977).
\textsuperscript{22} Brenner (1977) suggested that dependency analysis, because it shared a method of analysis with orthodox analysis, ended up by erecting a theory which is the ‘mirror image’ of the progressivist thesis that it wished to surpass.
\textsuperscript{23} The optimistic element of orthodox international economics (derived from Adam Smith’s propositions about the beneficial effects of exchange and the division of labour) was its prediction that expanding international trade would bring about economic development, because this permits the growing division of labour (the basis of a society’s wealth).
countries. Finally, orthodox theory incorporated a concept of capital in terms of competitive relations between small firms.

While dependency analysis continued to give primacy to relations between nations, it began with the proposition that relations between nations were systematically unequal. The relation of inequality was in part associated with concept of competition (unequal exchange) inherent in dependency analysis. However, dependency analysis was also articulated via the proposition that underdevelopment is structurally conditioned by the development of the industrialised nations. That is, the development of the industrialised nations requires the ‘development of underdevelopment’ or the ‘underdevelopment of development’ in the rest of the world. For Frank and much of the dependency school, the dependent character of the Latin American nations in particular, “is the hub on which the whole analysis of underdevelopment turns: the dependent character of Latin American economies [can be traced to]... certain processes causally linked to its underdevelopment” (Palma 1978). For Wallerstein the historical link is drawn even tighter so that the origin of capitalist development in the core can be traced to its relationship with the periphery (Brenner 1977). Whatever its origins, the division of the world into a bi-polar core-periphery mode, the periphery is locked into a dependent status.

From the perspective of IDI theory, two significant contentions of dependency analysis deserve attention. On the one hand, accumulation in the core nations is held to be conditioned by the creation of a ‘surplus’ in the periphery and its transfer to the core nations. On the other hand, this form of surplus extraction from the periphery, requires the ongoing imposition of a raw-material-producing, export-dependent economy upon the periphery to fit the productive and consumption needs of the core (Brenner 1977). The clear implication is that IDI flows from the core to the periphery will not occur in terms of the relocation of manufacturing production, that was the basis of the new post-war theory. Instead, IDI to the periphery is predicted to be concentrated in the development of extractive industries for export to the core nations. In this sense, dependency analysis is a pre-war model of IDI, based as Kay (1975) has noted on the redefinition of the problem of underdevelopment in terms of trade relations of certain nations with the developed countries.

Dependency theory has been the subject of much criticism, much of it linked to the conceptual agenda it shares with orthodox international economics. In particular, the emphasis on the analytical importance of exchange relations through the market (at the expense of an analysis of the social relations of production and consumption) is seen to expose dependency analysis to a flawed conceptual methodology. A further critique of dependency analysis is that it developed only an analysis of the internationalisation of capital utilising the methods of neoclassical economic theory. The analysis of the debilitating effects of international trade and capital flows were therefore advanced in only an incomplete way, within the sphere of circulation.

---

24 As Cowen and Shenton noted, a major hypothesis of underdevelopment theory is that "imperial authority, either of of pre-1931 British imperial model or of the US dominated post-1945 international order, did not enable true development. Indeed, it did the contrary: imperialism created and developed underdevelopment" (1996,p114).

25 This has, as Brenner (1977) termed it, meant that dependency analysis has been advanced through a sort of ‘Neo-Smithian Marxism'
(Cypher 1979). One of the main critiques of dependency theory is therefore that by focussing on the circulation of surplus between nations it has embodied a methodology which commences after the surplus has been produced\textsuperscript{26}. And, as Kay pointed out, the concept of surplus (as arising out of unequal exchange) led to the proposition that the underdeveloped world was the site of higher rates of surplus extraction. Yet the explanation most consistent with this underdevelopment was that "capital created underdevelopment not because it exploited the underdeveloped world, but because it did not exploit it enough" (1975,p55).

Similarly, the analytical primacy afforded to the nation-state in dependency analysis is analagous to that of orthodox international economics (and for our purposes trade models of IDI). The emphasis on internationalisation as relations between nation-states has provided a methodological barrier for both the analysis of dependency in the early post-war years, and made it vulnerable to changing global patterns of accumulation\textsuperscript{27}. The development of what became known as peripheral industrialisation is a case in point. Countries such as Singapore, South Korea, Taiwan and Hong Kong were sites of rapid accumulation based on industrial expansion. Of course, dependency analysis was acutely aware of these developments, and the developments were constituted as one of the key features of a 'new dependency’. But inasmuch as it incorporated these developments within the original model, it required changes in the original conceptual categories of dependency analysis. It was in this sense that Cypher suggested that dependency analysis did not have a methodology to explain historical change in a satisfactory way\textsuperscript{28}. The analytical projection of a particular conjunctural characteristic as if it were a permanent feature of capitalism (Palma 1976) is of course a characteristic that has been identified as a feature of post-war IDI theory.

---
\textsuperscript{26} As Dore and Weeks observed, "Such a procedure is hopelessly crippled in its analytic power... It is restricted to the realm of appearances. All the shortcomings of dependency theory derive from this. The transfer of surplus product from one geographic area to another - an act of exchange - can never explain the poverty of the one and the wealth of the other. The explanation of the poverty of some countries and the wealth of other lies in the nature of production not in the movement of products. If there is a net flow of surplus product out of a country, this represents the fact that there prevails barriers to reproduction on an expanded scale" (cited in Cypher 1979).

\textsuperscript{27} Kay suggested the terms of an alternative concept of internationalisation. He noted that there are two ways of approaching the capitalist world economy "One stresses the primary importance of class relationships and makes relations between nations - i.e. international relations - firmly dependent upon them. The other adopts the completeley opposite position of making the nation state its primary unit" (1975,p117).

\textsuperscript{28} His claim that dependency analysis was locked into "the static picture of underdevelopment first sketched by Paul Baran in 1952..." (1979,p40) remains perhaps a more contentious proposition..
DEVELOPMENTS IN THE STYLISED FACTS OF 1980's AND EARLY 1990's IDI
5.1 INTRODUCTION

The 1980’s and early 1990’s were a time of both continuity and considerable change in the stylised facts of IDI. Continuity with the stylised facts of early post-war IDI was evident in terms of the ongoing concentration of IDI activity within the industrialised nations, its association with the international activities of TNCs rather than merely as a capital flow between nations, and its occurrence in patterns not well described by the neoclassical paradigm of perfect markets. However, it was the transformations in IDI that had the most significant impact on IDI theory. Some of the important transformations in the last decade and a half have included new forms of funding for IDI, new forms of international corporate organisation and delineation, the growing link between IDI and merger and acquisition activity, and in terms of changing industry and national patterns of IDI.

In many ways, developments in international investment (including IDI) during the last decade and a half have assumed an importance beyond their own ambit. They have been associated with (and indeed at the forefront of) developments variously described as ‘internationalisation’ and ‘globalisation’. Recent internationalisation has been more wide-ranging than just developments in international investment, but an analysis of investment helps to provide an important point of access to understanding wider features of the period as well.

The analysis of recent international investment is not, however, without serious problems of its own. The changes in international investment have generated considerable controversy and debate at empirical, theoretical, and policy levels. While many of the developments in international investment in the 1980’s are by now well known, the way these are constituted as the ‘stylised facts’ of recent IDI theory remains controversial. The rationale for the current chapter is that IDI theorists cannot agree about which facts are relevant for, and therefore warrant investigation within, IDI theory. In the context of a growing apprehension about the general and universal nature of the theoretical framework for IDI, the stylised facts of 1980’s IDI can not therefore remain a solely descriptive question. The problem of whether to include many recent developments, and even how those developments should be constituted into the stylised facts is also very much a theoretical problem. As will be seen in Chapter 6, the explanation of the stylised facts has meant that IDI theory has had to adopt a more ‘fluid’ approach, and it is also now increasingly difficult to explain IDI by reference only to concepts ‘internal’ to IDI theory itself.

Nevertheless, the broader range of relevant ‘facts’ warrants a separate chapter. Since the theoretical impact of the changes in 1980’s and early 1990’s IDI have been so great and since also that there is no general agreement about how those changes are to be grasped conceptually, the current chapter will lay out the main stylised facts. While the current chapter is not simply descriptive, the detailed discussion of the theoretical (and to a lesser extent the policy) implications of these developments is pursued in more detail in the following chapter.
5.2 SPECTACULAR AND UNEVEN GROWTH OF IDI

The 1980’s was a period of quite spectacular growth in IDI. For the 1980’s as a whole, global cumulative flows of IDI grew by more than threefold compared with the 1970’s (see Table 5.1). During the 1980’s, the world stock of IDI grow by nearly $US2 trillion, and by the end of the decade, annual global IDI flows were $US200 billion per annum. Another indicator of IDI activity was that by the early 1990’s, there were around 37,000 firms with IDI assets generating $5.5 trillion in world-wide sales (i.e. larger than total international trade of goods and non-factor services between nations, of around $US4 trillion) (UNCTC 1993).

While there was spectacular growth over the decade as a whole, the year to year pattern 1980's IDI growth was neither even nor uniform. As can be seen in Table 5.1 IDI was significantly affected by the global recession in the early 1980’s. Not only was there a rapid slowdown in the rate of new IDI flows during this phase, repatriations of earlier IDI also became increasingly prevalent. However, from 1984/85 until the end of the decade, IDI commenced an explosive period of growth. In the late 1980’s and early 1990’s, IDI growth once again abated under the influence of an international recession, and in 1991 there was an absolute decline in the size of global IDI transactions. Since that time, however, global IDI has once again resumed strong growth.

Until the 1980’s, post-war IDI had grown at a faster - if more volatile - rate than global production, but at a similar rate of growth as international trade and global domestic investment. During the 1980’s as a whole, global IDI grew several times faster than world GNP, more than twice as fast as international trade, and several times faster than domestic investment (Figures 5.1 and 5.2). Between 1983 and 1989 the compound annual rate of growth of world exports was 9.4 percent, and world GDP 7.8 percent. Over the same period world IDI outflows grew at a compound annual rate of 28.9 percent (UNCTC 1991). As a consequence the stock of global IDI as a percentage of global GDP almost doubled during the 1980’s, from around 4 percent to 8 percent (Dunning 1995,p288).¹

¹ The growth and relative size of recent IDI flows, and its association with a range of other economic transactions has led one notable researcher to suggest that IDI "is now probably the most important form of economic transaction" (Sauvant 1993).
Table 5.1 Direct Investment Abroad from OECD countries 1971-1990

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971-1980</td>
<td>302,306</td>
</tr>
<tr>
<td>1981-1990</td>
<td>1,008,057</td>
</tr>
<tr>
<td>1981</td>
<td>48,581</td>
</tr>
<tr>
<td>1982</td>
<td>25,694</td>
</tr>
<tr>
<td>1983</td>
<td>35,276</td>
</tr>
<tr>
<td>1984</td>
<td>44,824</td>
</tr>
<tr>
<td>1985</td>
<td>56,152</td>
</tr>
<tr>
<td>1986</td>
<td>89,701</td>
</tr>
<tr>
<td>1987</td>
<td>134,771</td>
</tr>
<tr>
<td>1988</td>
<td>159,763</td>
</tr>
<tr>
<td>1989</td>
<td>195,999</td>
</tr>
<tr>
<td>1990</td>
<td>217,296</td>
</tr>
<tr>
<td>1991</td>
<td>162,317</td>
</tr>
</tbody>
</table>

Source: OECD 1992

While these figures on their own provide an indication of the strong growth in IDI flows during the 1980's, the figures need to be treated as only a rough approximation. As will be shown later in the current Chapter (and its theoretical implications discussed in more detail in Chapter 6), there was a significant transformation in several aspects of IDI during the 1980's, so that data on formally defined IDI tend to significantly underestimate the scale of IDI growth.

---

2 The concept of IDI, it will be recalled, is a creature of Balance-of-Payments accounting, where it is defined as that part of cross border capital flows that represent a direct financial flow from a parent company to an overseas firm that it controls flow (consisting of either new equity purchases, reinvestment of earnings by the controlled firm, or intracompany loans). However, even in its own terms, this measure contains a number of well-known defects.

1. Capital flow - It has long been recognised that a firm can become multinational or increase the scale of its multinational operations without any necessary international movement of capital per se. For instance, reinvested earnings, which was the largest category of IDI flow during the 1970's, involves only a nominal flow from the home to host country. Indeed, to paraphrase Krugman, once a firm has international operations, it is difficult not only to say which way money is flowing, but whether there is a capital flow at all.

2. Control - While the intention to control has always been at the core of the IDI definition, the nature and extent of ownership that is deemed to secure that control has been subject to ongoing change, and remains an ambiguous concept.

3. Debt - Only intracompany debt is counted as direct investment. Thus if a subsidiary borrows directly in host country capital markets, or in the Eurodollar market, even if the debt is guaranteed by the parent firm, it is not counted as direct investment. As will be seen shortly, during the 1980's, inter-company borrowing by subsidiaries (and parent firms) to fund expanded international activities became the largest source of new funding for TNCs during the 1980's, with important consequences for the pattern of IDI, and profound implications for IDI theory.

4. Book versus market value - while retained earnings are counted as part of direct investment flows, capital gains (both real and nominal) are not. This tends to lead to an understatement of the value of older investments relative to newer ones, with implications for cross national comparison of IDI stocks.

These definitional problems have provoked interest in the possibilities of more fluid and less hierarchical definitions of IDI (Jones 1987; Hooper and Richardson 1993, Julius 1991; Stekler and Stevens 1992).
Figure 5.1 Index of current value of exports and IDI outflows 1975 - 1979

Source: UNCTC 1991, p5
5.3 **Concentration of IDI Between Industrial Countries**

For most of the post-war period, IDI had mainly occurred as a relationship between firms in the advanced capitalist countries, (and between and within firms in North America and Europe in particular)\(^3\). In the second half of the 1970’s, however, there was a growing flow of international capital (including IDI) toward developing countries. And Figure 5.4 shows that for a time in the late 1970’s it seemed that international capital markets may have finally begun to play the role that neoclassical international capital theory had assumed it should: that of transferring funds from capital surplus to capital deficit countries.

The IDI boom in the 1980’s was, however, almost entirely a phenomenon of the industrialised world (Figure 5.3). Developing countries were largely by-passed during the boom in 1980’s IDI (Figure 5.4)\(^4\). This was of course attributable in part

---

\(^3\) It will be recalled from Chapter 2 that the post-Second World war period continued the trend toward a relative decline in the proportion of IDI flows going to developing countries (a trend evident in inter-war IDI flows). In 1914, for instance, around two-thirds of the stock of IDI was estimated to be located in developing countries; by 1938 this had fallen to 55 percent; and by 1960 it had dropped to around 40 percent (Dunning, cited in Wilkins 1989, p100).

\(^4\) Some of the recorded growth in IDI flows to developing countries in the late-1980’s were probably not even actually new flows at all, but the conversion of non-performing loans into the ownership of assets (so-called debt-equity swaps). A significant component was also related to intra-company transfers. Cornell noted for
to the Latin American debt crisis of the early 1980's, but the developed country concentration of 1980's IDI flows represented one area of continuity with the pattern of post-war IDI.

Within the advanced capitalist countries, there were, however some important and quite dramatic changes in IDI flows. In the 1950's and 1960's, firms from the US accounted for around two-thirds of outward IDI flows, while Canada, Australia and countries in Europe accounted for the bulk of IDI inflows. Figure 5.5 shows that in the 1980's, by contrast, outward IDI occurred from a much wider range of industrial nations, many of which had no prior history of large scale investment abroad. Furthermore, the 1980's saw the US challenged by both the UK and Japan as major source countries of IDI.

Just as significantly, there was a pronounced concentration in the major destinations for IDI within the industrialised nations. This was especially evident in the concentration of 1980's IDI flows toward the US (see Figure 5.6). Combined with the erosion of US hegemony in outward IDI, the dramatic growth of inward IDI to the US transformed the net US IDI position. Whereas the value of the stock of inward IDI in the US as a percentage of outward stock was less than 20 percent in the late 1960's, by the end of the 1980's, it had exceeded 90 percent (Lipsey 1993)\(^5\).

**Figure 5.3 Capital inflows to the industrial and developing countries*\(^\)  
In billions of US dollars; annual averages

*sum of gross inflows, excluding reserve movements


---

\(^5\) Considerable caution is required in interpretations of such figures. As footnote 2 noted, IDI definitions tend to significantly understate the value of older investments relative to new ones. Lipsey (1993) provides some revised estimates that confirm the basic trend, but provide lower estimates of the proportion of inward to outward IDI.
Despite the failure of post-war IDI to meet the predictions of neoclassical international theory (as an international capital transfer from surplus to deficit countries), until the late-1970’s, IDI outflows were still mostly understood in hierarchical terms. IDI outflow was significant for very few nations, particularly the US, and UK, and to a lesser extent West Germany and Japan. IDI was therefore significant for most countries as a form of capital inflow. These national patterns of IDI provided the basis of analytical distinctions between countries in terms of those which were exporters of IDI and those which were importers of IDI. Instead of capital abundance, the theory of IDI was constructed in terms of a package of capital flows and management by firms from the leading industrial or technological nation(s) to other advanced capitalist countries.
In the 1980’s, outward as well as inward IDI became increasingly important features of all national economies. IDI is not uniform between countries, there are still national patterns of IDI. One effect of the stylised facts of 1980’s and early 1990’s IDI has, however, been to erode the explanatory power of national models of IDI based on assumed differences between host and source countries (McCulloch 1993, p51). It will be shown in the next chapter that the increasingly multilateral pattern of both inward and outward IDI has been one of the most challenging aspects of recent internationalisation, and has tended to undermine the concept of internationalisation of post-war IDI theory.

---

6 Multilateral IDI has also made the task of calculating the national costs and benefits of IDI a profoundly difficult, and perhaps futile, project (Stekler and Stevens 1991, pp340-44).
5.4 EXTENSION OF IDI ACROSS ALL INDUSTRY SECTORS.

The stylised facts of early post-war IDI were constituted in a way that characterised IDI as an investment activity linked to the relocation of industrial activity in the manufacturing sector. While this was not always an accurate metaphor even then (IDI in the oil and gas sector rivalled IDI in manufacturing in the 1950’s and 1960’s), the metaphor tended to capture one of the more novel and important characteristics of early post-war IDI. However, the manufacturing metaphor of IDI inherited from the early post-war period now seems increasingly particular to that period. IDI growth in the 1980’s was recorded across all industry sectors, but concentrated especially in the services sector, especially in the banking and finance sector. The stock of IDI in the services sector has now become the largest sector of IDI activity.

The recent growth and diversification in the industrial composition of IDI has, however, increased the problem of accurately measuring the sectoral destination of IDI. The industrial activities of subsidiaries of a TNC are consolidated in IDI statistics according to the primary activity of the affiliate. This has created significant problems in interpreting sectoral IDI data, when many TNCs have activities across several industry sectors. When combined with changes in the sources of IDI

---

1 Average 1980-89

Source: OECD 1992

---

7 In the case of the US, for example, this rule has meant that several large scale investments in manufacturing by Japanese car manufacturers have been classified as IDI in the Wholesale sector (Stekler and Stevens 1992). Similarly, a proposed expansion by Bridgestone to expand Firestone’s retail network would probably have been recorded as an expansion of IDI in the manufacturing sector. It has been estimated that a consequence of this system of classification was that, in 1987, overseas affiliates in the Wholesale sector devoted more assets ($US4
funding, the industrial pattern of IDI (viz. its extension across all industry sectors) has necessitated a less institutional and more fluid concept of capital.

5.5 Changes in the Source and Nature of IDI Funding

5.5.1 Introduction

It will be recalled that it was the stylised facts connected with the funding of early post-war IDI, as much as any others, that were decisive in establishing post-war IDI as a new process, requiring a distinct analytical framework (especially in terms of the need to conceptualise the institutional form of capital in IDI). However, it was transformations in the stylised facts of IDI funding in the 1980's and 1990's that have been equally important in undermining key aspects of the conceptual agenda of post-war theory.

During the 1970's, changes in the funding of IDI (especially outward IDI from the largest investing nations of the US and UK), seemed to indicate that the capital flow aspect of IDI was not indeed the central aspect of IDI. In particular, the funding of 1970's IDI was increasingly being derived from the retained earnings of subsidiaries rather than from new capital flows from the parent to the subsidiary. Bruce Kogut (1983), for instance, estimated that during the 1970's, a significant shift had occurred in the source US IDI outflows, such that whereas in 1970, new equity injections and other inter-company outflows from the parent to subsidiary had represented 1.39 times that of reinvested earnings, by 1979, this figure had fallen to 0.39. The stylised facts of 1970's IDI therefore seemed to reinforce the concept of capital established by researchers in the 1950's and 1960's.

The 1980's was a period of continuing change in the structure of international capital flows, and many of these changes pertained to, or impacted upon, the funding of IDI. It will be shown in Chapter 6, that the explanation of these developments helped to undermine not only the conceptual agenda of the 1950's and 1960's derived theory, but even perhaps the project of an 'internal' theory of IDI (that is, the possibility of constituting IDI as a distinct object of analysis). The changes and their consequences for the patterns of 1980's IDI (and the implications of such changes for theory) requires that they be examined in some detail here.
In the 1980's, the trend to greater funding of IDI being derived from outside the home country continued, but the forms in which those funds were derived changed considerably. The new element in the funding of 1980's IDI was the high proportion coming from international capital markets. Thus a large and growing proportion of the funding of IDI was being derived from outside both the home country and from outside of the investing company as well. One consequence of the much more internationalised nature of IDI funding has been that the cross border implications of IDI are now very ambiguous.\(^{10}\)

It is axiomatic that IDI relates to the funding of productive and commercial activities outside of the firm's home nation. What has been so significant about the recent period has been that a large and growing source of IDI funding was derived from outside the home and host nation as well. In spite of this, in national Balance of Payments accounting terms, the growth of outward IDI has continued to be recorded as an 'outflow' from the host nation. In the 1980's however, IDI 'outflow' often required (in Balance of Payments terms) the addition of an 'inflow' of international borrowing into the home nation, even though there may have been no actual flow either in or out of the nation at all. The way international economics has attempted to deal with this problem (either in terms of a reconstruction of Balance of Payments accounting or in theoretical terms) are discussed in next chapter.

There were several important changes in the structure of international capital markets which were also associated with some important consequences for the nature of 1980's IDI. The changes and their consequences for IDI funding included:

- a rapid growth of international capital markets during the 1980's, became a significant form in which savings could be re-cycled into investment funding.

- the growth of internationalised credit occurred against a background of reduced demand from traditional users of credit.

- credit growth (and internationalisation) occurred in the context of a transformation in the users of credit and helped to stimulate a period of rapid financial innovation.

- much of the international credit in the 1980's found its way into IDI and a large proportion of 1980's IDI was funded from borrowings in international capital markets.

- the changed source of funding also had consequences for the nature of 1980's IDI. In particular, a large proportion of 1980's IDI was associated with Merger and Acquisition (M&A) activity.

- the interaction of the new sources of funding and the M&A-related nature of 1980's IDI introduced some novel characteristics to international M&A activity.

- international M&A activity via IDI was actively promoted by financial institutions, and an increasing proportion of their own profits were derived from

---

\(^{10}\) One of the implications is that recent IDI may not have involved a cross-border flow of capital from host to home country at all.
fee-related (rather than interest-rate) related activities associated with M&A activity.

- much of the 1980’s M&A activity occurred not for merger, but for, the later sale of the acquired firm either in whole or in parts.

- the scale of available credit made it possible for quite small firms to launch takeover bids at quite large and formerly secure companies.

- neither the use of international credit, nor involvement in M&A were evenly distributed. Some firms were quite large borrowers on international markets, and these firms were usually the same firms that made many takeover bids. These firms became variously known as ‘entrepreneurs’, ‘raiders’, and ‘asset strippers’.

5.5.2 Growth in International Capital Markets

From at least the mid-1970’s, international financial institutions were playing an increasing role in international capital markets\(^{11}\). The changing role of financial markets and institutions was manifold and is beyond the scope of the current thesis\(^{12}\), but several developments in this area impacted directly on the financial climate within which 1980’s IDI took place. The development of internationalised credit (via such developments as Eurodollar markets) from the mid-1970’s was spurred on by capital outflow restrictions by key governments and the ‘recycling’ problem of OPEC oil surpluses. During the 1980’s, international credit markets continued to grow rapidly under a different impetus. Despite the securitisation of much of this credit, the role played by financial institutions in the funding of 1980’s IDI remained significant\(^{13}\).

5.5.3 Reduction in demand for credit from traditional sources

The growth in global credit during the 1980’s also occurred in the context of a relative decline in the use of new funding for the purposes of expanded production and for uses in government debt funding (with the notable exception of the US) and capital expenditure\(^{14}\). In the context of the growing role being played by international credit markets in recycling investment, the reduction in credit demanded by traditional users of credit meant that in the early 1980’s liquidity began, to paraphrase Wood (1988), ‘piling up on the sidelines’.

---

\(^{11}\) Akyuz (1990), for instance, estimated that since the early 1970’s, international banking has grown at more than 20 percent per annum i.e. at about twice as fast as international trade (12 percent per annum) and world output (10 percent per annum). Between 1982 and 1988, the ratio of the size of the international banking market to total global fixed investment doubled, as did the gross size of the international banking market as a percentage of net capital flows across countries.

\(^{12}\) It bears noting however, that the rapid rate of growth of financial intermediation, for instance, created a significant widening in the social origins of banking officials, a factor that probably helped the ‘new’ takeover entrepreneurs to obtain funds and financial advice for their activities(Chernnow 1992; Hilton 1987).

\(^{13}\) For two different accounts of the evolving relationship between the international capital markets and financial institutions, see Poser (1993) and Moran (1991).

\(^{14}\) Goldman Sachs estimated that between 1983 and 1988 nonfinancial corporations borrowed 60 percent more than they needed for traditional uses of capital spending, inventories and working capital expansion (cited in Bulow, Summers and Summers 1990).
During the 1980’s, the corporate sector increased its use of credit. Corporate gearing was not increased in an even or uniform manner. While most firms increased their borrowing, A few firms borrowed a large amount of the credit, and it was the ‘entrepreneurial’ firms which used the funds for merger and acquisition activity (and for restructuring diversified conglomerates which had emerged out of the late-1960’s)\(^{15}\).

The entrepreneurial firms and firms engaged in leveraged buyouts, more than any other, that provided the mechanism by which overall corporate gearing was increased during a period of relatively slow investment growth in expanded production\(^{16}\). One of the consequences of the restructuring of corporate capital structure arising from the growing use of credit was that much of the credit advanced in the 1980’s was ‘recycled’ into equity purchases (Table 5.13). Friedman estimated that in terms of the US, “Corporations were not borrowing to invest but to finance transactions - including mergers and acquisitions and leveraged buyouts - that merely paid down their own or other corporations’ equity. As a result, the corporate sector’s net worth declined by more than one fourth compared to the size of the economy” (1991)\(^{17}\). These forces helped to stimulate a period of financial innovation that saw credit tailored to the needs of ‘new’ users, especially but not only to a widening group of acquisitive firms.

### 5.5.4 Financial Innovation

The second important transformation in international finance that helped to change the circumstances of 1980’s IDI related to changes in the form of international credit itself. The growth of international credit as a source of IDI occurred against a background of both considerable growth and innovation in international credit markets (Allen 1988). Not only was a growing proportion of international credit being channelled into IDI and as will be seen shortly, into merger-related lending (IMF 1990), there was considerable change in the forms and instruments of international credit\(^{18}\).

The growing use of new forms of credit and their increasingly internationalised forms during the 1980’s was in part related to the securitisisation of credit instruments that developed through the growth of Eurodollar and Eurobond markets in the 1970’s. It was also related in part to the ability of some non-financial firms to compete directly for funds on terms similar to banks in raising wholesale funds (Allen 1988). The increased securitisisation of credit led to a growing role of international of subordinated and sub-investment grade debt securities (junk bonds)

---

\(^{15}\) The late 1970’s and early 1980’s was marked by the emergence of surplus productive capacity across many industries. Wood suggested in this context that overcapacity and stockpiling of unsold commodities has one message to prospective investors “that there are few attractive areas in which to invest spare cash in new productive capacity” (1988, 8).

\(^{16}\) The link between international debt and M&A activity is discussed in more detail shortly. It only bears noting here that the total debt composition of leveraged takeovers during the 1980’s approached 80-90 percent (Burgess and Leen 1991).

\(^{17}\) In the US, the total assets of the corporate sector declined by more than 10 percent as a proportion of GDP between 1980 and 1989, and the net assets by more than one quarter (Friedman 1991).

\(^{18}\) Financial innovation in the second half of the 1980’s was quite dramatic. Burgess and Leen (1991) cite a study by the chartered accounting firm, Arthur Anderson that found that over 600 new financial products were launched between 1986 and 1990 alone.
(c.f. Blair and Uppal 1992), the extensive use of which helped to produce trend toward a declining rating of corporate credit.

The 1980’s was also a period of significant development of derivative financial instruments (Levich, Sanford and Corrigan 1988; Axilrod 1990). According to Allen (1988), many of the most important financial innovations during the 1980’s included the development of currency and interest rate swaps, options, forward rate agreements and Euronote facilities. Frankel (1989) noted that innovation in financing techniques also allowed the currency denomination to be divorced from the location of the asset, which in turn has helped to blur the earlier descriptive distinction between funding sources as either domestic or foreign.

Part of the process of financial innovation during the 1980’s was also associated with the development of financial instruments that had characteristics of both debt and equity, some of which came to be known as 'mezzanine' finance (Burgess and Leen 1992). These included convertible bonds, subordinated debt and non-voting stock. While there had been a degree of substitutability between some forms of debt and equity before the 1980’s (Friedman 1988), financial innovation in the 1980’s significantly increased both the substitutability between financial instruments and the range of financial instruments that had characteristics of both debt and equity (Bulow et.al. 1990). The descriptive and legal nature of the derivation of the distinction between debt and equity (and direct and portfolio) investment is discussed in the next chapter. Here it should be noted however, that one reason that the categories have been unstable over time is that they have been based on largely static and historically-specific attributes (Jones 1987).

5.5.5 International Credit as a Major Source of 1980’sIDI.

It was in the context of transformations in international capital markets, that a growing proportion of the funding of IDI was also being derived from (international) external sources (Vernon 1992). Feldstein (1994a,1994b) using US statistical data estimated that in the 1980’s and 1990’s only about 20 percent of the value of assets owned by US affiliates abroad were being financed by actual cross-border flows of capital from the US itself. The largest proportion (about 53.5 percent) were being derived from foreign sourced finance. The remainder came from retained earnings.

---

19 Akyuz for instance has concluded that “the internationalization of finance and financial openness raise the degree of substitutability of assets denominated in home and foreign countries, and issued by residents and non-residents...Indeed in a financially open economy domestic monetary and credit aggregates become extremely difficult to define in a meaningful and useful way... The same question arises also with respect to credits from Eurobanks. Here the difficulty is not a practical but a conceptual one” (1990,p121). See also Bernanke and Campbell 1988, and Warsharsky 1990.

20 Ginsberg (1990) has gone even further to suggest that the 1980’s merely served to highlight and exploit a legal (and descriptive) formalism between debt and equity that has been present from the beginning. He asserted that in terms of tax law for example, “other than in terms of outcome...there is not and has never was a ‘reality’ to a debt-equity distinction” (1990,170).

21 Financial innovation has gone under several names, such as securitisation, deregulation and innovation, but the process has served to blur the distinctions between forms of finance and between banking and securities market transactions (Akyuz 1990,p109) and between financial instruments (IMF 1990,p7).

22 Bulow et.al. (1990) noted that financial innovation during the 1980’s had been associated with a dramatic rise in the use of debt finance by corporations.
(26.5 percent)\textsuperscript{23}. This development was made even more critical, because of its association with the transformation in the international financial structure in general,\textsuperscript{24} and as shown in Figure 5.7 in the growth of IDI via international merger and takeover activity in particular.

**Figure 5.7 Breakdown of long-term Net Capital Outflows - US, UK, West Germany and Japan**

(a) Includes plant and machinery, new buildings and non-repatriated profits earned by TNCs. Note: Data for 1987, the year of the stock market crash, have been excluded.


Changes in the funding of 1980’s IDI was also associated with a continuing change in the basis of that funding. A large proportion of lending for IDI in the 1980’s was advanced on the basis not of the asset backing of the firm, but in terms of the historic and forecasted cash flows of the enterprises (or the assets of the target firm in a proposed acquisition). This was itself part of a longer term trend in the nature of IDI funding. Capital outflow restrictions by the US and UK governments from the late-1960’s had helped to stimulate the growth in external funding of IDI, especially in terms of host-country funding. These restrictions accelerated the trend toward a greater proportion of IDI funding to be derived outside of the home country and underpinned the transformation of the theoretical model of IDI. Furthermore, large-scale international investment projects in the late 1960’s and 1970’s, such as new capital-intensive mining projects, were being organised on a consortium basis involving several companies from several countries. These consortiums often did not

\textsuperscript{23}Similarly, a survey of Canadian TNCs by Knubley \textit{et al.} (1991) found that during the 1980’s 57 percent of DIA by firms from Canada was funded by international borrowings, with most of the remainder derived from retained earnings.

\textsuperscript{24}Blair and Schary (1990) provide evidence to show a few firms that engaged in more than one financial restructuring were disproportionately responsible for both the increase in debt in the corporate sector as well as for acquisition and divestiture activity.
have the resources to meet the large capital needs of the project, and a large part of
the funding of these projects occurred through local equity and especially long-term
borrowing. Importantly for the 1980's, their borrowing was also often conducted not
in terms of the asset-backing of the consortium partners, but in terms of the expected
cash-flow of the project. Some of the credit was derived from home and host-country
markets, but increasingly also, much of it was derived from syndicated international
bank loans and the use of emerging international capital markets, such as
Eurocurrency lending (Lipsey in Froot 1993, p113)\textsuperscript{25}.

5.5.6 Global Credit Boom and the Internationalisation of M&A activity

The coincidence of the growth of liquidity being re-cycled through international
credit markets, occurring in the context of low rates of growth of investment in
expanded production, stimulated considerable financial innovation. As Figure 5.8
shows, corporate financial restructuring, including the internationalisation of that
corporate restructuring through IDI was especially associated with M&A activity\textsuperscript{26}.

\textbf{Figure 5.17 - Net Merger Announcements in the United States -
by number and value of bid, 1980-1992}

![Graph showing net merger announcements in the United States from 1980 to 1992.](image)

Source: Mergerstat Review

The global growth of credit and its channelling into the financial restructuring of the
corporate sector and asset acquisition also ignited an expectations-driven inflationary
spiral in stock and other asset prices. As Burgess and Leen also noted, “any resultant

\textsuperscript{25} This link between debt and equity has had far-reaching ramifications for orthodox definitions of finance, which
will be discussed below.

\textsuperscript{26} Blair and Uppal (1992, p9) have shown however in clear terms that there was a dramatic shift towards credit in
new capital raising. The case of the US expressed this tendency most dramatically through the way debt was used
to acquire (and actually 'retire') equity in the form of M&A and management buyouts of public companies.
vacuum [in investment demand] was soon filled by groups of incumbent and pirate management teams funded by LBO specialists and [M&A] funds...Easy supply conditions widened the circle of corporate raiders” (1991,p80). This gave further impetus to the financial restructuring of the corporate sector (especially the M&A activity). Indeed, the continuing viability of this process would require a continual growth in funds (Burgess and Leen 1991).

In particular, the fraction of the acquisition price of M&A related IDI raised externally by the acquiring company increased dramatically (Graham and Krugman 1991). While the tendency toward financing the activities of affiliates in the local market was recognised as part of the development of post-war IDI theory, as part of the argument as to why IDI should not be seen principally as a capital movement per se. The internationalisation of capital markets and its relationship with changes in the funding of IDI did not, however, make a significant impact the on analytical debate until the 1990's. Three aspects of the evolving structure of corporate finance are relevant to 1980’s IDI and therefore deserve attention here: the role of financial institutions; the form of credit, and the basis of the credit advanced

Financial institutions played a direct role in the financing of 1980’s IDI. However, the role of financial institutions in 1980’s IDI went well beyond simply organising the credit for funding IDI by TNCs. Financial institutions also played significant additional roles in providing financial advice and even helping to locate potential IDI opportunities. This change was itself also part of a wider trend whereby financial institutions began to earn a larger proportion of their profits from fee-related rather than interest-rate related activities (from so-called off-balance sheet activities).

In terms of IDI, the fee-related activities related to the growing role of M&A activity in IDI growth. With a rapid growth in global credit, banks and investment advisers competed strenuously to finance the M&A business. Guthrie, for instance, noted that in the US, “investment houses have played an active role part in encouraging the boom in cross-border M&A... Corporates outside the US have in turn been responsive not only to buying operations that they have uncovered in their own researchers, but also to the operations that banks have marketed to them with increasing frequency” (1989,p12). Lindsay (1987) noted at the time that,

“Everybody [in banking] is either in or getting in the M&A game these days... Morgan Guaranty as a case in point not only is represented in all the major money centres; it also has 120 research professionals around the world maintaining data bases and analytical papers on every important industry, jurisdiction, by jurisdiction. Clearly, such talents are in place to develop business with and stimulate the [increasingly competitive] process of investment by potential acquirers.”

Financial institutions not only located takeover targets for acquiring firms, but arguably also helped to create the acquirers as well. The role played by the institutions in encouraging the use of credit by the takeover entrepreneurs was therefore partly related to the collapse of borrowing by traditional users (such as the developing countries), alongside a global increase in the availability of credit
(Lindsay 1990). David Hale, the prominent international financial adviser, has suggested that:

“In the Anglo-Saxon countries, because the banks were no longer willing or able to lend to Argentina, they redeployed their resources, creating a series of corporate Argentinias. It was Australia which provided the best illustration of how banking deregulation, fiscal conservatism and weak private investment interacted to produce financial excesses in the corporate sector” (1990,13)\(^{27}\).

A more direct way that financial institutions contributed to IDI activity was through IDI activity on their own account. In the 1990’s, it has been financial institutions themselves that have become some of the most active TNCs involved in IDI. As noted earlier in the Chapter, services sector IDI is now the largest sector of IDI, and it has been estimated that two-thirds of IDI in that sector is accounted for by financial institutions themselves (UNCTC 1993).

5.5.7 M&A Activity and the Boom in 1980’s IDI

The 1950’s and 1960’s model of IDI was developed mostly in terms of the international relocation of industrial production via the establishment of ‘greenfields’ facilities and the subsequent expansion of those activities by TNCs endowed with certain national or firm specific assets\(^{28}\). It was through this model that the capital flow paradigm of pre-war portfolio capital theory was superseded, and replaced with a model of capital and technology/management transfer.

\(^{27}\) A similar explanation was offered by Nicholas Sargen (1990) to account for the wave of investment in the US during the 1980’s.

\(^{28}\) See the table in Jenkins (1987) from Buckley and Casson on the numbers of new subsidiaries established in the 1950’s and 1960’s.
Figure 5.9 Number of foreign direct investments in the United States, by type of transaction, 1980-1987


During the 1980’s, the form of IDI was increasingly associated with the takeover of extant operations, than with either the transfer of capital or management/technology by firms.29 During this intense period of M&A activity, international acquisitions increased as a proportion of all M&A activity from around 9 percent by dollar volume in the period 1979-1984, to 22.6 percent in 1985-1990 (Sargen 1990; Blair and Uppal 1993). Graham and Krugman (1993) suggested that while international M&A activity was still being recorded as IDI for Balance of Payments purposes, what was really happening was corporate restructuring with few necessary implications for cross national capital movement per se.30 The transformation of the financing of IDI by international credit along with the predominance of M&A activity, also created problems for the post-war model and definitions. Merger related IDI also created difficulties for models that sought to determine the trade effects of IDI.

---
29 Howell and Cozzini (1990) observed that 1980’s IDI undertaken via M&A activity was “in contrast to the development of MNFs in the 1960’s and 1970’s (for example in oil, automobile, and food industries), which transplanted management, mainly grew through direct investment in foreign plant, equipment and buildings, and which often destroyed the national identity of the acquisition targets” (1990,p3). Takeover and merger activity was a component of IDI activity in the 1950’s and 1960’s. From at least the early-1970’s, IDI was associated with an increased reorganisation of ownership and control. The growth of international merger and takeover activity in the 1980’s was therefore spectacular, but not entirely unprecedented.

30 The implications technology flow and trade effects of the concentration of M&A activity in 1980’s IDI are also unclear (Stekler and Stevens 1991).
Chapter 5 - The Stylised Facts of 1980’s IDI

In the 1980’s, international mergers and acquisitions became the largest component of IDI, with the large size of individual investments in that process (Waverman 1991). (Harris and Ravenscraft 1991) and the ‘strategy of choice’ as the form of TNC growth (Wendt 1993)\(^{31}\). One of the most significant developments in 1980’s IDI was the growth of M&A activity as the predominant form of direct investment (Edwards and Graham in Froot ed 1991). Jungnickel (1993) estimated that especially in the second half of the 1980’s, the expansion of IDI was largely carried out through cross-border M&As\(^{32}\). Indeed, in the second half of the 1980’s, cross-border M&A activity became the fastest-growing part of total international capital movements.

The internationalisation of M&A activity was partly related to the internationalisation of equity trading in general, such that by 1990 one equity trade in seven involved a foreign investor, compared with one in 16 at the beginning of the 1980’s (Ayling 1986; Howell and Cozzini 1990)\(^{33}\). The internationalisation of 1980’s M&A activity also related to the process of the internationalisation of finance (discussed above) and the international restructuring of trade and production (discussed shortly).

The M&A wave was not a peripheral one related only to IDI. It was estimated that in the US, more companies were taken private through buyouts, and restructured financially than in any ten-year period since World War Two (Blair and Uppal 1993). Research also found that an estimated 84 percent of the price appreciation of business in the US during the 1980’s occurred through M&A activity (Swenson 1995).

In the case of the US for instance, Hamill (1991) estimated that between 1984 and 1988, foreign companies acquired a total of 2,055 US companies for approximately $126 billion, accounting for well over three-quarters of the total value of all inward IDI to the US in the period\(^{34}\). In the 1980’s, the majority of IDI inflow into the US was via the acquisition of existing activities (Stekler and Stevens 1992). Blair and Uppal estimated that whereas in the period 1979-84 acquisitions by foreigners amounted to 8.8 percent of the total value of acquisitions (9.7 by number), in the period 1980-1990 it grew to 22.6 percent of acquisition value (14 percent of all acquisitions) (p60). At it peak in the late 1980’s, the international component of M&A activity accounted for as much as 25 percent of total M&A activity, with acquisitions from Britain, Canada and Australia representing around half these international acquisitions (Sargen 1991).

5.5.8 Takeover Activity and the Restructuring of Corporations

A further contrast with earlier forms of IDI and M&A activity was that acquiring firms did not simply purchase the acquired firms to absorb them into the existing operations of the firm. Instead, the acquired firms were often acquired to be broken

\(^{31}\) This trend toward M&A activity increased in the total number of transactions (until 1988) and especially the average size of each transactions (until 1989).

\(^{32}\) This link between the merger boom and IDI helps to explain the volatility of IDI transactions in the late-1980’s and early 1990’s.

\(^{33}\) It was estimated by Healy and Palepu however, that in the 1980’s at least 30% of all cross-border equity purchases (i.e direct and portfolio investment) were related to M&A activity (1993).

\(^{34}\) Swenson (1993) found that between 1974 and 1990 inward IDI to the US in the form of M&A grew at a faster rate than total inward IDI.
up and on-sold (a process that became pejoratively known as ‘asset stripping’). Takeover activity in the 1980’s was as much related to the break-up and sale of conglomerate firms as to their absorption into a single enlarged grouping. In the US for example, whereas in the late-1960’s merger wave, the overwhelming majority of acquisitions were long-term takeovers of whole companies, “the driving force of the 1980’s takeover wave was the effort to dismantle conglomerate firms put together in the previous takeover wave and redeploy their assets to more valuable uses” (Blair and Uppal, also chart 59-60). It therefore seemed that the motivation for some M&A activity was as much about the purchase of undervalued assets for subsequent sale as for the expansion of acquiring firms per se.

The question of how the predominance of merger-related IDI in the 1980’s has been conceptualised will be pursued in more detail in the next chapter\textsuperscript{35}. It bears noting here however, that it is a development confronting to the 1950’s and 1960’s derived research agenda of IDI. With few obvious assets (except a willingness to borrow to buy firms and then on-sell their assets) 1980’s IDI was difficult to reconcile with the existing IDI theory. Some IDI researchers have even suggested that M&A related IDI is analytically distinct from ‘greenfields’ IDI, and in those terms Dunning (1992) even asserted that many of the activities associated with 1980’s IDI were so different to the conceptual paradigm that it really can’t be considered to be IDI at all.

5.5.9 Global Pools of Finance Exposed Large Firms to Takeover

Apart from the dominance of M&A activity and sheer size of many individual transactions, there were a number of significant financial and industrial features of M&A related finance. Earlier waves of merger and takeover activity were characterised, in general, by the process of larger firms taking over smaller ones. In the 1980’s, takeover activity was much more diverse with many quite small firms (‘entrepreneurial’ firms) able to take over quite large firms. Many M&A deals were initiated by comparatively small bidders, backed by investment bankers with long lines of credit, aimed at quite large and previously impervious corporations. With access to long lines of credit, size was no longer a deterrent to takeover and many large companies were taken over by much smaller firms. These entrepreneurial firms had a small capital base, but were able to access long lines of international credit to support their takeover offers. This merger wave was driven by relatively few firms that made many acquisitions (Blair and Uppal 1993). During the 1980’s merger boom, a small number of firms made many takeovers and these firms attracted considerable media and public attention, and established a reputation (as ‘entrepreneurial’ firms, ‘asset strippers’, ‘greenmailers’ and so on) for their ability and willingness to borrow heavily to fund high growth acquisitive strategies (Urry 1993)\textsuperscript{36}.

\textsuperscript{35} The M&A wave has also had important implications for other branches of economics. For instance, by this process, the concentration and centralisation of capital was achieved, but in a more circuitous manner, and with some important implications for the theory of the joint-stock company. For instance the leveraging of firms facilitated some dramatic changes in the form of corporate organisation, such as the tendency credit to facilitate the ‘privatisation’ of even very large firms (Jensen 1991).

\textsuperscript{36} To be an ‘entrepreneur’ in the 1980’s was to be engaged in M&A activity and to be a borrower on (international) capital markets.
5.5.10 Changing Forms of International Control

In the 1950’s and 1960’s, the paradigm for the transmission of IDI was through the establishment and expansion of wholly-owned subsidiaries. In the 1970’s, there was an increasing diversity in forms of affiliate control and ownership thresholds were lowered in response. In the 1980’s and 1990’s, forms of international control grew even more diverse and ownership thresholds were lowered yet again by many nations to as low as 10 percent (Vukmanic, Czinkota and Ricks 1985; Stekler and Stevens 1992). Yet the cases of minority ownership, licensing and other forms of non-equity control have occurred with increasing frequency. This has called into question not just the durability, but indeed the arbitrariness of any aggregate ownership threshold for defining of IDI.

Furthermore, TNCs have increasingly been expanding their activities, both at home and abroad by non-equity means and these forms of expansion establish relations between firms that stand somewhere between control and competition. These new relationships have led challenged earlier institutional notions of IDI.

![Figure 5.10 - Foreign Acquisitions and New Establishments in U.S. Manufacturing 1981-1988 (Billions of US dollars)](source: steekler and stevens 1992)

Portfolio theory of international capital was a theory of IDI as a long-term capital flow from one nation to another. The post-war theory of IDI as a combination of capital flow and management associated with national firms. The general post-war paradigm of IDI (and indeed the balance of payment’s definition) was of investment associated with the wholly-owned subsidiary. It was a model of the transfer of capital by way of establishment or expansion of subsidiaries abroad, where the parent firm
transferred all the capital from the home nation and did not use local capital markets to fund it.

It will be recalled that it was the evidence of increasing use of retained earnings and local capital raising that was one of the factors that demonstrated that IDI was not simply a process of capital flow, and convinced post-war economists that IDI of the need for a redefinition of the theoretical paradigm of IDI.

5.6 SUMMARY - THE 1980'S CHALLENGE TO THE CONVENTIONAL CONCEPTIONS OF CAPITAL, COMPETITION, AND INTERNATIONALISATION

Earlier chapters in the thesis have explored the development of a distinct theory of IDI, based on the explanation of the stylised facts of early post-war IDI. While the pattern of IDI in the 1970's introduced more pluralism into the stylised facts of IDI, transformations in the context and pattern of 1980's IDI offered the sharpest contrast with the pattern of IDI that established the conceptual agenda of post-war theory.

While the responses to the challenge of 1980's IDI are explored in more detail, some important points of contrast with the concepts of capital, competition and internationalisation can be summarised here. Post-war theory came to incorporate a concept of capital that recognised the importance of institutional factors in the IDI process, especially the institutional form of international capital, the TNC. Developments during the 1980's led to a growing recognition of the close relationship between IDI and other forms of international capital, and a (further) blurring of the distinctions between them (c.f Coleman 1972). Similarly, the growth in the activities of TNCs during the 1980's was occurring in several forms, and that IDI was only one of many ways that those activities were occurring. In short, IDI (and the activities of TNCs) in the 1980's required that a less rigidly institutional and more dynamic concept of capital was required.

The pattern and scale of 1950's and 1960's IDI growth required that it be grasped analytically as more than a derivative process. However, the concept of internationalisation inherited from pre-war international economics continued to explain IDI as an overflow from inherently national activity. Firms from one nation engaging in IDI were required to possess some advantage over firms in the host nation to compensate for the additional costs of operating across borders. The evidence of IDI as an increasingly common activity of industrial nations, and with the funding of that investment increasingly derived from sources external to the investing nation, suggested that IDI was related to factors beyond national determination (and even that internationality may confer certain advantages over purely national operation).

Post-war IDI theory was also developed in terms of the observed association between IDI and industries which were not structured in terms of perfectly competitive markets. It was perhaps not surprising then that the explanation of post-war IDI was developed on the basis of a concept of imperfect competition. The growth of IDI in

---

37 Especially in the context of prevailing assumptions inherent in international economics, such as the assumption of international capital immobility.
the 1970’s was also explained in terms of the growth in forms of market imperfection. However, the pattern 1980’s IDI heightened a logical problem embodied in the concept of competition of IDI theory. Increased capital mobility and the generalisation of IDI activity (along with the fact that it was occurring across industries with widely varying market structures) undermined the notion of IDI as product of market failure. The next chapter considers the analytical responses to transformations in the stylised facts of 1980’s IDI in more detail.
CHAPTER 6

EXPLAINING THE STYLISTED FACTS OF 1980’S IDI

The demise of general theories of IDI
6.1 INTRODUCTION

In the previous chapter, the stylised facts of 1980’s IDI were outlined separately from the theoretical explanations and responses to those processes, which is the task of this chapter. Of course, the ‘facts’ therefore must always be understood as theoretically ordered, so that the formal separation of facts and theory is somewhat artificial. Nevertheless, a separation of description and analytical explanation is required for the 1980’s and 1990’s for at least three reasons. While the pattern of recent IDI is now generally well recognised, there is a need to emphasise the nature and scale of recent transformations in IDI patterns. Furthermore, there has been no general agreement about which aspects of recent change are critical and which are not. For many IDI researchers, some aspects of recent IDI should not even be considered to be IDI at all.

The principal reason for the separation of the stylised facts from the theoretical consequences of those facts is because of the significance of the impact of those changes on IDI theory. It has been established during the thesis that in contrast to many other branches of economic theory, IDI theory had the virtue of being developed on the basis of explaining real developments rather than idealised models. However, explaining 1980’s IDI has tended to undermine many of the core assumptions of the post-war theoretical agenda. In the context of explaining 1980’s IDI, much of the conceptual agenda of the theory developed in the post-war years has had to be recast. In short, the requirements of explaining 1980’s IDI undermined the earlier confidence about the generality of (1950’s and 1960’s derived) IDI theory. Most IDI theory is now shaped in terms of particularity rather than universality, and in terms of paradigms and frameworks rather than general theories. That the notion of a general theory of IDI has unravelled in less than thirty years during a period when IDI has become a more not less significant international process may seem paradoxical. The chapter builds on the work of previous chapters in providing a way of contextualising the clash of theory and history in a way that shows this paradox to be more apparent than real.

The basic contention of the chapter is that the theoretical crisis of the 1980’s and early 1990’s has its roots in the historical development of IDI theory itself as much as in any of the actual empirical developments in the 1980’s and 1990’s. The current chapter takes up the task of analysing transformations in the context of and pattern of IDI. The chapter also explores some of the wider implications for international economic theory and for economic policy of the break-down in the coherence of the general theory of IDI. The chapter begins by recapitulating the position of the various models in the late-1970’s, and then explores the theoretical explanations of the transformations in 1980’s IDI. Finally, the chapter brings together the broad theoretical responses to the challenges posed by recent patterns of IDI.

The chapter identifies four basic responses by IDI researchers to the theoretical crisis of the 1980’s: the dismissal of the changes themselves (thus holding onto earlier patterns as the analytical reference point); the recognition of increasing heterogeneity of IDI patterns (and becoming more explicitly eclectic); conclusion that it is no longer possible to explain the changes in a general model (and adopting a more descriptive approach); and finally the casting of 1980’s IDI as the beginning of a
new era (requiring new concepts and categories to explain them). These responses to the theoretical dilemmas posed by 1990’s IDI makes the re-evaluation of models of IDI a compelling exercise.

While the thesis argues that there can be no general theory of IDI, it does not, to paraphrase Buckley’s (1987) warning, consider that the choice is now between theoretical nihilism, on the one hand, or a complacent eclecticism on the other. A general theory of IDI is not possible because the concept of IDI itself is both historically and theoretically specific, and IDI must be understood as at best an indicator of only one aspect of a wider process of the international expansion of capital. The question of the nature of the IDI process cannot be answered outside of the historical context within which that IDI takes place. In short, the analysis of IDI must be situated within a wider theory of accumulation. The chapter concludes with a suggestion that an explanation of the changes in 1980’s IDI can be made through introducing different concepts of capital, competition and internationalisation, and utilising a different methodology for IDI research. The next chapter provides a case study of outward IDI from Australia during the 1980’s and early 1990’s.

6.2 Theoretical Models of IDI at the Beginning of the 1980’s

It was noted in Chapter 4, by the close of the 1970’s, research into IDI and the TNC had reached something of a theoretical hiatus. The earlier confidence that competing models of IDI research were searching for (or had found) the general characteristics of IDI or of the TNC, was no longer such a widespread feature of IDI research. Nevertheless, for many if not most IDI researchers, the 1980’s opened on the basis that a general theory of IDI remained at least a possibility.

Until the early-1980’s then, the general post-war optimism about the possibility of a general theory of IDI was still largely intact. In retrospect, of course, we can see that the ‘heroic age’ of IDI theory was probably already over. By the early 1980’s, the central issues of IDI theory had already begun to move beyond debates about which of the main models provided the best general model of IDI, to questions about the lack of generality and universality of the whole theoretical agenda. As the 1980’s progressed, what was at stake in debates about IDI was the very possibility of any unified model of IDI at all. By the late 1980’s, a consensus had emerged that no general theory was possible, and IDI research was increasingly conducted under the rubric of descriptive or eclectic ‘paradigms’.

While the stylised facts of 1970’s IDI had unsettled the general theory, it was the nature and scales of that growth IDI occurred in 1980’s IDI that brought the crisis in IDI theory to a head. In terms of the conceptual triad developed in the thesis it becomes clearer that the current crisis in IDI theory was not entirely the product of developments in 1980’s IDI. Nevertheless, there can be little doubt that the

---

1 It was argued by Fieldhouse for instance that it had become necessary to identify many distinct reasons for IDI, and asserted that, ‘Once such fundamental contrasts are perceived, the spurious unity of the concept of the MNC disintegrates...’ (1986,p.25).
2 In a review of 1980’s IDI Froot reached the rather understated conclusion that traditional theories of IDI had left many recent features of IDI ‘unexplained’ (1993,p.2).
3 Even the uniqueness of the 1980’s should not be overstated. After all, many of the trends in IDI during the 1980’s actually predated that decade, while many others were more general than just IDI itself.
cumulative effects of spectacular growth and an intensification of other change in 1980's IDI undermined the coherence and robustness of many models of IDI. Most immediately, some formerly popular models of IDI were found to have lost their ability to explain important features of recent IDI\(^4\) and were relegated to explanations of early post-war IDI. More generally, the 1980's undermined the possibility that a set of conceptual categories were capable of explaining patterns of IDI over time.

The challenges to IDI theory presented by 1980's patterns can be illustrated in terms of the conceptual triad (of capital, competition and internationalisation), developed earlier in the thesis. The concept of (imperfect) competition\(^5\) created a logical paradox for IDI theory in the 1980's. The rapid increase in the global mobility of capital, represented in part by the exponential growth of 1980's IDI, may seem to represent an increase in market efficiency. In IDI theory, however, the concept of competition required that it be explained as its opposite - as an increase in market imperfections. The only possible way out of this analytical impasse was either to introduce a non-neoclassical concept of competition (a prospect that, as Raymond Vernon (1986, 1993) has recently observed, throws open the whole theoretical agenda of post-war IDI theory) or to modify the concept of internationalisation (a process that began to occur in the late 1980's and early 1990's and is taken up below). The apparent compatibility of the concept of imperfect competition with neoclassical economics had been one of its great attractions to IDI theorists\(^6\) and thus the possibility of discarding completely the largely neoclassical research agenda of IDI theory was almost ruled out by definition. It will be shown below that one of the consequences of this crisis is that the concept of competition in IDI theory is now in a state of flux.

A similar problem also emerged for the concept of capital in IDI theory. It was noted in Chapters 3 and 4, that industrial organisation models, incorporating an institutional concept of capital, helped to transform the analytical paradigm of IDI theory, and directed explanatory attention to the characteristics of, and activities occurring within, international firms (TNCs). The institutional concept of capital helped to provide new insights into the post-war growth of IDI, but tended to do so in away that locked IDI theory into the particular institutional form of international capital that prevailed in the early post-war period\(^7\). During the 1970's, the growing diversity of forms of organisation of cross-border business where TNCs were able to control affiliates abroad with lower levels of ownership unsettled the rigidly institutional notion of capital, and encouraged more dynamic and comprehensive

\(^4\) It will be recalled that in the early post-war years, the major source of growth in IDI was from the US, and the TNC was widely seen as a US invention (Wilkins 1969; Hymer 1971).

\(^5\) And the related assumption about the national nature of investment under perfect competition.

\(^6\) Models of IDI incorporating such a concept (such as internalisation models for instance), permitted researchers to pursue the analysis of IDI and the institution of the TNC, "without straying very far from the comfortable pastures of static general equilibrium theory" (1984,p30). Rugman (1981), for instance, suggested that, "To explain the existence of multinational firms it is necessary to introduce transaction costs into conventional [i.e. neoclassical: MR] economic theory."

\(^7\) The theory's prematurely institutional focus (to paraphrase Jenkins) is related to its methodology, where the firm is the unit of capital not the institutional form of capital, with the consequent neglect of relations between individual capitals. Parry noted of the concept of capital in internalisation models that, "implicit in the internalisation approach is the view that it is easier (less costly) to monitor activities and enforce proprietary rights over information and know-how within an internal organisation than it is to enforce such rights in contractual, market relationships with third parties (1985).
approaches. During the 1980’s, more and more firms began to extend operations internationally, and many of these were established through low levels of equity and even non-equity forms - relations that seemed to stand between direct ownership and competition. As Buckley noted, ‘multinational firms’ dominance is no longer through ownership of production, but through a network of contracts appropriate to the strategy of the firms...” (1988,p183). These developments challenged the institutional concept of capital that had been a core component of the concept of capital. It was also in the context of institutional diversity that Casson (1989) concluded that IDI theory had been far too concerned with the particular institutional forms of international capital that prevailed in the early post-war period.

Finally, the concept of internationalisation in IDI theory was challenged by the sheer scale of IDI growth. It has already been noted that in the process of re-evaluating the concepts of capital and competition some of the underlying assumptions concerning the advantages necessary for international operations had been called into question. IDI theory embodied a concept of internationalisation based on an assumption that economic activity was inherently national in nature, and firms expanding abroad via IDI did so by virtue of their possession of some ability to overcome the additional costs of cross border organisation. By the late-1980’s, this assumption began to break down, and IDI researchers have since increasingly questioned why IDI requires some special national advantage. Other IDI theorists have even begun to suggest that internationalisation may itself confer advantages over purely national operations.

By the close of the 1980’s, these problems had discredited the notion of a general theory of IDI or the MNE. Theoretical scepticism has become so widespread that it is now widely held even by earlier proponents of general models that a unitary model of IDI is no longer possible. According to John Dunning (1989), it is now generally accepted that no single predictive theory of international production exists, or is even possible.

The chapter explores how a theoretical hiatus at the beginning of the decade rapidly became a crisis for the entire conceptual agenda of post-war IDI theory, and why this crisis occurred in the midst of one of the most spectacular periods of IDI growth. The chapter also examines the way IDI theory has attempted to reconcile this period of turmoil with its research agenda since then.

The next section considers the way models of IDI were affected by the explanatory demands of the 1980’s and their implications for the theoretical agenda of IDI.

---

8 Dunning transformed the claims for his own analytical project from a general theory to a ‘paradigm’. Peter Buckley also suggested that in as much as a general theory existed it was being directed towards a general theory of the firm, encompassing the MNE as a special case (1987). Against even Buckley's claim, however, was that the nature of the firm itself was undergoing significant re-evaluation, and for instance there has been a growing recognition that the boundaries of the firm are not easily defined in economic terms (Jensen 1987,1988).

9 Three broad responses by IDI researchers and analysts can be identified- to reject the changes as unrelated to long-term IDI processes; to preserve claims to general models by making them more eclectic; or to give up on the notion that there can (now) be a general model of IDI.
6.3 RECONSTITUTING THE CONCEPT OF CAPITAL- EXCHANGE-RATE MODELS

Developments in international capital flows during the 1980’s had some quite paradoxical effects on IDI theory. One effect of greater capital mobility and a closer relationship between forms of international capital was to erode the coherence of the largely static and institutional concept of capital that had become an integral part of orthodox IDI theory. This development encouraged IDI researchers to consider more fluid notions of capital, and, ironically perhaps, some IDI researchers reverted to pre-war concepts of international capital. Much of this work occurred in terms of attempts to introduce more institutional flexibility into industrial organisation models. Developments in the context of IDI, including in exchange-rate volatility, financial innovation and the changing funding of IDI, also encouraged a ‘new wave’ of research based on the earlier portfolio capital theory.

The reconditioning of portfolio capital-type models was stimulated by the evidence presented in Chapter 5 of the growing relationship between IDI and other forms of international capital, and by two further developments in the 1980’s. One was that during the IDI boom in the second half of the 1980’s, the US was by far the largest single location for inward IDI. This development finally undermined those models of IDI which had centred explanatory focus on the characteristics of outward IDI from the US and the activities of US-based TNCs during the 1950’s and 1960’s. The boom in inward IDI occurred during a period when the US dollar depreciated against most major countries, and this pattern seemed to suggest that instead of attributes of individual companies, 1980’s IDI may fall within the explanatory range of the earlier portfolio capital theory.

IDI researchers, such as Caves (1988 and 1989) and Froot and Stein (1989, 1991), found a strong negative correlation between the trajectory of the $US exchange rate and inward IDI over the 1970’s and 1980’s. Employing an imperfect capital markets hypothesis, Froot and Stein explained the currencyIDI relationship as the result of the relative wealth effects generated by exchange-rate movements. From the mid-1970’s, the US dollar exchange-rate had been considerably more volatile than had changes in the rate of return on net worth of corporations engaged in manufacturing in the US. Froot and Stein concluded that exchange-rate shocks had generated a greater volatility in the relative wealth of domestic and foreign companies than had the potential effects of profitability shocks. The model thus

---

10 The growth of inward IDI into the US accelerated in the early-1970’s, and by the early 1980’s, the US had emerged as the single most important destination of IDI.
11 It will be recalled that in the early post-war period, the US had been the single most important source of IDI outflows. Until the mid-1960’s for instance, the US accounted for around 70 percent of the accumulated stock of IDI and 85 percent of all IDI outflow since 1945 (Dunning 1991). A general assumption inherent in many models had been that IDI was a US phenomenon and that factors developed by the US in the post-war period provided a strong motivating reason for cross border direct investment. The development of the US as a major location for inward IDI had posed explanatory problems for IDI, when post-war IDI was seen as an expression of particularly US competitive characteristics.
12 Caves suggested that the correlation may be explained by the fact that currency depreciation makes assets in that country cheaper in world markets. The depreciation of the US dollar exchange-rate in the second half of the 1980’s coincided with a dramatic growth in inward IDI into the US. Froot and Stein found that inward IDI was the only type of capital inflow that was statistically negatively correlated with the value of dollar.
13 The ‘imperfection’ proposed that drives the relationship was especially information asymmetries about particular assets.
predicted that IDI would tend to flow from countries with appreciating currencies toward those with depreciating currencies. This is a proposition not dissimilar to the currency-area hypothesis explored in Chapter 3, which conceptualised IDI essentially as an arbitrage process similar to that of portfolio capital.

Exchange-rate models had the advantage of emphasising the obvious links between IDI and other forms of international capital in the 1980's. There were, however, a number of serious problems with exchange-rate models as an explanation of IDI in the 1980's. Firstly, the concept of internationalisation inherent in the exchange-rate model could not grasp the potentially complex nature of the effects of exchange-rate volatility on IDI. McCulloch (1994) pointed out that exchange-rate changes set in motion a number of effects on firms that makes currency price changes less clear than the exchange-rate model assumes. A permanently depreciated currency would for instance mean that the value of a firm's earnings (in that country) are also likely to be affected when converted back into its 'home' country currency. Furthermore, where a TNC acquires another firm engaged in production with high a degree of imports in its production process or a high degree of exports in sales, other effects of the exchange-rate come into consideration. The different and variable impact of exchange-rate variability on particular industries or firms means that the direction of any possible effects of exchange-rate movements on IDI at a national level are more ambiguous than simply asset price arbitrage. Consequently, the direction of any exchange-rate effect can be undetermined in such models. In some cases, exchange-rate depreciation may make IDI more profitable, while in others it may make it less profitable.

A related issue here was that many developments in international capital markets during the 1980's blurred exchange-rates effects for international companies in the international economy. In particular, exchange rate models cannot account for the dramatic increase in capital mobility during the 1980's, and particularly for the strong internationalisation in the sources of funding of IDI growth (borrowing by companies in international capital markets, including the use of cross-currency interest rate swaps). These developments in international capital markets during the 1980's dramatically increased the degree of integration of capital markets across national borders. It also meant that companies in nominally different exchange-rate regions, with different exchange rate experiences in the international economy, could access funds in international capital markets and, through a range of secondary markets, insulate any interest-rate and exchange rate movements from their repayment schedules. As a result, models of IDI relying on exchange-rate differentials between nation-states, or firms based in different nation-states became less rather than more effective in their explanatory power.

Secondly, the strong correlation between exchange rates and inward IDI in the 1980's was limited to the US. While Froot and Stein found a significant association between inward IDI and exchange rate movements for the US, no similar correlation was found when evidence of trends in the exchange rate and inward IDI for other countries was examined. The lack of a relationship between inward IDI and

---

14 This correlation runs counter to the expectations of conventional financial theory, which classifies IDI as a long-term capital flow. IDI motivated by changes in currency levels (especially related to exchange-rate volatility) suggests an essentially speculative nature to IDI. In such circumstances portfolio capital, rather than IDI, should be more closely correlated with exchange-rate movements (McCulloch 1994).
exchange-rates was also confirmed by other studies of Derwenter (1992a, 1992b), Healy and Palepu (1994), Swenson (1994) and Adler (1994). All these studies suggested that evidence for the relationship was applicable only to the US, and even there, the relationship found for the US inward IDI might be questionable.

More significantly perhaps, the basic hypothesis of the exchange-rate model was incompatible with the broad international patterns of IDI in the 1980’s. It was a model of IDI that attempted to explain a specific aspect of that pattern, namely the concentration of IDI inflow to the US. It could not account for either the pattern of US outflows (which also grew rapidly at the same time that inward IDI was expanding), or for the growing cross-flow of IDI between most of the major developed economies, and many developing countries as well. In the second half of the 1980’s, when a spectacular period of IDI growth was occurring, both inward and outward IDI from all the major industrial nations was one of its key characteristics. This relates once again to the concept of internationalisation of pre-war theory, and is precisely the problem encountered by earlier attempts to use exchange-rates as an explanatory vehicle for IDI\textsuperscript{15}.

Finally, the concept of capital of pre-war international investment was still incapable of explaining the association of IDI with the internationalisation of firms. Exchange-rate models emphasised direct investment as a transfer of capital, when it has been observed that IDI may involve no cross-border capital flow at all (at least not in balance of payments terms). The dominant IDI paradigm understands IDI more as a transfer of technological or management skills by firms than of capital between nations (Lipsey 1994). The exchange-rate model remained a model of capital flow and, as Krugman observed about cross-hauling of IDI, “the one thing we know definitely, after two decades of intelligent thinking about DFI is that whatever it is, it is not an investment. It is an extension of control. Once you have an entity that sprawls across borders, which way do you say the sprawl is going?” (1985,p34)\textsuperscript{16}.

There was in short no viable way of returning to the pre-war concepts of capital, of portfolio capital theory in the face of the crisis in IDI theory in the 1980’s. Reverting to portfolio theory under conditions of uncertainty could not resolve the analytical dilemmas of explaining 1980’s IDI. In particular, what the attempts to use portfolio theory highlighted was that attempting to assign national attributes to capital flows has become an increasingly difficult task. It was in this context that Vernon (1993) concluded that the 1980’s had eroded the explanatory power and analytic value of IDI models based on the nationality of investment (or of the nationality of the investors). As will be shown below in the cases of developments in trade and industrial organisation models, the only way IDI theory could grasp 1980’s IDI has been to introduce alternative concepts of competition and internationalisation.

\textsuperscript{15} The earlier criticism of Buckley (1987), for instance, noted of the criticism of Aliber’s currency area thesis that it could not explain the empirical fact of simultaneous cross-investment.

\textsuperscript{16} While international patterns of capital flow still exhibit national patterns, global capital flows have not become more hierarchical, but less. In the case of the internationalisation of firms, the national direction of capital flows or control, makes the cross national capital flow analogy even more circumspect.
6.4 RECONSTITUTING THE CONCEPT OF COMPETITION - TRADE MODELS

In earlier chapters, it was observed that trade-based models of the international economy (based on an assumption of international capital immobility), had explained international capital flows largely in derivative terms. In the post-war period, the growing mobility of capital and the disparity between the national patterns of capital and trade flows therefore created serious problems in understanding IDI within trade theory (Hymer 1961)\(^{17}\). Developments in the 1970’s continued to undermine the assumption of international capital immobility inherent in trade theory, and researchers working within trade theory were forced to modify their concepts to explain prevailing patterns of both trade and IDI\(^{18}\).

The current section explores the attempts to modify the concept of competition in IDI theory that occurred through models of IDI that drew on trade theory. These attempts to modify the concept of competition occurred in the context of both the rapid growth of IDI from most industrial nations and the increasingly two-way nature of that growth. Rachel McCulloch observed that, “The greatly increased extent of two-way foreign direct investment and even of two-way flows within a given industry has blurred the distinction, at least among industrial nations, between host and source countries” (1993,p51). It was in this context that the stylised facts of 1980’s IDI undermined even the expanded comparative advantage (or the newer competitive advantage) models\(^{19}\).

The pattern of 1980’s IDI therefore posed a fundamental challenge to the explanatory power IDI models based on the proposition that there were specific national types of IDI\(^{20}\). The inherent limitations of models based on this proposition was also observed of specific models, such as the Trade-Enhancing (T-E model) that contended that there was a ‘Japanese-type’ IDI which was analytically distinct in its competitive characteristics to other national types of IDI. Encarnation (1992 and 1993) suggested that the T-E model had become less valid because the distinctiveness in the competitive characteristics of Japanese IDI had diminished (because of convergence

\(^{17}\) The development of a distinct theory of IDI can be traced directly to critiques in the early post-war period of those trade models.

\(^{18}\) Paradoxically, however, the 1970’s pattern of IDI tended to also undermine the Product-Cycle model, the most well-known attempt to synthesise trade and international investment.

\(^{19}\) Two problems in particular were confronted any form of extended comparative advantage model. One was that IDI growth was not even but quite volatile, and the second that the pattern of growth took place across most industries at the same time. As Frooth (1993) concluded;

"...it is hard to believe that the tide of underlying competitive advantage followed closely (or at all) the behaviour of total FDI flows over the last decade. Very rapid increases in 1979 through 1981, strong declines from 1982 through 1985, and then increases of unprecedented size from 1986 through 1990. One would have expected changes in national competitive advantages to be reflected in more steady trends. Second, to the extent that any developments happen quickly, one might have expected that they would occur in a single industry at a time - say, the automobile producers of Japan - as shocks to competitive ability come to be reflected in world ownership patterns. Yet the surges of the past fifteen years take place across virtually all industries simultaneously. He also suggested that there that in many industries there was little if any meaningful changes in competitive advantage, and there was also evidence in some cases, such as IDI by banks from Japan that IDI ran counter to comparative advantage.

\(^{20}\) It will be recalled that the evidence of post-war capital mobility undermined the notion of nations possessing a fixed set of factor endowments, and tended to negate the related proposition that citizens in any nation face the international economy in a collective and unified way.
during the 1980’s), and that many of the claimed differences in national IDI patterns were no longer supported by empirical evidence 21.

Attempts were therefore made to both reconstitute the concept of competition in response to the explanatory problems posed by 1980’s IDI22. Any concept of competition utilised for 1980’s IDI had to meet several requirements, especially the requirement introducing more dynamic context to the theory. It was for instance difficult to maintain that the burst of merger related IDI in the second half of the 1980’s, related to a sudden change in the relative costs and prices of using international markets. The concept of competition embodied in IDI theory (especially in the internalisation model) was, to recall Vernon’s comments, a descendant of static general equilibrium economics. This enabled IDI theory to be capable of describing aspects of the growing diversity of forms of IDI, but it neither predict nor explain many of the 1980’s developments. Buckley, acknowledged that “the introduction of more dynamic element into the theory is a matter of urgency. This is a difficult task” (1988). The addition of a more dynamic element is a ‘difficult task’ because it throws open the concept of competition of IDI theory.

Not only did any concept of competition therefore have to engage with capital mobility23, it had to concede that IDI was more than simply a response to the imperfections in the market structure of intermediate products. In the mid-to-late 1970’s, the concept of imperfect competition had displaced earlier more rigid concepts, but by the mid 1980’s its earlier popularity had begun to appear a source of the theory’s weakness rather than one of its strengths. By the late 1980’s, the problems of the concept of imperfect competition for developing a general explanation of IDI had become quite acute. To paraphrase Vernon, the concept of imperfect competition had tended to ‘crowd out’ the analysis of other concepts that might be useful in explaining IDI (1993).

The concept of competition which has begun to emerge in IDI theory is one that attributes the nature of IDI to the competitive characteristics of the industry, the nature of the production process and to inter-firm rivalry (McCulloch 1993; Vernon 1993). Rather than the neoclassical-type concepts of competition, concepts derived

---

21 In relation to the proposition that Japanese-type IDI was trade enhancing and was characterised by minority-ownership (joint ventures with local firms and so on) in contrast to American-type IDI, he concluded that “Even if accurate at the time reported (itself a questionable assumption), these earlier differences between Japan and United States TNCs had, by the early 1990’s, withered away. And by the same logic, additional progress along a common evolutionary path should also diminish other more persistent vintage effects” (1993; p26).

22 An alternative explanation of cross border capital mobility was offered via a reversion to the earlier concept of competition of IDI. Here IDI is conceptualised as an aberration, a response to market failure, and in particular as a response to cross-border trade restrictions (McCulloch 1994). There was, however, little or no evidence to link trends in tariff and other forms of trade protection to patterns of IDI. While there was trends to reductions in trade protection, there were some increases in non-tariff protection. The pattern was therefore, mixed. Balassa for instance contended that the directional change of IDI could not be explained by reference to increased protection. “Protection had declined rather than increased as tariffs have been greatly reduced in a parallel fashion in the United States and in European countries in the framework of the Kennedy and Tokyo Rounds, and quantitative restrictions have not been imposed on their mutual trade in the products cited”(1985) Balassa’s conclusion, that the causes for the spectacular growth and changes in the pattern of contemporary IDI had to be found elsewhere than in changes in national trade barriers, pointed to the requirement for a different concept of competition. The general conclusion being reached then was that trade barriers per se cannot explain the patterns and characteristics of recent IDI. Caves for instance concluded that current IDI activity and current tariff levels may not be closely related “even if that relationship was originally a close one” (Caves 1982,41).

23 Markusen suggested that in the face of an increasing international mobility of capital, that international trade theory had devoted too much attention to commodity trade and not enough to factor movements (1983).
from game theory and managerial/behavioural theory, have been advanced in its place. The problem here is that by definition, these concepts are premised on uncertainty and do not easily ‘fit in’ with earlier neoclassical-inspired models. On the contrary, as Vernon has implied, this re-evaluation represents a move away from the neoclassical conceptual heritage of IDI theory.24 By the early 1990’s, an inversion in the concept competition has become wider, and instead of IDI as a response to (or result of) market failure, IDI is now increasingly being understood as an expression of internationalised relations of competition.

6.5 RECONSTITUTING THE CONCEPT OF INTERNATIONALISATION - INDUSTRIAL ORGANISATION MODELS

In Chapters 2 and 3, it was noted how concepts derived from industrial organisation theory (and institutional economics) helped to transform the paradigm of IDI theory. In Chapter 4, it was then shown how the changing stylised facts of 1970’s IDI undermined several industrial organisation models of IDI. Growth and change in 1980’s IDI also challenged the universal nature of the industrial organisation-derived concepts inherent in IDI theory, especially the claims of the pre-eminent industrial organisation model - the internalisation model.

By the mid-1980’s, internalisation models were no longer being advanced as a comprehensive and unitary model of IDI. In an auto-critique of the internalisation model, Peter Buckley, concluded that internalisation had become “a concept in search of a theory” (1983)25. Thomas Parry (1985) noted that internalisation models provided a sound explanation of certain types of IDI - namely vertical integration, transfer pricing and quality control, but was not the basis of a general theory of IDI. Fieldhouse suggested that many motives for IDI “had no necessary connection with the internalisation concept”(1986). Dunning also suggested that internalisation was a satisfactory explanation of why a firm should choose to engage in foreign investment rather than organise cross border activities in other way. But when it claimed to explain the level, structure and location of all production (as required by a general model), the theory lost much of its incisiveness and was open to serious challenge (Dunning 1991)26.

It has already been noted that during the 1980’s, as part of the breakdown of industrial organisation models as a general theory of IDI, a modification was forced in the rather rigid institutional concept of capital. Just as importantly, the fact that IDI was now a general experience for most industrial nations, and a normal activity of many firms in those countries, made the concept of internationalisation inherent in IDI theory less tenable. Post-war IDI had been explained in terms of national firms “spilling over into foreign markets” (McCulloch 1993,p38). Firms engaging in cross-

24 According to Vernon, the prospect of successful modelling of IDI and the TNC will require the shedding of many of the key assumptions of neoclassical economics. “The behaviour that emerges [from recent probable future MNEs] will not be easily explained in terms of models that satisfy neoclassical conditions” (1993,p77). A further problem with these alternative concepts is that they do not seem to generate a clear policy program.
25 Buckley was acknowledging criticisms about the excessive generality of the concepts employed in the internalisation models. Stanley Fisher for instance objected that “almost anything can be rationalised by invoking suitably specified transaction costs” (cited in Williamson 1993).
26 Ether suggested that a paradox had emerged for the internalisation model in that it had become an analytic black box “always appealed to but never explained” (1986).
border investment were therefore thought to be somewhat exceptional, and that they
must possess some "compensating advantage" to overcome the additional costs of
conducting business in foreign lands. The evidence of the increasing number of firms
operating abroad, and the growing scale and international orientation of the activities
of those firms, began to undermine the explanatory power of concept of
internationalisation as an exceptional development. It has been increasingly evident
within IDI theory, especially industrial organisation models, that a modification of
the concept of internationalisation was occurring.

Instead of an inherent disadvantage of operating internationally, many models of IDI
(including internalisation models) have begun to propose a concept of
internationalisation where the internationality of firms is now taken as being a
natural or normal part of their activities. McCulloch for instance has suggested that
IDI should now be seen in the context of firms that now have an inherently global (as
opposed to the earlier national) nature. She has suggested for instance that "direct
investment is an integral part of a large firm's overall strategy for global production
and sales"(1993,p38). McCulloch (1985), pace Vernon, initially suggested that the
role of uncertainty (and therefore risk management) might help explain the growth of
IDI in the 1970's, but noted that international diversification of portfolio investment
had also increased markedly in the 1970's. This suggested that in addition to risk
management, there may now be reasons to conceive of multinationality as a normal
part of the firm's activities27. This is an approach that has been receiving increasing
attention28. The re-evaluation of the concept of internationalisation (which is now
often posed in terms of "globalisation") has been paralleled by work being conducted
within trade theoretic paradigms, especially the work associated with writers such as

The re-evaluation of the concept of internationalisation has even extended to a
virtual inversion of the earlier concept of internationalisation. Some researchers have
now started to consider, that there might actually be advantages for firms of
operating internationally rather than nationally. Dunning for example, suggested that
in the last decade the theory of international production had moved away from a
reliance on country-specific advantages in production towards firm-specific
advantages (ownership and internalisation). He postulated that this was due to a
maturing of firms whose ownership advantages are now less dependent on the
characteristics of their home country, and more dependent on their degree of
multinationality. This transition was associated with intra-industry IDI and a new
organisational efficiency of MNEs, which leads them to seek international expansion
in its own right (Dunning and Norman 1986). This is almost an inversion of the early
theories where multinationality was a problem to be explained, since it was assumed
that operating abroad imposed additional costs over domestic business. It has been
suggested that while it was earlier held to be necessary for firms to possess some
intangible asset to make initial investment abroad profitable, once a firm has begun
to operate across borders, internationality may in itself actually endow advantages

27 McCulloch suggested that the most obvious advantage of multinationality was international flexibility on
transfer pricing as a means of tax minimisation.
28 Sauvant has suggested for instance that, "the approach that FDI should be seen as an integral part of a firm's
overall global strategy is a promising one and deserves further investigation" (1993, p54).
over nationally-oriented firms (Kogut 1983, 1985, 1989)\(^{29}\). Other researchers had begun to reach similar conclusions. Bartlett and Ghosal (1988, 1990) have also for instance, contended that one of the advantages possessed by TNCs is that they are exposed to a range of experiences not available to national firms. The implications for models of IDI of such a conceptual inversion have so far been only partial and suggestive. The possibility of a conceptual inversion in the study of IDI as a response to recent internationalisation has been recognised explicitly by two of the major figures in IDI research (Casson (1986)\(^{30}\) and Dunning (1991)\(^{51}\).

The critical issue here is that the undermining of the earlier concept of internationalisation, along with the concepts of capital and competition that constituted the core of the earlier theoretical agenda, helped to erode the claim for post-war IDI being a general theory of IDI for all times. The next section discusses the effects of this conceptual re-evaluation on IDI theory.

### 6.6 The State of IDI Theory in the Mid-1990's

It has been established that the cumulative effects of growth and change in 1980's IDI has been to undermine the notion that post-war IDI theory represents a general and universal theory of IDI. The purpose of the current section is to explore the responses of IDI researchers to the theoretical crisis. In this section four broad responses by IDI researchers to the theoretical crisis in IDI are identified: to suggest that 1980's IDI was due to one-off factors and therefore to deny the analytical significance of the period; to concede the 'plurality' of IDI patterns and examine IDI using more explicitly eclectic approaches; to deny the possibility of a general theory and resort to descriptive approaches; and finally to identify 1980's IDI as the beginning of a new phase of international capitalism requiring either new concepts and categories or a wider theory of accumulation. While each of these responses are considered in turn, they have not been mutually exclusive, and it will be shown that some researchers have adopted more than one of the responses at various times.

---

\(^{29}\) While Bruce Kogut was the probably the first orthodox economist to identify the need for a transformation in the concept of internationalisation, Rachel McCulloch was one of the first researchers using the internalisation model to recognise both the need for such a transformation, and to argue that it could be made compatible with internalisation concepts. She suggested for instance that “What is particularly significant about the function of internalisation in optimisation under uncertainty [that had become a characteristic of the 1970's and 1980's] is that the investing firm's essential advantage arises from being multinational” (1985).

\(^{30}\) Casson (1986) criticises the assumption of a static configuration of nation-states. He suggests that one of the common problems of IDI theory is that “Taking the nation-state for granted, they inquire into the viability of the enterprise... given the costs of operating across national borders, what are the economic advantages of doing so? But this question can be turned around the other way. Given the economic advantages of operating on a global scale, what is the rationale for continuing to split the world into different nation-states...[A]n individual, may within limits choose the state from which he takes up citizenship... The same point applies to a legal entity such as a firm.”

\(^{51}\) Dunning attempted to slide the inversion through the E.P. He suggested for instance that “One of the most significant characteristics about international production is the extent to which it aids the mobility of assets, notably money capital and innovatory capacity, and of intermediate products, notably technology and management skills, across national boundaries. This mobility immediately offers the owners of these assets and products a wider option in their location and use. In particular, they may be no longer constrained to add value to them in the countries in which they originate. And, the evidence shows that they do not. If one takes the 600 or so billion dollar industrial companies identified by Fortune magazine, the about one third of their sales was produced outside their home country in the late 1980's...”
6.6.1 Not IDI at all, or just an exceptional period

Some IDI researchers have suggested that 1980’s IDI was such an exceptional period that much of it can be discounted as not being a true test of either the concepts or the general theory. These researchers have contended that much of what was recorded as IDI in the 1980’s was not actually IDI at all, but something else. Dunning, for instance, suggested that much of the merger and takeover activity, especially that relating to conglomerate activity was not really IDI at all,

“because it involved the purchase of a set of assets which the firm is not intending to organise, manage or integrate in any way. The question of why a firm seeks to acquire such assets then comes down to its expectation that the assets it acquires will appreciate in value with time, or enable it to earn a better rate of return than it could get from any alternative use of resources... in that case it is not a direct investment at all but a portfolio investment” (1991).

Other researchers have contended that the pattern of 1980’s IDI was due largely to one-off factors that won’t recur again. This view is based on the association of the 1980’s IDI boom with processes of de-regulation of capital markets, exchange rate volatility and financial innovation, the sustained economic growth during the 1980’s, and the M&A wave. All these factors, either individually or collectively, are taken to mean that IDI in the 1980’s was a temporary one-off surge. Karl Sauvant (1993), for instance, has suggested that much of the surge in the 1980’s can be explained as a one-off, policy and technology induced phenomenon. In that sense, IDI growth in the 1980’s, can be dismissed in analytical terms since it was not a development of long-term theoretical significance.

One problem with the 1980’s ‘exceptionalism’ thesis as a view of recent internationalisation is that it does not resolve the analytical problem of explaining recent IDI. Nor does it provide an explanation for the evidence of much greater levels of IDI\textsuperscript{32} or for the MNE as a more general way of organising production. Furthermore, there have been several previous attempts to deal with the problem of whether a period of IDI growth or change was an ‘exceptional’ period because it did not conform to the existing model. For instance, in the 1960’s there was still debate about whether IDI was basically a stock adjustment phenomenon or required a different theoretical paradigm. Similarly, the growth cross investment within the same industry (intra-industry IDI) in the late-1960’s and early-1970’s was another such period of change\textsuperscript{33}. As Erdilek commented, “...not all serious students of DFI

\textsuperscript{32} A less extreme version of the exceptionalism thesis runs that theories of IDI are good at explaining long-term patterns, but not of short-term patterns or changes. Froot, for instance, concluded that “Traditional theories are very useful for explaining basic long-term patterns of FDI...In spite of their [earlier: MR] successes, however, the traditional theories leave many recent features of FDI unexplained. These facts suggest that existing theories do a good job of explaining neither the timing of the magnitude of surges nor their broad cross-industry composition”.

\textsuperscript{33} Cantwell (1991), for instance, noted that developments in IDI theory during the 1980’s that led to greater eclecticism represented a continuity with changes in the 1960’s and 1970’s.

“In the 1970’s and early 1980’s, it became fashionable to search for general theories of international production which encompassed all the contributions of earlier writers thought to be significant. These were sometimes advanced as general theories of the MNC, the main institutional agent of international production, or general theories of FDI, the major means by which international production is financed. When confronted with evidence on certain types of international production that their ‘general’ theories did not seem to explain, the proponents of such theories all too frequently seemed to respond either by dismissing the relevance of the evidence or by
yet agree that IDFI is a particularly significant economic phenomenon deserving of special attention, apart from that accorded separately (sic) and independently to its constituent parts. Even a few...express a certain degree of scepticism about the theoretical and/or empirical content of IDFI. They tend to view IDFI merely as a corollary to the existing models of DFI in general. They also doubt that it can be easily identified and measured”(1985). Krugman, for instance, had also suggested that there was a problem with the whole notion of IDFI, because of the difficulty of determining the relevant industry from the point of view of IDI, and of determining which way IDI was going.

More significantly perhaps, at an empirical level, the approach is premised on IDI in the 1990’s reverting back to earlier, less complex and less general patterns. While the decline in the growth of IDI in the late-1980’s seemed to indicate that such a reversion may have been underway, evidence of 1990’s IDI has largely undermined the ‘exceptionalism’ thesis. The possibility of IDI becoming more ‘normal’ again (i.e. like the 1950’s and 1960’s in character) therefore appears to be extremely unlikely. On the contrary, in terms of IDI, the 1980’s may be better characterised as a transitional phase - a movement toward a thorough-going integration of individual firms into the global economy. In this context, the 1980’s may be exceptional only in that it was marked by an intensification of a process which has had a long historical trajectory.

The other responses to the theoretical problems of explaining recent historical change are more significant, since they attempt to engage with, rather than dismiss the recent developments in IDI. They are also more confronting for IDI theory since these responses signal the end of the earlier analytical agenda.

6.6.2 No general theory and accept a more descriptive paradigm

Another response to the theoretical problem of explaining recent historical change has been to concede that a general overarching model of IDI is not (or at least no longer) possible, and to adopt an explicitly descriptive approach. Theoretical scepticism about IDI has become quite widespread since the mid-1980’s and it is more than a decade since any serious claim was made for a general theory of IDI.

---

34 A similar rejection of changing patterns of international activity occurred in international trade theory in relation to the growth of intra-industry trade in the 1950’s and early 1960’s. With the continued growth of \textit{intra-industry trade}, however researcher in trade were forced to incorporate intra-industry trade into theoretical explanation Erdilek (1985). A related point is that a high proportion of that growth in intra-industry trade took the form of \textit{intra-firm} trade. By the mid-1970’s, intra-firm trade accounted for between 35 per cent and 40 per cent of all trade in industrial plants in OECD countries, outside of Japan (Helleiner and Lavergne 1980; Dunning 1985).

35 Krugman suggested that the industry determination problem was also a problem in trade, where researchers “ended up defining intra-industry in terms of what it was not. It was not related to comparative advantage, that is, it did not involve trade based on differences in factor endowments. Therefore, an industry was a group of products within which you could not distinguish according to the criteria which gives rise to more conventional sorts of trade” (1985). Roussel suggested that the classification scheme used to define industries was somewhat arbitrary, and concluded that “the amount of IDFI, the reasons for it and the policy implications all depend heavily on the degree of aggregation used to define ‘industry’” (1985).

36 In a recent literature review delong and Vos (1994) suggested that contributions to IDI literature could now be categorised in terms of theoretical approaches, descriptive approaches, and studies of determinants and effects of IDI.
In many ways, however this is the most problematic response, because it puts not just the whole post-war theoretical agenda of IDI at stake, but is a renunciation of the possibility of analysing IDI as a distinct theoretical phenomenon.

A number of key IDI theorists have begun to critique the terms of the post-war theoretical project. Graham and Krugman suggested that recent IDI is linked to issues and processes that are beyond the limits of existing theoretical understanding, and concluded that "it is unlikely that theorists will produce really convincing models of FDI anytime soon" (1993,p32). Similarly, Casson (1986) identified several weaknesses common to all theories of IDI37, and concluded that "As a result, the concept of the MNE which underpins current theories remains too narrow to make analytical study of the economic history of the MNE an especially rewarding subject". Casson therefore contended that "there is no really satisfactory general theory of the MNE". Similarly even models incorporating an explicitly eclectic approach as the basis of a general theory retreated in their claims to generality. Dunning (1987) conceded that "Because of its generality, the E.P. has only limited power to explain or predict particular kinds of international production; and even less, the behaviour of individual enterprises".

This burst of theoretical scepticism is in part simply an over-reaction to the confidence in general theories of IDI in the 1960' and 1970's38. While the rejection of the possibility of developing an analytical approach represents a sharp contrast to the earlier optimism about a general theory of IDI, like the first approach of rejecting the evidence, theoretical nihilism doesn't resolve the analytical issues raised by transformations in 1980's IDI. Instead, resorting to a solely descriptive approach is a self-defeating response to the theoretical crisis posed by developments over the last decade and a half. One important issue it does raise, however, is the possibility of a general theory that is confined only to the IDI process.

### 6.6.3 Greater eclecticism

By far the most popular approach to the explanatory dilemma posed by 1980's IDI has been to resort to an increasingly eclectic approach to the theory of IDI. Theoretical eclecticism has taken two forms. The first has been to concede that there is not one unitary type of IDI, but that several 'types' of IDI exist. In other words, models of IDI are models of only a particular form of IDI. It has been increasingly found that the determinants of IDI are numerous and that IDI has become characterised by differentiation and variety. It was concluded that such results supported the value of an eclectic approach to explaining patterns and determinants of IDI (UNCTC 1991; Ethier 1986)39. In other words, in order to explain one type of IDI, researchers may need to draw on one model of IDI, but the explanation of other types of IDI may require the deployment of concepts from other models.

---

37 These included that the theory was too steeped in the special institutional forms of foreign involvement (i.e. the MNE) which developed in the post-war period, and were based on assumption of a fixed configuration of nation-states and other institutions, which renders theories historically limited.

38 A less nihilistic approach has simply been to observe that the general theory of IDI had been undermined by changing patterns of IDI. Hertner and Jones (1986) have observed that "there is still no generally accepted definition of the MNE...and[ ] given the lack of general agreement on definitions, it is not surprising that there is still no consensus amongst economists concerning the theory of the MNE"

This concession creates the second and related eclectic response - that individual models of IDI have themselves become more eclectic. In order to preserve the claims of particular IDI models to being a general theory (or paradigm), models of IDI have increasingly drawn on several explanatory models. In order to explain the much greater scale of IDI and the more diverse patterns within that process, theories of IDI have tended to incorporate elements from more than one model of IDI, often along with elements from other branches of economics.

While there is a longer history to eclecticism than the 1980’s, the important new element to 1980’s eclecticism is that it occurred in the context of a breakdown in the notion of a general theory, so that all models of IDI have become more explicitly eclectic. Casson concluded in the early 1990’s that, “Internalization is only one of a number of principles needed to explain international business behaviour...explanations of internalization... usually require a synthesis with other principles too” (1991). Rugman, once the main proponent of internalisation as a general theory to subsume all other models has now suggested a need to recognise “the close, indeed intimate relationship of internalization theory to the [explicitly] eclectic model of Dunning” (1985). Kravis (1985) also supported the need for a general approach along the lines of Dunning’s eclectic model.

Peter Buckley (1988) has recently observed that an established theoretical synthesis of IDI exists, albeit based on the internalisation model of IDI. But he has also recognised that if such an accepted theoretical synthesis exists, then it is not without several significant problems. He warned that IDI theory was now in danger of “complacency [from the continual resort to increased eclecticism to resolve explanatory and analytical problems] on the one hand and [theoretical] nihilism on the other”.

In particular, two basic problems emerge from importing elements from other theories to explain current patterns of IDI. The first relates to the increased theoretical inconsistencies with drawing on elements of different theories. It will be recalled from the analysis of the Eclectic Model in Chapter 4, that while the introduction of elements from several theories helped to bolster the claim for a general theory of IDI, the nature of the relationship between the elements of the eclectic paradigm and their development over time were left unresolved. In the 1970’s, Dunning was emphasising ownership and locational advantages, while in the

---

40 Dunning (1990), for instance has suggested that “there is no such thing as a once (sic) for all explanation of international business”, and that any explanation of IDI “may need to draw upon a different set of the competitive advantages of firms and the locational advantages of countries”. According to Lipsey, “Many answers may be needed because there may be many motivations, varying with the firm involved, the industry, and the home country, and the time the decision is made” (1989,1).

41 It will be recalled that even in the formative period of the internalisation model, a synthetic approach was already evident (Buckley and Casson 1976). The derivation of internalisation/transaction cost economics was itself acknowledged to be an explicitly eclectic paradigm (“a combined economics and organisations perspective”) has been acknowledged (Williamson 1993). Casson’s recent attempts to introduce into the internalisation model literature form quality control and entrepreneurial theory represents in many respects more a continuity than a break with the past (1987, 1988).

42 Etzioni (1986) suggested that internalisation had emerged as “the Caesar of the [eclectic model’s] OLI triumvirate”.

43 It is likely that here Buckley was issuing a warning to colleagues like Casson who have suggested, in an almost self-satisfied way, that there was now even a danger that “as a result of recent advances theory may outstrip empirical evidence” (1991)
mid-1980's he was emphasising internalisation advantages. In the 1990's, a further
transition has taken place. Dunning and others have introduced additional elements
to the eclectic model in an attempt to capture current changes occurring in IDI, and
to deal with claims that the eclectic model is framed largely in static terms (Vernon
1985). These included explanations of the development of non-equity forms of
association and control, the dynamics of corporate strategy and behaviours,
entrepreneurship and the concept of an investment development path or cycle
(Dunning 1986, 1993). The reason for the transition from one set of factors to another
has never been specified in analytical terms.

The second and more fundamental problem with the increasingly eclectic nature of
IDI theory relates to the theoretical status of IDI. If there is only a theory which
explains current IDI, but which has to be continually amended as IDI changes, in
what sense does it remain a theory at all. This problem relates to the fourth and final
response to the crisis in IDI theory.

6.6.4 A general theory of accumulation not IDI

The final approach to IDI theory has been to suggest that it is not so much that the
theories have changed but that capitalism has. Turning adversity into a strength,
Dunning (1995) has for instance suggested that the theoretical problems related not
to issues internal to the theory, but rather to a fundamental change in the nature of
international economic organisation.

"Over the last decade or so, a number of events have occurred that,
viewed collectively, suggest that the world economy may be
entering a new phase of market-based capitalism - or, at least,
changing its (sic) trajectory of the past century. These events
recognise no geographical boundaries; and they range from
changes in which individual firms organize their production and
transactions, to a reconfiguration of location-specific assets and the
globalization of many kinds of economic activity (emphasis
added)".

44 The eclectic model identified the existence of multiple and separate ownership advantages (which can be either
structural or transactional), but the dynamics of those advantages and their durability. In the 1970’s, structural
advantages were emphasised, while later explanations emphasised transactional advantages (Buckley 1987).
45 Krugman (1989) contended that the eclectic model had a deep-seated methodological problem - a methodology
inherent in its descriptive approach. He noted that the E.P. was a model that employs a methodology that goes the
wrong way around - it derives the causes of IDI from a study of its effects. Lecraw identified three aspects of
inconsistency inherent in the eclectic model. The E-P had become excessively general and descriptive, and was
in danger of degenerating into a checklist against which the researcher displays the data. Such a problem may
lead to an obscuring or an obliteration of the interrelationships and determinants between the factors. The E.P. is
large, complex and broad in scope. Employing the theory to explain any aspect of international production
normally requires simplification or the use of only a small portion of it. The E.P. claims to synthesise (or
subsume) all theories of international economic activity. There was however little evidence that whole was much
more than the sum of its parts. “Only to the extent that the E.P. leads us to analysis that goes beyond (in depth or
in scope) that of other theories and leads to additional hypothesis... can the E.T. establish both its pre-eminence
and, more importantly, its usefulness as a tool of economic analysis.” (Lecraw 1985). It is perhaps not surprising
therefore that empirical testing of the E.P. had not been very convincing.
46 Dunning went on to suggest that two concepts in particular needed to be reviewed. The first was the role of the
state. He suggested that globalisation actually means that there was now a larger, but different role for the state to
help markets work better. The shift required the state to extend its role from a regime of based around
The transformations Dunning identified were based on a perceived shift in the nature of international economy, including a transition in the basis of national comparative advantage from the possession of 'natural' assets to one based on 'created' assets. This transition was said to be based partly because of the growing distinction between the competitiveness of firms and nations; and partly in response to the process of globalization. According to Dunning (1993), it is a feature of created assets that they tend to be more internationally mobile (and TNCs are one of the main vehicles increasing mobility). He concluded therefore that under the new regime, competitive market forces alone do not necessarily ensure an optimum innovation-led growth path for the firm or the nation in a dynamic and uncertain world. The second concept now being challenged by developments that mark the new phase of capitalism was that co-operation amongst firms was becoming as important as competition between them as an organisational form (a shift from hierarchical to alliance capitalism). In terms of theories of IDI and the MNE, Dunning suggested that while "...the autonomous firm will continue to be the main unit of analysis for understanding the extent and pattern of foreign-owned production...[models of the MNE are] increasingly being affected by the collaborative production and transactional arrangements between firms (1994)"

The suggestion of a new phase of capitalism, and a new phase of IDI, does signal the problem of theoretical approaches internal to IDI. In particular, it reinforces a central contention of this thesis, that IDI theory was based on the particular characteristics of a form of international capital in one period. It is perhaps no surprise then that economic historians have found the most difficulty in this approach. For instance, Charles Jones (1987), an economic historian of international business in the nineteenth century, observed that the definition of IDI has changed markedly over time. He has gone on to contend that the basic concepts upon which any definition of IDI must be based are politically and culturally derived. As such, he concluded that all definitions of IDI are historically specific and inherently unstable over time. Jones was especially critical of the superficial retrospective application of, "mid-twentieth century descriptive categories [especially of IDI theory’s concept of the firm and nation] to the nineteenth century”. The impossibility of a general theory internal to IDI, extending on Jones’ argument therefore relates as much to the historical limitations of any model of IDI as to its theoretical coherence. Buckley has similarly suggested that recent modifications to the concepts of IDI theory have been required "to encompass the changing realities of the world economy" (1990)47. But the lesson from the post-war period is that a similar danger now exists in posing the current era as ‘new’ requiring new concepts and categories to explain them, and especially in assuming that these categories can then be used to explain future developments in the new era.

Cantwell (1991), has also concluded that “The use of an industrial organisation context by more recent authors partly reflects a change in the issues and the institutions under study themselves. Hymer’s objective had been to investigate why national firms went abroad, rather than to evaluate the operations of existing MNCs’. Today the concern is with the way international industries are organised”

---

47 He went on to note that the most useful concepts were not coming from the standard marginalist, elements of neoclassical economics.
While this approach is still attempting to understand changing patterns of IDI in terms ‘internal’ to the theory, the response points to the developments which mean that IDI itself may be disappearing as a discrete object of analysis. The evolution of the IDI theory since the 1980’s has been in the direction of incorporating the study of IDI and the TNC, into a wider analysis of international business. There has been a growing recognition that neither IDI, nor even the TNC captures the full range of forms of conducting even cross-border activity (Krugman 1990; Dunning 1991). It is now understood that international accumulation is more than just a process of the expansion of TNCs. Furthermore, the nature of recent internationalisation cannot be adequately understood as simply the sum of cross-border transactions more generally (Bryan 1995).

This development therefore raises the wider issue of the need to place IDI within a general theory of accumulation. While the exchange-rate, trade and industrial organisation models have all been picking up aspects of the change in the 1980’s and 1990’s IDI, it is only through the analysis of the complex interplay of capital, competition and internationalisation, not one aspect alone, which is the key to understanding recent IDI.

The thesis therefore contends that IDI needs to be understood in aggregate in the context of transformations in capital accumulation in aggregate, and individually in the context of the particular circumstances of IDI. This is methodology is explored in terms of the Australian case-study in the next chapter.

6.7 Conclusion - Towards an Alternative Methodology for the Research of International Investment

The current chapter has explored how the theoretical hiatus of the early 1980’s was transformed into a crisis for the general and universal status of IDI theory. The ‘new’ stylised facts of 1980’s and 1990’s IDI helped to undermine the conceptual agenda of the ‘old’ early post-war theory. The crisis has engendered a range of theoretical responses, which have generally made the theory more explicitly descriptive and theoretically eclectic. All responses have opened up another issue for IDI theory - the way that change is understood theoretically. The explanatory problems posed by recent internationalisation has therefore raised conceptual problems for IDI theory.

Post-war IDI theory established the conceptual importance of the institutional form of international capital, particularly in terms of the characteristics (and investment calculations) of international companies (or TNCs). During the 1980’s and early 1990’s, the increasing plurality of forms of cross-border activities of firms (including non-equity relationships), the changing relationship between firms, and the erosion of distinctions between forms of international capital has tended to undermine the earlier institutional concept of capital. More fluid (and to paraphrase Holloway less ‘thing-like’\(^48\)) concepts of capital have been required to explain IDI in the 1980’s and 1990’s.

\(^48\) Holloway observed that while capital has been understood as capable of movement, capital “...is defined first in terms of its attachment: attachment to a company (Volkswagen), attachment to a branch of industry (the automobile industry), and attachment to a place (Puebla, Germany)... In all these examples, capital is treated as a thing, a thing that can be owned, a thing that is normally attached to a particular place, company, branch of
More importantly perhaps, the 1980’s has challenged the whole methodological approach to international capital. IDI theory has been characterised by an analytical focus on the internal structures of capital, a methodological approach which it shares with many other branches of economics. An alternative methodological agenda, pace Kay (1975, 1991) address the transformations in organisational forms of capital terms of their implications for the social relations between capital and labour.

The development of the joint stock company from the mid-nineteenth century provides a useful analogy for illustrating the contrast between the two methodological approaches. The analogy with the joint stock company will show that there are two distinct methodological approaches to understanding the evolving development of accumulation. One approach focuses on the internal organisation and structures of capital, while another is developed in terms of the social relationship of accumulation, and thus in terms of the consequences for relations between capital and labour.

From the late nineteenth century, with the emergence of the joint stock company, private capital began to be eclipsed by capital in the corporate form. The rise of the joint stock company was associated a series of other transformations, which taken together are generally taken to be a period of major significance in the history of capitalism. The invention of the limited liability joint stock company helped to resolve two immediate problems of organising the private capitals of many individual investors within the one entity - it protected investors from bankruptcy in the event of the firm’s insolvency and relieved them of liabilities arising from their use of their control. Limited liability also established a more suitable basis for the increase in the ‘scale and scope’ of the operations of individual firms (Chandler 1989); encouraged the reduction in the number of individual capitals; helped to change the form of competition (which Keynes termed the “the end of laissez faire”); and was attended by a change in the relation between the state and individual capitals (Kay 1977).

Corporate capital also seemed to liberate capital from the traditional property relations within which it had developed49. In particular, the joint stock company had the effect of separating the ownership and control of capital within the firm, or to put it another way, it separating the money-capitalist from the active capitalist50. Coupled with the view of the competitive order of the nineteenth century as the classic form (or ideal type) of capitalism, the growth of the joint stock company appeared to signal the maturity of capitalist organisation and possible even the beginnings of a transitional phase (a period of decaying, or as Lenin termed it, moribund capitalism).

This methodological focus on the internal structures was not peculiar to radical/marxist analysis. In fact, orthodox neoclassical economics came to embody

---

49 Lenin observed that with large individual capitals, production had become social, even though appropriation remained private.

50 Kay suggested for instance that “The first act of rupture of the traditional property relations within which capital developed, typified by the nineteenth century entrepreneur and captain of industry, takes place within the firm as the separation of ownership and control” (1975, p79).
this approach par excellence. For neoclassical economics, the growth of the joint stock company also appeared to represent a movement of capitalism away from its classic form, and the changing competitive characteristics and organisational structures were usually posed in terms of imperfection, market failure and monopoly.

From the point of view of the social relations between capital and labour, however, an altogether different perspective can be delineated. From this perspective, the emergence and growth of the joint stock company represented a major advance for capital. The corporation changed the form of capital by separating (and ‘liberating’) capital from the individualised power of the capitalist. The company itself emerges as the owner of capital, charged with the responsibility for accumulation. As Kay (1991) has so powerfully pointed out, the joint stock company represented not decay of the classic form of capitalist development, but its beginning. In terms of this alternative approach, the joint stock company represented the emergence of capital as both the object and subject of property. It was therefore a major advance for capital “towards its realisation as a conscious social force, by breaking it free of the fetters of private ownership” (Kay 1975, p.79). The joint stock company has been a great spur to the accumulation process, by providing a legal form through which the concentration and centralisation of capital has taken place (Blake 1939). It is this methodology that permitted Kay to conclude that the superseding of private by corporate capital in the late nineteenth and early twentieth century, represented the replacement of one set of capitalist forms, which had become a fetter on its further development, by others better suited to accumulation in changing conditions of production. In this way, the transition to corporate capital represented an important consolidation of capitalism.

This methodology for analysing the development of the joint stock company provides insights for an alternative approach to the study of IDI in the 1980’s and 1990’s. From the point of view of the changing structures of capital, the generalisation of the international company as the representative form of individual capital may again appear to represent maturity (or even the end of history). Lenin had earlier predicted that in the forthcoming phase of capitalism, international relations would be characterised by the export of capital and this would be peculiar to the final stage of capitalism. Indeed, since that time, the internationalisation of capital through the expansion of individual capitals has been an extremely important development in the evolution of the organisational structure of capital. The international company represents the explicit integration of activities and accumulation processes across national space. From this perspective, the development of the TNC as the general form of individual capital may signal the culmination of process begun in the early post-war years where the international corporation (or TNC) has finally superseded that nation-state and created a ‘borderless world’ (Ohmae 1991, 1995).

---

52 As Kay put it, “Where human capacities are reduced to an object [wage labour:MR], what could be more appropriate than for capital to become a person” (1991,p.84).
53 Blake said that the corporation “is a great aid in concentration: in fact, without the corporation form the inevitable expansion of capital would he hampered seriously. Even for an economic tendency, it is necessary to seek embodiment in a proper juridical form” ((1939,p.368).
In terms of the internal structures of capital, therefore the generalisation of the TNC as the normal form of capital may appear to represent the maturity of capitalism as an international process. The developments in the internationalisation of individual companies since the Second World War (the emergence and generalisation of the TNC) was initially posed in terms of an aberration from the general form of capital operating within 'its' national economy. From the perspective of the internal organisation of capital, where national corporate capital had become accepted as the classic form of capital, internationalisation appeared to represent an aberration (requiring the possession of a unique advantage). The nation-state remains a critical analytical unit in such analysis, it is rather that more and more companies are 'outgrowing' their nation.

From the perspective of relations between capital and labour, however, the more general pattern of IDI in the 1980's and 1990's can be posed rather differently. Instead, capital is understood as a global relation of value in movement, a perspective which opens up a different appreciation of the growth of 1980's and 1990's IDI. Instead of recent internationalisation being posed as the demise of nation-states and of national companies, recent internationalisation (the emerging global nature of individual capitals) represents an era when the universal (and global) properties of capital are increasingly being expressed within its individual corporate form. For several decades during the twentieth century, when the general organisational unit became that of (national) corporate capital, the global social nature of capital could be grasped largely only in theoretical terms. The international nature of the capital could only be grasped theoretically. Today, when firms increasingly reproduce on a global scale of reckoning, the global nature of capital can increasingly be observed as part of our daily experience.

The capital relation contains within it the tendency for capital to expand in size and across space, and it is only from the point of view of the organisational structure of the corporation that the tendency appears as a recent development. That is, the growth of IDI and of TNCs are not to be conceived in terms of a concept of internationalisation which asserts the analytical primacy of national accumulation. Rather an alternative methodology grasps domestic accumulation as an aspect of an inherently global relation. What is particular about the recent phase of internationalisation is the degree to which international processes are explicitly being articulated within individual capitals. IDI is thus a national expression of global relations of competition between individual capitals. It is this development that enables the generalisation of TNCs as the representative form of capital (and the explicit regime of global calculation which they embody) to be seen, pace Kay, as an advance for capital towards its self-realisation as a conscious and global social force.

An alternative methodology also requires that internationalisation be grasped as more than just a cross-border capital flow, and even more than simply the activities of TNCs. This methodology therefore begins, pace Holloway (1992), with the proposition that the nation-state is an expression of the internationality of capital.

---

54 Despite the requirement for IDI theory to break from its rigidly institutional concept of capital, these developments also seem to validate the analytical focus on the organisational structures of capital. And as MacWilliam (1991) has observed, private international capital flows represent relations between capitals.

55 In this context, it has been argued that the continuing inherent nationalism in contemporary international economics can be understood as a manifestation of a profound bourgeois crisis of confidence (Jones 1987).
rather than the reverse. While the nation-state is not the appropriate unit of analysis, the nation-state remains critical to an analysis of the internationalisation of capital (Bryan 1995a). The state thus remains a critical subject of analysis in IDI. National differences and particularities are part of the explanation of the direction and timing of IDI by TNCs. Bryan has, for instance, contended in this regard that "...capital moves at different rates in different forms and in different directions at different times and an analysis of internationalisation must explain this" (Bryan 1995, p10). But as Bryan has also argued, a conclusion that emerges from this thesis is that it is not the general tendency towards the internationality of capital which requires explanation, but the particular form it takes at particular times.

It has also been seen here that post-war IDI theory incorporated a concept of competition based on the observed association at the time between IDI and markets with less than perfectly structured markets. While this concept broke with the strict neoclassical concept of competition of pre-war portfolio theory, perfect competition remained the concept of competition from which the new theory of IDI derived (vis IDI as a creature of imperfect competition). During the 1980’s and 1990’s, increased capital mobility, and the generalisation of IDI as an activity of firms across industries with quite different market structures, has tended to undermine this notion of IDI as product of market failure. On the contrary, it now seems more appropriate to conceptualise IDI flows as an expression of international relations of competition between owners of capital, rather than as an aberration from perfect competition - an expression of market failure.

Finally, post-war IDI theory was developed by the requirements of explaining international investment in an era when IDI was concentrated from the US to other developed industrial nations. In doing so, IDI theory broke down the notion of international capital flowing down a hierarchy of nations. IDI theory was nevertheless, still developed in terms of the national characteristics and patterns of IDI. Since the 1980’s, IDI has been concurrently flowing into and out of the advanced industrial countries, and across all sectors of the economy. Thus, while IDI theory broke with the pre-war concept of internationalisation, in the 1980’s and 1990’s there is now even a suggestion of the virtual disappearance of national patterns of IDI (Ohmae 1990; Vernon 1992).

Without necessarily having recourse to this absolute position, it must be recognised that developments in the last decade and half have forced significant modifications in the concepts and categories required to explain recent IDI. Indeed, in an era when the very legitimacy of the general theory of IDI has been raised, there is a need to return to the particularities of those investments to see whether the analysis of recent IDI can conceptualised in an alternative way. The next chapter seeks to examine the case of direct investment abroad from Australia, as a way of clarifying the specific

---

56 In this regard, Holloway has contended that “The global nature of capitalist social relations is... not the result of the recent ‘internationalisation’ or ‘globalisation’ of capital, both concepts which imply a moving out from a historically and logically prior national society. Rather it [the global nature of capitalist:MR] is inherent in the nature of the capitalist relation of exploitation as a relation... between free worker and free capitalist, a relation freed from spatial constraint” (1994).

57 A survey article in The Economist (1992), contended that understanding developments during the 1980’s, “mainly through the lens of the national economy...disguise the character of the transformation of finance - which was, above all, an international phenomenon”.

problems of explaining recent IDI in existing terms and to identify the contours of an alternative research agenda.
IDI IN THE 1980’S AND 1990’s-
A case study of direct investment abroad from Australia
7.1 INTRODUCTION

The current chapter builds on the work of the previous two chapters by way of a case study of direct investment abroad from Australia during the 1980’s and 1990’s. Chapters 5 and 6 established that the requirements of explaining the stylised facts of IDI in the 1980’s and early 1990’s served to challenge the conceptual agenda of post-war IDI theory. It was found that transformations in the pattern and context of IDI in the 1980’s highlighted the particularities of the pattern of IDI in the 1950’s and 1960’s, upon which post-war theory had been based. It was in the light of the 1980’s evidence that many of the leading figures in IDI theory began to conclude that the notion of a unitary general theory of IDI had ceased to have credibility\(^1\).

The proposition developed in the current chapter is that the determinants and patterns of IDI have become so diverse that they can no longer be encompassed by the sorts of theoretical determinants which were so confidently enunciated in the post-war period. Hence the current chapter makes the case that the analysis of IDI needs to return to the study of the particularities of IDI - particular national patterns and particular company patterns.

Australia provides a useful nation to which to apply these propositions, because Australian evidence shows that there is a small number of key companies that dominate the national data (so that particular case studies prove significant). Yet there has still been a distinctly Australian pattern to IDI since the 1980’s, indicating that these individual cases are not devoid of a national dimension.

An issue to be addressed in this chapter is to explain why the data on outward IDI from Australia displayed a pattern of expansion (and contraction) which was different from other advanced industrial countries. It will be shown that the pattern of outward IDI from Australia has been more volatile and extravagant than has been found for other countries. Indeed, Ergas and Wright (1994) found that for a country with only small-scale IDI outflow before the early 1980’s, Australian outward IDI, has since been significantly above the level that might have been expected from an economy with Australia’s characteristics\(^2\). The transformation in the scale of direct investment abroad (DIA) was described at the time by the then Treasurer, Paul Keating, as “a development unique to this new age of Australian internationalism”\(^3\)(1988, p19). While IDI outflow collapsed in the late 1980’s, outflow growth has resumed a rapid growth in the 1990’s. Recent surveys have also found that for many Australian firms, international rather than national expansion will be the major source of future growth\(^3\).

It is now increasingly accepted that a nation’s IDI cannot any longer be interpreted as a statement about that nation’s position in the international economy, because

\(^1\) The breakdown of the notion of a general theory of IDI also raised the wider problem of even constituting IDI as a distinct object of analysis.

\(^2\) Australian sourced IDI now makes up the fourth largest share IDI stocks in the UK, ahead of direct investment from Japan (UK CSO 1994).

\(^3\) A survey by Access Economics (1994) found that almost 25 percent of the value of all projects planned by Australian companies for that year would be directed offshore, compared to a share of offshore projects in total capital expenditures of only 10 percent one year earlier.
flows of IDI have a wide range of determinants. It has also been recognised that with the increasingly global nature of direct investment, the analysis of IDI has been constrained by a taxonomy conceived within an assumed coherence of nation-states (Vernon 1993). Part of the theoretical crisis in IDI theory during the 1980’s has therefore been an increasing recognition that national patterns of IDI are no longer generative of theoretical postulates, and that national data and definitions themselves need to be understood as conceptual constructions.

Nonetheless, accumulation is not devoid of a national dimension. There are national patterns of IDI, albeit loose ones, that need to be explained, and these patterns remain important in explaining the underlying dynamics of the distribution of recent IDI. But there are multiple dimensions to these national patterns which make them difficult to formally model.

In the context of the breakdown in the concept of internationalisation of post-war theory, consideration of the particularities of IDI outflow from Australia during the 1980’s becomes a compelling exercise. The chapter contends that a significant reason for the distinctive and volatile pattern of Australian IDI outflows was the particular way companies of Australian origin (or designation) were integrated into international financial markets during the 1980’s. The explanation of the particularities of outward IDI from Australia will therefore necessitate an examination not simply of Australian balance of payments statistics, but also of the particular forms of accumulation of individual companies.

The chapter therefore examines the particularities of IDI outflow from Australia, in the context of global transformations in accumulation during the 1980’s, and in terms of the individual patterns of capital accumulation within and from Australia. The chapter begins by providing the historical context for the emergence of large-scale outward IDI from Australia. That background will explore how earlier patterns of IDI were understood by (and in significant ways contributed to) the emerging theory of IDI in the 1950’s and 1960’s. The chapter then proceeds to consider the nature of outward IDI growth in the 1980’s and early 1990’s. The chapter concludes by addressing some of the implications of developments in outward IDI from Australia for the concepts of capital, competition and internationalisation of IDI theory.

### 7.2 IDI Theory in the Australian Context: IDI Inflow

For most of the post-war period Australia’s history of IDI had been largely one of a recipient of IDI. Along with Canada and several European countries, Australia became one of the most significant destinations of post-war IDI growth. The annual

---

4 The term designation is used, because it will be noted below that many of the companies with the largest outward direct investments from Australia, such as CRA, Comalco and BTR Nylex, are themselves expatriate firms. Moreover, in the cases of other firms, such as News Corp., formal nationality is defined as a variable of corporate decision making.

5 The problems of analysing aggregate data are now well recognised in financial economics, where “an enormous number of poorly understood or unrecognised variables [are] buzzing around in the [aggregate] statistical data” (Herzel 1990).

6 Brash (1966) estimated that by the early 1960’s, only Canada, the UK, Venezuela and West Germany had a larger stock of US direct investment than Australia. He also estimated that on a per capita basis, the stock of IDI
inflow of private capital to Australia increased from less than $80 million in 1948 to almost $450 million in 1964 (Brash 1965). 7

Most attention to the pattern of IDI in Australia has therefore not surprisingly tended to address the nature and consequences of IDI inflow. 8 From the early studies of IDI in Australia during the post-Second World War period, IDI inflow has been almost exclusively the area of study of IDI research. 9 Economists working on the patterns and effects of early post-war IDI in Australia included Arndt 1957; MacDougall 1958; Penrose 1960; Perkins 1960; Hogan 1963; Kemp 1962; Wheelwright 1963; and Brash 1966. Indeed, the Australian case was critical in the formative analysis of post-war IDI theory (Fieldhouse 1986). In particular, MacDougall’s partial equilibrium analysis of the national gains of IDI stood for a long time as the seminal theoretical exposition of the national effects of IDI, while Penrose and Brash have been widely cited as key case studies of the post-war form of corporate investment from the US.

Research into the rapid post-war growth of inward IDI into Australia was initially conducted in terms of the existing portfolio capital theory. In these terms, Arndt (1957) referred to inward IDI growth into Australia in the 1950’s as a new form of international borrowing. 10 There was also a gradual recognition that post-war IDI had certain distinct characteristics that might require IDI be investigated in terms different from other forms of international investment.

As suggested above, the model of the costs and benefits of inward IDI developed by MacDougall (1960) has been extremely influential in the development of post-war IDI analysis. While MacDougall remained convinced that IDI could still be considered in terms of the existing comparative static framework - and largely in terms of the balance of payments effects as a form of foreign capital inflow 11 - he nevertheless recognised that the analysis contained several limitations for analysing post-war IDI. Similarly, Perkins (1960), who argued the case for the net benefits of inward IDI, advanced those claims largely within the existing (pre-war) theoretical paradigm. Nevertheless, he also conceded that the new form of international capital

---

7 Brash also found that a large proportion of US subsidiaries in Australia had activities in the manufacturing sector, and had been established most of their wholly-owned subsidiaries in Australia since the end of the Second World War, but especially after 1955. It will be recalled that these were some of the key characteristics that became incorporated into the stylised facts of the new theory of IDI.
8 It will be recalled from earlier chapters that many of the early developments in post-war IDI theory were undertaken through the examination of the characteristics of inward IDI into the industrial countries from the United States that became prominent recipients of IDI. The rapid growth of inward IDI in the 1950’s and 1960’s helps to explain why research into IDI in Australia was overwhelmingly concerned with the characteristics of inward IDI.
9 Hughes (1971) stands out as notable early exception.
10 While Arndt continued to here to call this a form of borrowing, he identified several features that would become integrated into the stylised facts of post-war theory, including the change in the form of inflow from overseas borrowing by governments to investment by branches of overseas firms, especially in manufacturing industries (often characterised by monopolistic market structures).
11 MacDougall (1960) was confident that the analysis of post-war IDI could be conducted within, “rather conventional tools of economic analysis”. 
raised new problems for post-war analysis (associated with the problem of the foreign ownership).\textsuperscript{12}

The analysis of post-war IDI inflow into Australia also helped to shift IDI theory away from international portfolio capital theory toward concepts derived from industrial and institutional economics in the 1950’s and 1960’s. Indeed the transformation in the conceptual agenda of post war theory was significantly inspired by Australian case-studies, particularly Edith Penrose’s (1956) study of the Australian activities of the US manufacturing firm, General Motors. She noted that a large proportion of the funding of the post-war growth of the local subsidiary, GMH, was being derived from the retained earnings of the local subsidiary rather than by capital flows from the US parent. Penrose argued that the funding of GM’s Australian activities indicated that IDI may need to be considered more in terms of the international growth of firms than in terms of the existing portfolio capital flow model. Penrose was thus one of the first post-war economists to begin to shift the paradigm of post-war IDI from that of portfolio capital to industrial economics.\textsuperscript{13}

Donald Brash’s (1966, 1970) analyses of the post-war growth of US investment in Australia were also widely regarded as an important analytical development of post-war IDI. His work largely sidestepped the question of the welfare effects of IDI, and instead helped to develop an analysis of IDI on the basis of the new concepts of competition and internationalisation in IDI theory. Brash contended that the rapid growth of IDI inflows to Australia was in part a consequence of imperfect competition, in terms of both market imperfections and firm-specific advantages. In particular, he suggested that while high levels of barrier protection had helped to contribute to the growth in the establishment of US subsidiaries to manufacture locally\textsuperscript{14}, technological advantages were almost certainly the main advantage that overseas controlled manufacturing subsidiaries possessed over domestic firms. In this sense, therefore, Brash’s work anticipated aspects of the Product Cycle model of Vernon, which cast IDI advantages in terms of the life cycle of newly innovated products, as discussed in Chapter 4.\textsuperscript{15} The notion of IDI as an outgrowth of technological innovation and technology transfer was an area that received considerable research interest in Australia, for example with Hogan (1967) and Hughes (1977).\textsuperscript{16}

\textsuperscript{12} Perkins later observed that “There are various forms that overseas borrowing may take. The one that has been overwhelmingly the most important for Australia in recent decades has been direct private investment: that is to say, investment in Australia by overseas companies by the setting up of branches or wholly or partly owned subsidiaries” (1968).

\textsuperscript{13} In the context of the evidence that a large proportion of GMH’s funding of new growth was being derived from its retained earnings, Penrose (1956) contended that, “Once a foreign firm is established (in a new country) its continued growth is an increase in foreign investment, but an increase which is more appropriately analysed in the light of a theory of the growth of the firm rather than of foreign investment”

\textsuperscript{14} Brash noted that “In the absence of any obstacle to trade, there would be no reason why an expanding market in Australia should not be served by exports from the United States” (1966,p6).

\textsuperscript{15} Anticipating Vernon, Brash even suggested that “if the primary pre-condition for international direct investment in manufacturing is differential rates of technical progress, there seems to be no reason why foreign ownership of capital in Australian industry should not continue to increase as long as foreign countries do more research in all sectors of manufacturing than this country, and trade barriers prevent their enjoying the fruits of this effort through exporting” (1966,p52).

\textsuperscript{16} This notion of IDI as a transfer of ‘technology’ became a particularly popular vehicle for IDI research in Australia. It bears noting that the technological notion of IDI parallels the ‘thing-like’ concept of capital that the
Chapter 7 - IDI in the 1980's and 1990's

Research by Parry (1972, 1974, 1976) and others attempted to incorporate the new concept of imperfect competition of IDI theory to explain the growth of foreign-based firms in the manufacturing sector. Parry noted for instance that "international investment in general, and the operations of MNE's in particular, is more properly treated within the framework of imperfect competition" (1977). Parry's work was also developed in terms of technological advantages of investing firms.

The radical tradition of which Wheelwright was a key early figure generated an extensive Australian literature centring on the concepts of 'dependence' and 'deindustrialisation' (McInnes 1970; McFarlane 1972; McCarthy 1973; Catley and McFarlane 1978; Kemeny 1980; Camelleri 1980; Tsokhas 1986). When combined with the analysis of monopoly capital, the analysis of international investment was often advanced in terms of both the analysis of big monopoly firms and the dependent position of the Australian economy associated with the 'foreign' control over key national industries.

As was seen in chapters 3 and 4, IDI theory moved towards the study of international industrial firms, in terms new concepts of capital, competition and internationalisation. Part of the new conceptual paradigm was the development of a radical tradition advanced in terms of a critique of the imperialist intent and impact of IDI within recipient countries. Wheelwright (1963) provided an early critique of the effects of post-war IDI into Australia largely on the basis of the emerging theory. Wheelwright was critical of the analysis of post-war IDI on the basis of the pre-war comparative static economic paradigm (exemplified by MacDougall and Perkins). What made this critique particularly important in the international literature was that it presented an argument (parallel to an emerging radical literature in Canada) that IDI could have harmful effects in advanced capitalist countries; not just in the 'third world'. Wheelwright went on to make a major contribution to the development of an Australian radical approach to IDI and the TNC, especially by the incorporation of the monopoly capital models (discussed in Chapter 3) into such analysis (Wheelwright 1971, 1972, 1980; Fitzpatrick and Wheelwright 1965; Wheelwright and Crough 1982; Wheelwright and David 1989).

While such analyses were generally highly empirically based, their objective was nonetheless to fit Australia into a global structure of 'dependence' and a 'new international division of labour'. Hence, as for the more conservative interpretation of IDI the developments of the 1980's came as theoretical shock to the radical tradition, undermining their largely ahistorical (and perhaps simplistic) models of the global economy and presenting investment patterns inconsistent with the inherently nationalist and institutionalist nature of the models.

---

thesis has found to have been an integral part of IDI theory. For a contemporary example of such an approach see Hutchinson and Nicholas (1990).

17 Wheelwright's analysis was also based on the earlier radical analysis of the British empire in Australia by Fitzpatrick (1969). Wheelwright as inheritor of Fitzpatrick's mantle of leading radical intellectual, was a central figure in the establishment of the post-colonial agenda of radical discourse.

18 The concept of dependent development was also applied retrospectively to pre-war economic development (Cochrane 1980).

19 In the early 1980's, Catley and McFarlane continued to refer to Australia as an 'American dependency' (1983, p89).
In this sense, a surprising degree of common ground can be seen in Australia, between the orthodox analysis of MacDougall, Penrose, Brash and Parry, and the radical analysis of Wheelwright and others. Thus, while there was significant difference over the net benefits (or net costs) of IDI, there was generally shared agreement that IDI could be considered both as an object of analysis (with particular competitive and corporate characteristics), and analysed in terms of its national determinants and effects.

Nevertheless, concern for the potential loss of national economic and political sovereignty (and over the lack of ‘opportunity’ for participation by local firms in the new manufacturing and mining ventures\(^{26}\)) would also establish the basis for government policy in the late 1960’s and 1970’s that helped to secure protected access for ‘national’ firms in the new mineral developments\(^{21}\). It will be shown below, that in those local equity policies of the 1970’s is part of the explanation for the delayed formal internationalisation of many Australian firms (in terms of international investment). This form of restructuring of capital in the domestic sphere also helped to impart certain characteristics on the pattern of international investment from Australia when it began to occur on a significant scale from the early 1980’s onwards.

The terms of the debate in Australia remained clear during the early phase of IDI theory, as explained in chapter 3. From the 1970’s, the terms of this debate began to change. In the 1970’s and especially in the 1980’s, there was a notable shift in the forms of inward investment toward portfolio capital and debt (Flint and Twite 1980). On this basis, inward IDI in Australia during the 1980’s underwent another phase of rapid growth. In an international context, Australia remained an important site of IDI inflow during the 1980’s. For the decade as a whole, Australia maintained a share of around 5 percent of total inflows to the OECD countries and in 1990, only six countries received more inward IDI in aggregate than Australia (UNCTC 1992; Ergas and Wright 1994).

IDI inflow growth during the 1980’s also involved some significant changes in the patterns of those flows (Edwards 1992; BIE 1993). Inflow in the 1950’s and 1960’s was associated with the international relocation of manufacturing and with the establishment and expansion of large-scale mineral projects, with investment derived from the U.K. and U.S. In the 1980’s, the US and UK remained major sources of inward IDI, with Japan also becoming an important source-country. While 1980’s IDI growth helped to renew research interest into inward IDI in Australia (Edgington 1988, 1990; Wheelwright and David 1989; Hutchinson and Nicholas 1989; Towe 1990). The study of inward IDI has remained central to the research agenda in Australia, but the theoretical framing of that research began to reflect the crisis in IDI theory by resorting to an incorporation of the modified concepts of competition, capital and internationalisation (associated, for instance, with transaction cost

\(^{26}\) Several companies of Australian origin were quite critical of the lack of local participation in the development of new mining developments in the 1960’s and 1970’s. Gordon Jackson, the then General Manager of CSR Ltd claimed that “the government need not be too encouraging in fields where the maturing Australian economy is becoming self sufficient in skills and in ability to find and do business successfully”. (quoted in Price and White 1981).

\(^{21}\) For a history of the post-war regulation of IDI inflow see Kenwood (1995).
theory). More significantly perhaps, the theoretical crisis was reflected in the studies through an increasingly eclectic and/or descriptive approach to the study of IDI inflow, and more particularly by its inability to either anticipate or explain the spectacular growth of direct investment abroad from Australia.

7.3 THE EMERGENCE OF LARGE-SCALE OUTWARD IDI FROM AUSTRALIA IN THE 1980’S - AN OVERVIEW

Despite the focus on inward IDI, Direct Investment Abroad (DIA) from Australia also has a long history. The origins of outward investment can be traced back even before the separate colonies federated at the turn of the century, when trading and plantation firms such as the Colonial Sugar Refineries (CSR), Burns Philp and W.R. Carpenters had investments in the South Pacific (Buckley and Krugman 1975). Indeed, it has even been suggested that a motivating reason for the federation related to the protection of the offshore investments and trade interests of colonial firms in the Pacific islands (Meaney 1976; Thompson 1980; Rosewearne 1986). In the 1920’s and 1930’s, in the lead-up to the Second World War, the expansion of trading and investment activities by companies from Australia prompted the leading trade policy analyst, Crawford (1939), to suggest that Australia was emerging as a pacific economic power. In the 1960’s and especially in the 1970’s, the growth of outward IDI shifted toward South-East Asia, associated with the offshore acquisition and relocation of manufacturing activity (BIE 1984).

Prior to the 1980’s, however, there was just a handful of TNCs of Australian origin and just two or three with significant operations beyond Asia and the South Pacific. This situation changed very quickly from the early 1980’s, especially with the implementation of financial sector deregulation in December 1983\(^{22}\), which culminated in the floating of the Australian dollar and the lifting of capital controls\(^{23}\). The comparative pattern of Australian IDI in the 1980’s is shown in Figure 7.1.

Outward IDI from Australia was insignificant at the beginning of the 1980’s, but started growing before the surge of IDI from the rest of the world in the mid-1980’s. Also, during the global boom in 1980’s IDI, outward IDI from Australia grew much more rapidly than for the rest of the world, so that by 1987 Australia had the third largest level of outward IDI transactions as a percentage of GDP of all OECD

\(^{22}\) The liberalisation of investment controls occurred over more than a decade culminating in the floating of the exchange rate and liberalisation of formal capital controls in 1983 (Grenville 1991).

\(^{23}\) Until 1962, exchange controls were used by successive Australian governments to limit direct investment overseas by Australian residents to those deemed able to make a significant contribution to Australian foreign reserves via developing new, or expanding existing, export markets; as well as those aimed at protecting existing investments. The broad aims of the controls was the desire to conserve domestic capital for investment in Australia, although the controls also aimed to reduce exchange-rate volatility arising from short-term external disturbances. In 1962, exchange controls were relaxed to allow virtually automatic approval to direct investment which involved either a significant measure of Australian participation, or the export of expertise or skill. While this criteria remained until the early 1980’s, it is generally agreed that the policy represented only a minor barrier to direct investment abroad (Flint and Twite 1984, Grenville 1989).
countries\textsuperscript{24}. Only the United Kingdom and the Netherlands, the world’s oldest foreign investors, exceeded Australia’s level.

But from 1988, with IDI from the rest of the OECD still rising, albeit at a slower pace, outward IDI transactions from Australia contracted rapidly and more than halved over each of the next three years. By 1991, outward IDI transactions from Australia plummeted to a negative value, in part due to the repatriation of earlier outward IDI, as well as the liquidation of many investments relating to the collapse of several high profile outward investors. Yet from that time to the present, outward IDI from Australia has again surged, though under a different guise from the 1980’s\textsuperscript{25}.

Insofar as this pattern of outward IDI from Australia arose in the context of the removal of national controls on international capital flows generally it cannot (except in its initial phase, perhaps) be attributed to the changing structure of national regulation. The common pattern must be related to more diverse common experiences of companies in Australia.

![Figure 7.1 Outward IDI From Australia, Transactions, 1960/61 - 1994/95](image)


In contrast with the significant research that was conducted into the rapid growth of post-war IDI, academic interest in the spectacular growth of DIA since 1980 has been extremely modest\textsuperscript{26}. There has, by contrast, been considerable research interest

\textsuperscript{24} The growth of outward IDI was even more dramatic when compared as a percentage of domestic investment. Outward Australian IDI increased from 3 percentage of domestic investment in 1982-83, to 27% in 1987-88, and then fell to zero in 1990-91 (OECD 1991).

\textsuperscript{25} The recovery of outward IDI transactions in 1994 and 1995 (averaging around $5 billion) represented about 1.2 percent of GDP, a figure exceeded only in the late-1980’s).

\textsuperscript{26} Edwards (1994) has provided one of the few academic accounts, although cast in terms of the export and employment effects of DIA, and therefore from within the same analytical framework as the state policy studies.
by state institutions into the implications of 1980’s and 1990’s DIA. Beginning in the
early 1980’s, but particularly in the 1990’s there has been quite active research into
the policy implications of DIA by a variety of governmental bodies. What has
characterised the policy-related studies has been that so much of the analysis has
been conducted without drawing on the theory of IDI. Inasmuch as the policy studies
have adopted a theoretical approach they have been largely developed in terms of
models which give emphasis to the national determinants and national effects of
IDI, and done so in explicitly descriptive/ eclectic terms.

The fact that so much research on 1980’s and 1990’s outward IDI has been
conducted in largely descriptive terms signals that IDI theory was no longer deemed
useful even for policy considerations. Yet the fact that so much IDI analysis was
emanating from the state signals that it is seen as a critical concern for national
policy in terms of the Balance of Payment’s, employment, and industry
competitiveness effects of outward investment. The policy ‘problem’ is that
outward IDI has not been behaving like exports in terms of the balance of payments
or more specifically the trade effects of IDI (Bryan and Rafferty 1996).

The failure of IDI to behave like trade in either pattern or direction is not unique to
Australia. Similar issues and patterns have been observed in countries like the US
and UK and has provoked much debate about the role of IDI in economic policy both
in Australia and elsewhere (Reich 1991; Tyson 1991; Lipsey and Blomstrom ct.al.
1988; Blomstrom 1990). There has been a growing recognition that IDI is
important to processes of international economic activity in the late twentieth
century. But there has been little agreement on how IDI relates to processes of
cross-border trade, let alone national management of global economic processes.
The increasing degree to which the competitive relations between firms are being

27 The research has been quite extensive and includes Bennett, Merchant and Metcalfe 1981; BIE 1984, 1993;
1995; Industry Commission 1996;
28 Howe, (1994) for instance, has suggested that IDI outflow growth from Australia was an expression of the way
opportunities for Australia in the world economy were grasped in that decade. He stated that “Globalisation
presents many opportunities for Australia. Taking advantage of these opportunities requires the effective
exploitation of Australia’s comparative advantages in skilled labour, resources and technology. Increasingly, this
exploitation occurs not only through trade, but through foreign direct investment” (1994,p11 emphasis added).
In a similar way, the direction of IDI in Australia has often been considered as a function of national comparative
advantage or competitive advantage characteristics (AMC 1992; DFAT 1993 & 1994). In the case of trade flows
from Australia, there has been an observable tendency toward a greater concentration of two-way trade within
the east Asian region (Garnaut 1989; Austrade 1993). The process of trade regionalisation has been a wider one
than just the East Asian region. The European Union and NAFTA are in part institutional expressions of trade
regionalisation (source here). There has been a general expectation that IDI will (eventually) be drawn along the
same path as trade routes, that is toward the east Asian region. Garnaut (1991), DFAT (1992), and Howe (1994).
Howe, for instance, has asserted that ‘Traditionally (sic), FDI flows have been between Australia and the OECD.
In the future, however, FDI patterns are likely to follow the change in trade patterns towards Asia’ (1994,p111).
This indeed may happen at some time in the future. There is little empirical evidence to support the proposition
that the pattern of IDI is moving toward those of trade flows. On the contrary, the recovery of IDI growth in the
1990’s has seen a continued concentration of two-way IDI within the OECD.
29 As Craig and Yetton suggested, the key policy issue in terms of the national effects of DIA was “whether they
will ‘solve’ the trade deficit” (1992).
30 Despite the assertion that there was a characteristically Japanese form of IDI, that was trade enhancing
(Kojima 1979; 1984), empirical evidence of the 1980’s did not support this assertion (Encarnation 1993).
31 In Australia, there is quite a long history of research about how IDI inflow builds economic activity biased
against export activity. This view has undergone some revival recently (Jones 1992). A newer literature has also
emerged concerned with the effects of IDI on trade and employment (Edwards 1993; AMC2, DFAT 1993).
expressed through IDI has lead some to suggest that a ‘decoupling’ may be required in the implicit or assumed link between exports and international competitiveness (Craig and Yetton 1992).

Although the instinct to discard (or at least avoid the slavish adherence to) the theory of IDI is ‘correct’, the implication cannot be simply to revert to description supplemented by Balance of Payments’ implications. Hence the next section is informed by the alternative concepts of capital, competition and internationalisation developed in Chapter 6.

7.4 THE RISE AND FALL AND RISE OF OUTWARD IDI FROM AUSTRALIA, 1980 - 1995

The roller-coaster pattern of outward IDI from Australia in the 1980’s and 1990’s is exceptional by international standards. In this section and the next, the pattern of that IDI is investigated in more detail to identify both the domestic determinants and the particular characteristics of the investments themselves. The section therefore considers the determinants of 1980’s IDI, including those that made some of them vulnerable to the after-effects of the October 1987 stockmarket crash, and that permitted the subsequent resumption of IDI growth.

Compared with global trends, outward IDI from Australia was low in the post-war period and relatively slow to increase in the second half of the 1970’s. The majority of outward investment from Australia in the 1970’s was held by the Commonwealth Government (as official and reserve assets of the Reserve Bank of Australia), and only a small proportion held as portfolio investment and loans by individuals and corporations. Yet outward IDI growth was particularly rapid in the early and mid-1980’s, before falling away dramatically in the late-1980’s. Finally, there has been a marked recovery of outward IDI in the early-to-mid 1990’s. Each of these phases warrants some attention.

Before the 1980’s, outward IDI was made difficult, but not impossible, by Australian state exchange controls. Particularly from the 1950’s, Australian companies had expanded investment into Papua New Guinea (a United Nations-appointed Australian protectorate until 1973), New Zealand and some South Pacific islands. Only a handful of companies had established any presence elsewhere. That which did occur was directed mainly toward the ASEAN group of countries and the United States (Utrecht 1980; BIE 1983a, 1984b). Nonetheless, the fact that companies such as TNT, Boral and Mayne Nickless (in the transport and distribution industry) and Monier, Boral and Pioneer (in the building products industry) and News Corp (in publishing) had managed to establish significant international profiles (especially in the US) indicates that the barriers of formal exchange controls should not be exaggerated (Korporaal 1986).

Rather than controls on outward IDI, it can be argued that a significant reason for the slow growth of outward Australian IDI in the 1970’s, was the concurrent imposition of strong restrictions on inward IDI - a peculiarly Australian policy initiative of the time, during an investment boom in the Australian mining industry. These
restrictions created domestic opportunities for large ‘Australian’ companies reducing their demand for IDI-type opportunities (and stimulating a shift in the form of inward investment toward loans and portfolio investment).

The large and sustained growth in minerals-related projects in Australia during the 1960’s and 1970’s generated high levels of investment in a range of new large-scale, export-oriented mining and mineral processing activities. Australian government controls on foreign ownership of the deposits (along with export licensing controls) required 50 percent Australian equity participation, and this had the effect of ‘drawing in’ many of the largest companies operating in Australia as joint venture partners in large mining projects in order to meet local equity requirements. State controls thus both created protected investment opportunities for some of Australia’s largest companies and discriminated against the equity form of inward international investment (Bryan 1986).

The first effect of these policies was to diminish (or at least delay) the desire or need of many large Australian companies to expand internationally via offshore direct investment. Some of Australia’s largest manufacturing and agricultural companies, such as BHP and CSR, which might have been expected to internationalise their operations in the 1970’s, instead diversified into Australian mining, albeit now in internationally-exposed rather than protected industries. A consequence was both to delay the formal entry of Australian companies into international investment, and to re-direct the long-term focus of accumulation of many of these companies from a manufacturing and agricultural base to a mining and mineral processing base. Accordingly, as these companies started to expand internationally in the late-1970’s and early-1980’s, investment was disproportionately concentrated in mining and mineral products (see Appendix 7.1).

The second effect, discrimination against foreign equity, encouraged international investment to be transmitted to Australia in the form of foreign debt and portfolio investment. Foreign mining companies such as the RTZ subsidiaries CRA and Comalco, funded many of their ventures into Australian mining with funds raised not on the basis of asset backing, but on the collateral of long-term sales contracts for the minerals (McKern 1976). One effect of this development was to give companies in Australia ‘early’ exposure to new forms and sources of international credit to fund investment. This ‘exposure’ flowed through to smaller (and to newer) Australian

---

32 These opportunities also extended to the infrastructure and service-related activities associated with the mineral developments.

33 A further response was to encourage expatriate firms to ‘Australianise’ their operations (under naturalisation policies). This policy also helps to explain the prominence of expatriate firms in outward IDI in the 1980’s and 1990’s.

34 The stimulus given to the shift in the form of international capital inflow from direct investment to debt as a consequence of state policy meant that inflows of private sector debt increased from around 10 percent of total private sector inflows in the mid-1970’s to almost 90 percent in 1987. Edgar and Mercer (1987) noted in this regard that, “The actions of the Foreign Investment Review Board... made foreign direct investment in property and equities difficult over a large number of years. As a result, debt was the way required capital could flow into Australia”.

35 In a corporate history of the Bank of America, Hector reported that the funding of RTZ/CRA’s Bougainville copper mine was in the 1970’s one of the most complex the bank had then attempted. The Bougainville loan, which followed the financing of the companies development of RTZ’s iron ore mine at Hamersley in the northwest of Australia, “involved the legal systems of three countries, banks in Australia, England and the United States, and subsidiaries of RTZ in all three countries” (1988:pp130-31).
companies, some of which later emerged in the 1980’s as the big IDI companies, such as Bond Corp., Bell Group, and EldersIXL. During the 1970’s, these companies began drawing on international sources of credit to restructure domestic manufacturing companies, via merger and takeover activity. The consequences of this development will be taken up shortly.

Although outward Australian IDI grew comparatively slowly in the 1970’s, its growth at the beginning of the 1980’s was surprisingly fast and early compared with the overall pattern of growth of the rest of the OECD. The speed of growth is in significant part affected by the low base figure which has already been explained, but the growth rate remained high throughout most of the decade. When viewed as a proportion of GDP, the rate of growth of outward IDI from Australia remained exceptional over the 1980’s - at least until after the stock market crash of late-1987. In the 1970’s, outward IDI flows had averaged 0.3 percent of GDP. In the early 1980’s, this increased to 1.5 percent, and peaked at 2.3 percent of GDP in 1987. Over the decade as a whole, only four countries - the UK, the Netherlands, Sweden and Switzerland - recorded higher outward IDI as a percentage of GDP. For a country with no tradition of IDI, and no immediate geographic proximity to the major destination countries of 1980’s IDI, Australia’s experience in the mid-1980’s was exceptional.

In addition to the low base factor and the delayed internationalisation of older companies, the growth of Australian IDI is to be explained by the emergence of a new force - the so-called ‘new entrepreneurs’. These companies included such firms as Elders IXL, Bond Corp, the Bell Group, TNT, Qintex, Adsteam and IEL. In the 1980’s, the predominant sources of outward IDI came from many of these new growth-oriented companies, under the control of high-profile managing directors with access to long lines of credit and a desire for rapid expansion. In each case, quite small, locally-focused (and usually formerly ailing) public companies were transformed into large corporations in the space of just a few years through international and national leverage buyouts.

This investment growth exhibited a number of common characteristics which deserve mention. First, 1980’s growth was concentrated in the hands of a small number of companies. Such concentration was not particular to Australia, and was also a characteristic of other smaller prominent IDI nations such as Canada (Globerman 1994) and the Netherlands (Belederbos 1992). As Table 7.1 shows the concentration of outward IDI from Australia during the 1980’s was particularly extreme. Figures based on annual IDI transactions show an even higher concentration in the top 5 or ten investing companies.

---

36 Dechow (1987) has provided a perspective on the explosive growth of these firms in the 1980’s. She estimated that at the end of 1980, none of the seven firms in her study were among the top fifty in terms of market capitalisation. By 1986, six of her study companies (and all those listed above) were listed in the top twenty. News Corp could be considered a forerunner of this group.

37 It will be recalled also that concentration of IDI by relatively few firms was an important feature of IDI even in the 1950’s and 1960’s (Hymer 1971). It has also remained a feature of recent IDI (UNCTC 1993).
Table 7.1 Total Outward Direct Investment from Australia -
Concentration of Outward Direct Investment -
Levels - 1988-94 ($000)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Direct Levels</strong></td>
<td>28,240</td>
<td>37,300</td>
<td>39,500</td>
<td>38,300</td>
<td>43,340</td>
<td>45,200</td>
<td>47,600</td>
</tr>
<tr>
<td><strong>Top 5 Contributors</strong></td>
<td>11,045</td>
<td>14,119</td>
<td>16,839</td>
<td>17,206</td>
<td>19,871</td>
<td>20,384</td>
<td>20,229</td>
</tr>
<tr>
<td><strong>Top 10 Contributors</strong></td>
<td>14,631</td>
<td>17,547</td>
<td>19,237</td>
<td>19,177</td>
<td>22,753</td>
<td>23,174</td>
<td>26,024</td>
</tr>
</tbody>
</table>

Source: ABS Cat 5350.0 and unpublished data

A problem for analysing the industry composition of outward IDI transactions and stocks from Australia during the 1980's is that the several large transactions accounted for large changes in totals. For instance, in 1985 the secondary sector outflow amounted to $1,121 million. The 'Metal Products' subsector of that total was $1,068 million. That outflow accounted for about 95 percent of the secondary sector outflow in that year and was more than the total metal products outflow transactions for the rest of the decade as a whole. In 1988, the Secondary sector share of outflow transactions was $1,345 million. The 'Food, Beverages and Tobacco' component of that sector's transactions was $1,545 million, more than the entire total outflow of the secondary sector in that year. Similarly, the 'Paper, Printing and Publishing' category has been almost entirely dominated by the recorded transactions of one large international investor, News Ltd (see Appendix 7.1). By the early 1990's that category accounted for about more than one third of outward IDI stocks in the secondary sector. The same characteristic can be observed of outward IDI in the 'Wholesale and Retail' sub-sector of the tertiary sector, dominated by outward investment by two major companies; and the finance, insurance and business services category of the tertiary sector.

A second characteristic of outward IDI from Australia is that it predominantly took the form (and indeed stills takes the form) of takeovers. This tendency was particularly true of the new internationalising enterprises whose accumulation strategy was premised on the use of large credit facilities to acquire control of whole

---

38 Edwards (1994) noted large investments by individual companies can disturb the general pattern of shares going to particular sectors.
40 Two large investments in brewing in the UK by Bond Corp and Elders.
41 The Coles-Myer Group and Woolworths.
42 This category is dominated by the international ownership of banking assets of three Australian-based banks, and one pension fund. This category of investments also raises the distinction between direct and portfolio investment, and this raises the crucial problem of determining 'control' - by equity threshold or by intention to control or influence management.
companies, and subsequently to sell down many of its parts. While this trend was consistent with the global association of IDI and international merger activity, the case of Australia is exceptionally high. The distinctiveness of the Australian case is partly because so much of Australian IDI was undertaken in the 1980’s when IDI was associated with takeovers was high (UNCTC 1993), but became the type of companies that dominated Australian outward IDI transactions (the entrepreneurial companies mentioned above, so that outward IDI from Australia has grown largely by takeovers).

The third characteristic of 1980’s IDI that it was going predominantly to the US and Europe (especially to the UK) and did not seem to be related to the experience of Australia’s trade into Asia. This pattern was in part associated with a focus on the takeover of existing activities in established markets, rather than by greenfields developments in emerging markets.

So while debt-funded investment and leveraged buyouts became a widespread characteristic of the international economy in the mid-1980’s, this development had already become a conspicuous feature in Australia from the late-1970’s. The timing and the distinctively Australian character of the development is difficult to explain. Conventional theories of IDI, and formal macroeconomic analysis offer little to build upon in this question. Certainly it is clear that the companies which had been large in the domestic corporate world were ‘old’ companies, run on conservative financial principles, and dependent for their viability on the Australian state securing a globally-isolated industrial and financial system. They had their origins in protected manufacturing, and there was a long tradition of fund-raising through share issues and retained earnings. Conversely, the ‘new’ companies, and the nouveaux riche ‘entrepreneurs’ were not from the established elite43 - indeed there were strong social conflicts between the ‘establishment’ and the new entrepreneurs44. The conflict between the establishment and new entrepreneurs is now seen as reaching its zenith in the takeover battle for the largest Australian public company, BHP by Bell Group (Haigh 1987; Thompson et.al. 1987). In 1986, senior executives from what might be taken as the establishment firms were also involved in the formation of an anti-raider association known as the Australia (or Club) 2000 (Samuels 1986). The club planned to form an intricate web of cross shareholding through a holding company, Australia 2000 Ltd (Malley 1986). The interlocking shareholdings would have been designed to insulate those companies from the sharemarket raiders. At least twenty one companies were named as potential or actual members of the Club 2000 project45. While the Australia 2000 project never got off the ground, it does reveal the challenge posed by these new acquisitive firms for many existing corporations, irrespective of size46.

---

43 Some of these new entrepreneurs paraded their working class origins somewhat extravagantly, though with great and popular success, at least for a time.
44 This was amplified by the fact that many of the new entrepreneurs and their companies were also based in the ‘peripheral’ cities of Perth and Brisbane, while the home of ‘old money’ is Melbourne and Sydney.
46 The way that financial restructuring was played out in the form of old versus new was certainly not particular to Australia. Smith (1990), for instance, noted that “Earnest battles were certainly fought...between the New Men
Perhaps the single most important fact of this period is that the companies which did emerge as leading Australian international investors in the mid-1980s were unimpeded by convention, and were prepared to gamble on a world of perpetual growth. In an era when cross-border takeovers became a major component of IDI activity, these entrepreneurial companies had already grown up with an orientation to merger and takeover activity.

Internationally, Bond Corporation was probably the best known of the entrepreneurial firms, albeit in part for the retrospective exposure of financial profligacy. The case of Bond Corp. is illustrative of a number of the features of outward Australian IDI outlined above. Bond Corp. had grown rapidly in the 1960’s and 1970’s through extensive use of (increasingly international) credit for domestic takeover activity and property development (Maher 1990; Barry 1990). Bond Corp. was one of the first Australian companies to access credit (and financial engineering advice) from Wardleys, the newly-formed and fast-growing merchant banking arm of Hong Kong and Shanghai Bank, to acquire a controlling interest in the Perth-based Swan Brewing Company in 1980. By the late-1970’s, Bond Corp.’s activities had also already begun to take on an explicitly international flavour, with the purchase of the UK-based Airship Industries, an ailing company attempting to produce helium-filled blimps for defence navigation and advertising purposes. The success of Bond’s America’s Cup yachting campaign in 1983, gave Bond access to and credibility with US financial institutions. By the mid-1980’s, Bond Corp. had embarked on an explosive period of growth, based on diversified international merger and takeover activity in such industries as brewing, mining, broadcasting and communications.

In the 1980’s, access to long lines of international credit meant that entrepreneurial firms were often able to launch takeover bids for much larger firms. Through hostile takeover bids for some of the ‘older’ large and medium-sized companies with low gearing ratios and hence potential to secure further loans, many extant companies became absorbed into the new regime. Even the ‘older’ companies not so absorbed were drawn into international credit markets (and into international investment activity as well) at least in part to diminish their attractiveness for takeover. The form of involvement in international credit markets, and the particularly Australian characteristic of this involvement will be considered later.

In the debt-laden form of funding of much of this IDI, also lies the explanation of its underlying fragility and rapid decline after the stock market crash of October 1987. Having built investment empires on the basis of rising share prices and high gearing, the stock market crash not only damaged their existing activities, it undermined opportunities for future growth, upon which the credit funded expansion had been

and the entrenched capitalists of the 1980’s, bitter battles that the former often won." What was particular to Australia was the close association of outward IDI and the new entrepreneurs.

47The fact that financial institutions were prepared to grant these companies such long lines of credit remains to be explained, and is beyond the scope of the current paper (but see footnote 28). How the funds were obtained will be addressed shortly.


49The most celebrated case was the attempted takeover of BHP, Australia’s largest company, by Bell Resources, along with Elders IXL role as white knight. See Thompson et.al. 1986.

50On the importance of the defensive restructuring of corporations, see Dann and deAngelo (1988), and Kneebler (1986).
based. Several firms such as the Bell Group were plunged rapidly into a crisis, but several others such as Bond Corp and News Corp. seemed to have emerged largely unscathed, only to face a crisis later in the 1980's or early 1990's (Barry 1990; Shawcross 1992; Sykes 1994). While some firms re-emerged after this crisis, most have done so on the basis of a quite different accumulation strategy often, as with the case of Elders (now Fosters Brewing Group), with a different name, different managements and different owners.

By contrast, the recovery of outward IDI in the 1990's has taken on a different character. One of the significant changes is that the sectoral composition of IDI has narrowed.

Figure 7.2 - Changing Sectoral Composition of Outward IDI from Australia, 1990-1995

With the relative demise of 'new entrepreneurs' at the end of the 1980s, and the emergence in the 1990s of financial institutions as the primary international investors from Australia, the value of Australian international assets remains dominated by just a handful of companies.

From a (low) base spread across all sectors, there has been a relative shift away from manufacturing and especially mining, and towards services. By the 1990's, financial, property and business services were dominating Australian IDI, and in 1993-94, for instance, outward IDI in this category made up 42% of total Australian direct
investment abroad stock. In particular, the dominance of financial institutions as direct investors in their own right has become pronounced. IDI remains concentrated among a relatively small number of companies (see Table 7.3), and takeovers continue to be the predominant form of investment. Three of the top ten outward IDI companies are banks and life offices that have expanded internationally through acquisitions abroad. Also, many of the companies that had restructured into mining in the 1970's (such as BHP, CSR, CRA and Burns Philp) are now significant international investors, though not necessarily in (or only in) mineral-related activities.

The focus of investment remains as in the 1980’s in Europe, and now to a lesser extent the US. Stocks of outward IDI in the US, UK, New Zealand and PNG have actually increased as a share of total outward IDI, accounting for more than 80% of total outward investment from Australia in 1995, compared with 72% of the total in 1990 (ABS 1996). Finally, several of the most significant outward IDI companies are themselves affiliated to or subsidiaries of other international companies (such as BTR Nylex, CRA, Ampolex and Comalco). Indeed, the importance of expatriate firms in Australian outward IDI data signals that the notion of this process as one of ‘Australian’ IDI has reduced meaning as a statement about the ‘Australian’ economy and its position in international investment.

51 Despite the trend apparent in figure 7.4, there is need for caution in interpreting such data. The sectoral composition is classified by the dominant activity of companies or the industrial designation of the subsidiary. The leading 1980s investors were rapidly expanding, diversified investment companies, and this diversity is sometimes lost in the system of classification in which companies are classified in sectors according to their dominant sectoral location or by reference to the designation of the main activity of a subsidiary. Moreover, the companies themselves operated systems of internal finance which made debt and equity interchangeable, so that a clear differentiation of loans from IDI is misleading.

It also warrants recognition that a sectoral or industrial disaggregation of data, on such a small base sees particular companies, and even particular investments heavily affecting the data. For example, since 1987, more than one half of Australian manufacturing IDI stock has been in the category ‘paper products and publishing’. Roughly 90% of this (and hence almost half of total outward IDI in manufacturing) is attributable to one company, News Corp. In fact, the case of News Corp suggests that problems of concentration of appear to be even more extreme. While ABS data estimated total outward IDI from Australia in the US in 1994 as $8.6 billion, we estimate that News Corp alone had assets in the US of $13.9 billion. Another illustration of concentration is BHP’s investment in US steel in 1985, which accounted for 95% of secondary sector outflow for that year, and more than the total metal products outflow for the whole decade. The fact that the nationality of News Corp is a variable of the particular purposes for which it is being used, and therefore in dispute adds a further level of fragility to the data (see Bryan and Rafferty 1996).

52 This was despite successive government attempts to ‘talk up’ Australian investment in Asia as an adjunct of trade growth and a component of successive Australian governments’ increasing orientation to economic links with Asia.

53 Add to this the fact that Rupert Murdoch’s News Corp is Australia’s single largest outward IDI firm, yet the notion of Australia being its ‘home’ are more a statement of corporate history than of corporate identity.
Figure 7.3 - Stock of Outward IDI from Australia, Selected Years  
((percent of total stock)


Table 7.3 Top Ten International Investing Firms From Australia,  
selected years

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>EldersIXL</td>
<td>News Corp.</td>
<td>News Corp.</td>
</tr>
<tr>
<td>2.</td>
<td>News Corp.</td>
<td>National Australia Bank(NAB)</td>
<td>AMP Society</td>
</tr>
<tr>
<td>3.</td>
<td>ANZ Bank</td>
<td>ANZ Bank</td>
<td>NAB</td>
</tr>
<tr>
<td>4.</td>
<td>Westpac Bank</td>
<td>BHP</td>
<td>BHP</td>
</tr>
<tr>
<td>5.</td>
<td>Industrial Equity Ltd.</td>
<td>Pacific Dunlop</td>
<td>Esso Aust.</td>
</tr>
<tr>
<td>6.</td>
<td>TNT</td>
<td>BTR Nylex</td>
<td>ANZ</td>
</tr>
<tr>
<td>8.</td>
<td>BHP</td>
<td>Ampolex</td>
<td>Pioneer Int’l</td>
</tr>
<tr>
<td>9.</td>
<td>Bond Corp.</td>
<td>CRA</td>
<td>Comalco</td>
</tr>
<tr>
<td>10.</td>
<td>CRA</td>
<td>Westpac</td>
<td>CRA</td>
</tr>
</tbody>
</table>

Source: IBIS Business Information

7.5 THE FUNDING OF OUTWARD AUSTRALIAN IDI

A key to the rapid growth (and decline) of 1980’s IDI by takeovers was that Australian IDI in the 1980s was heavily funded by credit raised in Eurofinance markets. It is the particular national history of this access that gave the national characteristic to direct investment abroad from Australia. To recapitulate, Australia’s peculiar pattern of IDI from the beginning of the 1980s is to be explained in terms of
the activities of a small number of ‘new’, highly geared companies raising credit in Eurofinance markets to fund international takeovers\(^{54}\). We know now that their high credit exposure left them, and hence their IDI-related activities, highly vulnerable to a stockmarket downturn. In establishing the particularity of Australian experience in this important area, some background is warranted.

Prior to the 1970’s, Australia’s international financial position had seen a relatively stable flow of direct investment from the US and UK accommodated in the state’s exchange rate management through a regime of tariff and quota-based restrictions on imports and encouragement of exports. A resultant relatively strong currency, combined with tight foreign exchange controls and restrictions on foreign banking, secured a relatively autonomous domestic financial sector. Domestic corporate fund-raising was heavily concentrated in the stock market. Even the rapid growth of international banking in the late 1960’s manifested in Australia principally as an inflow of portfolio investment.

The domestic financial system was almost entirely directed to domestic accumulation. Even in the resources boom of the late 1960’s referred to above, the response of the banking sector to the demand for credit was for the domestic banks to pool resources in preference to seeing the entry of international financial institutions\(^{55}\). Hence international credit flows were relatively small, predominantly by governments and the subsidiaries of foreign TNCs, and in the form of short-term bank credit.

With the 1970’s came a volatile period in international investment and credit, along with the floating of major currencies and the opening up of international credit markets. The response of the Australian state at that time was largely ‘protectionist’ - tightening foreign investment controls and imposing restrictions on short-term capital flows. This secured the dominance of ‘old’ capital and a low-debt-funding regime well into the 1970s. The initial evidence of ‘international’ credit raising by the corporate sector in Australia was, ironically, foreign direct investors in Australia raising funds on Australian and international credit markets (Treasury 1981; FIRB 1979)\(^{56}\).

By the last third of the 1970s, international merchant banks were exerting an increasing, albeit unofficial, impact of the Australian financial system, some of it funding expansion by ‘foreign’ capitals in the mining industry; but much of it also

---

\(^{54}\) The close association between international credit and IDI has further undermined the notion of IDI as a capital ‘flow’ from the investing nation to the host nation. The extensive use of international credit to finance outward IDI creates additional problems for interpreting Balance of Payments accounts for countries engaged in outward IDI during the 1980’s. As the Reserve Bank of Australia (1990) noted:

> "...the increase in [Australian] net debt over the second half of the 1980’s more than financed the current account deficit; it financed the expansion of Australian equity investment abroad as well. Had that expansion not taken place, Australia’s net foreign debt would have been much lower - in rough terms, about $40 billion lower."

\(^{55}\) This included formation of the joint venture Australian Resource Development Bank, as well as the syndication of individual loans between domestic banks.

\(^{56}\) According to the Foreign Investment Review Board (FIRB), Between 1970 and 1980, the total Australian-sourced debt employed by foreign controlled enterprises increased more than tenfold, while Australian equity contributions doubled (FIRB 1982).
funding domestic takeovers in manufacturing and retailing, notably by companies which became the leading international investors of the 1980s\textsuperscript{57}.

Both the pattern and extent of foreign investment in Australia and the organisation of the national financial system explain why Australian corporations had low levels of debt on their books at the beginning of the 1980s\textsuperscript{58}. Low gearing ratios became a critical strategic matter once the ‘entrepreneurial’ companies in Australia gained easier access to international financial markets. It was earlier contended that national capital controls were not an absolute impediment on IDI; but the lifting of those controls in 1983-1984 coincided with a global acceleration in IDI and their relaxation certainly facilitated an expansion of outward IDI from Australia, particularly by facilitating access to international borrowing.

\textbf{Figure 7.4- Debt/Equity Ratio of Australian Companies, 1968-1990}

![Debt/Equity Ratio Graph]


Figure 7.4 shows estimates of debt/equity ratios for companies in Australia. In the 1980s, the pattern of growth is roughly parallel with other industrialised countries\textsuperscript{59}. The significant factor about the Australian pattern was the national figures are dominated by the borrowing patterns of a few, highly debt exposed companies\textsuperscript{60}. The

\textsuperscript{57} During the 1970's, Australian-based companies were increasing their use of Euromarket borrowing. Martin (1980) reported that companies such as Hamersley Iron (a joint venture led by CRA), Alcoa of Australia, CSR, BHP and Western Mining all had resort to Euromarkets. As a consequence, the foreign borrowings of Australian-based companies increased from $1.3 billion in 1968 to $5.3 billion in 1978.

\textsuperscript{58} In response to the early 1980’s recession, corporate gearing declined further.

\textsuperscript{59} The limitations of such measures makes finer points of comparison dubious. The Reserve Bank of Australia’s measure, based on a sample of 140 companies, indicated that the debt/equity ratio increased from 0.4 to 0.7 in the first half of the 1980s. By 1985/86 Australian corporations were raising 40% of their capital through debt (Mills, Morling and Tease 1993).

\textsuperscript{60} A further consequence of the domination of the new entrepreneurial firms as the main borrowers in the 1980's was that as the then Deputy Chief Executive of the ANZ Bank observed, little of the extra borrowing was used to accelerate capacity expansion. The ratio of net business capital stock to GDP actually declined between 1983 and 1988 (Bailey 1989).
most highly geared companies were those identified earlier largely with the 'new entrepreneurs' and their borrowing was almost entirely derived from the Eurofinance markets.

Following the liberalisation of national capital controls in 1983 and 1984 the financial relations of Australian corporations became rapidly integrated into the international financial system.\textsuperscript{61} Two aspects of this integration deserve mention. The first is the role played by international merchant banks and investment houses in organising the lines of credit, and providing financial advice and encouragement to the entrepreneurial firms in their takeover bids. This extended increasingly into the marketing of takeover targets to the entrepreneurial firms uncovered by the banks own researchers (Guthrie 1989). One prominent international economist, David Hale (1990) has claimed for instance that,

"The world's bankers purposefully nurtured entities such as Bond Corp...because the traditionally heavy users of capital in the international economy (mining companies, oil companies, shipping companies, utilities, developing countries, government infrastructure builders) dropped out of the marketplace during the 1980's. Indeed, it may some day be argued that the creation of Bond Corporation was itself a form of financial public works for the international banking community"(1990,21)."

Despite this counterpoint to the notion of entrepreneurial firms as the initiators of the takeover battles, Hale nevertheless identifies the fact that at a time when financial institutions were seeking new lending opportunities, the entrepreneurial firms had already established reputations as heavy users of debt. This, and the relative lateness of large scale direct investment abroad by the older companies from Australia, helps to explain why entrepreneurial firms were so prominent in 1980's IDI, and for the volatile pattern of that investment.

The second important development was the form of international credit itself. It was through the participation in the Eurodollar, and in turn in the interest-rate swaps markets that Australian companies acquired long-term debt to fund international takeovers. The swaps market emerged for Australian companies around 1985. At this time, the crisis of the US dollar (which led to the Plaza Agreement and the Louvre Accord, orchestrating the relationship between the US dollar, the Yen and the DM) saw Euromarkets diversify away from the 'big three' currencies.

Swaps markets offered some distinct advantages for the debt-hungry new entrepreneurs. First, in international credit markets, the Australian dollar was (and remains) a second order currency, but nonetheless with significant international demand for hedging and speculation on the value of raw materials. Moreover, the companies under the control of the new entrepreneurs were not 'blue chip' companies. These companies borrowed long-term funds at significantly higher interest rates than the larger establishment companies. Swaps of repayment obligations with Triple AAA rated companies seeking short-term or flexible rate debt

\textsuperscript{61}This process was led by state enterprises, particularly the Australian Wheat Board
in first order currencies therefore offered the chance of reduced repayment obligations.

In this relationship, short-term borrowings were favourable to borrowers in Australia. In their domestic financial relations, corporations operating in Australia had always relied quite heavily on short-term securities and bank credit. Prior to the 1980’s, Australia was one of the few nations other than the United States to develop a commercial paper or promissory note market. In their international borrowings during the 1980’s, corporations originating from Australia continued to rely on short-term securities in international capital markets. By the end of the 1980s, Australian borrowers had issued more Eurocommercial paper than any other nation. Thus, the short-term foreign currency denominated borrowing by corporations of Australian designation in the Eurocommercial paper market were being swapped with long-term Australian dollar denominated debt acquired through Eurobond issues.

It is clear that this pattern of international expansion made Australia’s international investors particularly vulnerable to the stockmarket crash of 1987. Highly geared with long-term debt repayment obligations, companies like News Corp., Bond Corp, Elders IXL and Quintex were particularly vulnerable to falling asset values, particularly accentuated in the case of Elders IXL by the conjunction of the attempted managerial leverage buyout.

The effect is seen clearly in Figure 7.1, from a high of $11billion in 1988, Australian IDI was negative by 1991, with some of the leading IDI companies insolvent.

---

62 Swaps permitted the conversion of short-term debt into long-term repayment obligations but without the premium to be paid for long-term borrowing. The use of swaps, therefore tended to blur the earlier distinctions between the term structure of borrowing.
7.6 **THE PARTICULARITIES OF INDIVIDUAL CORPORATE INVESTMENT - CASE STUDIES**

The chapter contends that a significant reason for the distinctive and volatile pattern of Australian IDI is the particular integration of companies of Australian origin (or designation) into international financial markets and the particular expansion of Australian dollar-denominated liabilities in those markets. The explosion of the Eurobond and Eurocommercial paper market in the mid-1980’s saw enormous borrowings by Australian industrial companies. In the 1980’s, Australian companies were, for instance, the largest issuers in the Eurocommercial paper market, and Australian dollar-denominated assets were being traded significantly out of proportion to the size of the Australian economy.

**Figure 7.4 New Issues of $A Eurobonds 1980 - 1990**

These funds became one of the means by which a relatively small number of highly geared Australian companies financed their expansion via domestic and international takeover activity. With high gearing ratios, the stock market crash of October 1987 impacted profoundly on most of these companies. Some of the leading Australian international investors of the 1980’s are now insolvent, and their senior managers facing legal prosecution. The story of outward IDI from Australia during the 1980’s is therefore in part representative of the ‘speculative decade’ label now widely attached to that era. However, the extensive ‘recycling’ of internationalised credit into IDI through cross-border M&A also raises some impetrate issues about IDI and its relationship with other international processes.\(^{63}\)

In the 1990’s, by contrast, IDI outflow from Australia is on a different footing. Some of the 1980’s international investors are still prevalent, but the leading Australian international investors are now financial corporations engaged in expanding abroad

\(^{63}\) Chapter 5 explored many of these developments, including the blurring of the debt-equity distinction.
by international acquisition of other financial corporations. Companies based in Australia have also restructured their financing structures and sources. Instead of borrowing directly in Eurofinance markets, they are now also borrowing through international banks, especially internationalised 'Australian' banks, and doing so more modestly. Nonetheless, one effect of the 1980's has been to draw financial institutions of Australian origin increasingly into international expansion on their own account, and the international direct investment assets of 'Australian' firms are now predominantly owned by banks and other financial corporations. Again this seemingly paradoxical domination of outward IDI from Australia by the international activities of financial institutions raises some important analytical issues about the IDI process.

The chapter has shown that the explanation of DIA from Australia requires a recognition that while there are national patterns, those patterns are no longer generative of theoretical postulates. In this sense, there has been a growing requirement for theoretical explanation of 1980's IDI to engage with a wider theory of international capital. Perhaps the theory of IDI appears, therefore, to have gone a full circle, with the nearest approximation for IDI in terms of portfolio theory, articulated through individual company's managing assets on a global scale. The current section draws on aspects of the cases of several of the major individual companies of Australian designation (in the appendix to the chapter), to show that there are elements of portfolio theory that help to explain 1980's IDI. The concepts of competition, capital and internationalisation required to explain recent IDI have changed too much to permit the old pre-war theory to be resurrected as a general theory.

In that context, it has been necessary to examine the particularities of the national pattern. The current section considers the particularities of the investments of individual corporations. The chapter has also established that DIA growth during both the 1980's and 1990's has been dominated by relatively few investing firms. While the concentration in IDI is not peculiar to Australia (nor for IDI), the ongoing domination of DIA makes a few companies highly significant for explaining national patterns.

The focus on takeovers as the form of DIA from Australia and on international borrowing funding as the key distinctive determinants of the pattern of DIA from Australia signals that national patterns, at least in the case of Australia, are not to be found in the national attributes conventionally associated with explanations of IDI. The problem of this form of expansion is highlighted by the cases of Bond Corp, Elders IXL, TNT and the Bell Group, which were all involved in the rapid expansion of outward IDI via takeover activity. In these cases, further growth by takeover was undermined in the wake of the October 1987 stockmarket crash (such as Bell Group and Elders IXL), or as with Bond Corp (taken over by Lion Nathan from New Zealand) and more recently TNT (taken over by the Dutch-based firm KPN) the companies themselves became vulnerable to takeover activity. Instead, this growth was projected as much in terms of the firms' ability or willingness to take on large individual borrowings to fund a series of ongoing individual corporate acquisitions.

---

64 For more detail on the individual corporate stories, see the appendix to the chapter.
rather than the national attributes of the firms per se. Both the merger and takeover activity, and subsequent bankruptcy or takeover of these firms highlights the fragility of any attempt to aggregate the story of individual firms into national stories.

Moreover, the fact that so much IDI was involving takeovers in diversified industries, shows that the conventionally defined attributes of the corporations themselves are insufficient to explain this IDI. The diversified nature of the corporate expansion of most DIA firms suggests that the particular advantages of the firms resists easy explanation in terms of the nation (or even national industry)-specific nature of the firms.

A further problem for the DIA data is the significance of ‘expatriate’ firms amongst the largest DIA firms. In Australia, three of the top 10 DIA investors (CRA, Comalco and BTR-Nylex) have been subsidiaries of overseas firms, which have been classified as Australian for DIA purposes. The ‘naturalisation’ policy of the Australian government, particularly of firms in the mining industry in the 1970’s, encouraged these subsidiaries to introduce local equity. The subsequent offshore investments by these firms was thus considered DIA from Australia. In the past eighteen months, the parent firms have restructured the subsidiaries to integrate them more fully into the global structure of the parent’s operations. Both CRA and Comalco have been reintegrated into the global operations of the parent firm, RTZ. While the CRA operations will remain the headquarters for various parts of the corporate group’s operations, the firm’s future operations will be more explicitly oriented to global decisions. In a similar way, BTR-Nylex was also a local subsidiary of the British-based BTR group, which incorporated local equity and management, and operated with considerable autonomy. Recent restructuring of the firm’s parent has also seen BTR-Nylex being reintegrated more directly into the firm’s global operations.

The case of the largest DIA firm, News Corp, also poses the problem of the interpretation of national data. While News Corp, remains an Adelaide-registered firm, and accumulation in Australia remains significant for the company, its proprietor is a US citizen, and almost three-quarters of News Corp assets and sales are located in the US, Canada and Europe. For some purposes, News Corp is considered an Australian firm, while for others it is a US firm, but News Corp highlights the increasing degree to which the national attribution of the firm has become an almost arbitrary act.

The growth of DIA in the 1990’s has been dominated by financial institutions. Three of the top 10 most profitable outward investors in 1996 were financial institutions (National Australia Bank, AMP and the ANZ Banking Group). These corporations, instead of expanding simply by way of portfolio investment or international lending, have also expanded through the acquisition of other financial institutions abroad. The significance of financial institutions in the DIA story serves to undermine the earlier notion of IDI as the relocation of industrial firms with certain technological or competitive advantages, and accentuated the blurring in the demarcation between direct investment and other forms of international capital.

65 One Australian manager even became chairman of the firm’s British parent for a time.
7.7 CONCLUSION

The Chapter has considered the case of direct investment abroad from Australia during the 1980's and 1990's. The Australian case is important because it has provided important material for the development of international direct investment theory in two of its critical phases. In the 1950's and 1960's, Australian evidence and Australian research provided some of the formative early post-war material for the development of a new theory of IDI. In the 1980's and 1990's, DIA from Australia has exhibited a pattern of growth and decline that is more extreme than the total international pattern. In the heightened nature of trends in DIA growth from Australia during the 1980's and 1990's, is also therefore one of the important case studies for understanding the breakdown of the general theory of IDI.

The study found that there is a national pattern to recent DIA from Australia, but that the pattern could not be explained by the general explanatory concepts of IDI theory. There has been a qualitative change in international patterns of IDI which has come with the globalisation of capital and the securitisation of financial markets. Indeed, looking at particular companies from Australia which expanded via DIA, it can be seen that in the 1980's, the pattern was driven partly by the 'late' entry into DIA and international finance. As that pattern has settled down in the 1990's, the distinctively national pattern may appear to be disappearing. Particular corporate stories become more important. But since particular corporate stories can rapidly change direction via mergers, acquisitions and takeovers, become qualified by vicissitudes in financial markets and overall financial strategies.

It is increasingly recognised within IDI research that a nation’s IDI cannot be interpreted as a statement about that nation’s position in the international economy, or about the nation’s innate attributes which may attract an inflow or facilitate an outflow of IDI. International direct investment is to be understood more in terms of the discrete activities of individual corporations. But the discrete activities of individual corporations are not devoid of a national dimension, and corporations are in part products of their environment. Multi-national corporations are products of multiple national environments, as well as of a global investment regime.

A particular aspect of Australian IDI from the 1980s was that it started from such a low base and the companies which became leading international investors had such a short and volatile history. The companies which led the surge of Australian IDI in the 1980's were novices, and very much products of an Australian environment. Australia’s history of IDI in the 1980s was thereby distinctive - it was no accident that so many companies in Australia had the same pattern of expansion and contraction, funded in the same way, and with the same susceptibility to a stock market downturn.

This chapter has sought to identify the distinctively Australian dimension to that pattern. It is argued that this dimension lies in a combination of the late entry of companies of Australian origin into IDI, and the particular exposure of Australian companies to the Eurofinance market, in terms of their standing as borrowers and the standing of the Australian dollar in the mid 1980’s. As these characteristics have changed into the 1990s, Australia’s IDI has taken up what could be called a more
stable and ‘normal’ pattern. It has also been shown that in the 1990’s outward IDI from Australia continues to be dominated by a few large investors. Several of these firms resist an easy national identification as ‘Australian’ either because they are themselves subsidiaries of overseas firms; have such a large proportion of their activities abroad that their nominal national identity is itself a variable of the firm’s decisions from time to time, or as in the case of the entrepreneurs, so much of ‘their’ capital was derived from international credit. The chapter therefore raised the wider question of what it means to impute a nationality to capital, a question which has a long history at a policy level, and is again an issue of intense interest.

The consideration of the ‘Australian’ dimension to 1980’s IDI has also raised the wider issue about a concept of internationalisation that begins with an assumed prior coherence of national economic processes, with IDI conceived as an outgrowth or spilling over. Discussion of national economic activity or of the characteristics of a particular national economy is usually done on the basis of adding up of activities of economic agents in that nation and giving them a national stamp (via. Balance of Payments accounting). As such the concept of ‘Australian economy’ is the adding-up of activities of people and companies who are in Australia. This is a descriptive legal category, but used as an analytical category when constituted in terms of theories that attempt to understand economic processes as if Australia constituted an organic and unified economic unit. The thesis has argued that this approach has always been analytically flawed. Until the recent period of internationalisation, however, the issue was less pronounced, because in the 1950’s and 1960’s cross-national activity by individuals was less complex and general. As more individual agents have increased their international activities, things have become more complex, and national boundaries now seem much less immutable. In an increasingly globally integrated economy, it is increasingly arbitrary to allocate the economic activities of different internationalised companies between countries. Recent internationalisation has therefore served to open the issue of the descriptive status of national boundaries.

The chapter has also explored the growing relationship between developments in international credit markets, the internationalisation of merger and takeover activity and IDI. It has shown how outward IDI from Australia during the 1980’s was closely associated with the process whereby international lending was ‘recycled’ into IDI by cross border takeovers, and this helped to give to the pattern of outward IDI from Australia particular characteristics. The use of cross-currency interest rate swaps as a major financing tool in internationalised capital markets also raises issues of the notion of what is now national and what is foreign borrowing. A further effect of the

---

66 For one historical illustration of the ambiguities of national policy, predicated upon stamping a nationality upon capital because it is regarded as an instrument to fulfil a particular object, see Cowen (1987). The current interest in the consequences of ascribing a nationality to capital is perhaps best illustrated in the US debate over ‘who is us?’ (See Reich 1992; Tyson 1993; Ohmae 1995). For a discussion of this issue, see also Bryan and Rafferty (1996).

67 The nationality criterion is defined in terms of residency, where a resident is defined as a person or "entity that has a close association with the territory of Australia than with any other country" (ABS 1994). In this framework, the discrete acts of individuals are being allocated in a quite subjective ('closer' association) way to take on a national status. The arbitrariness of this criterion is highlighted by the case of the largest outward direct investor, News Corp., with its registered office in Adelaide and its proprietor, Rupert Murdoch, now an American citizen.

The growing use of debt in IDI funding has been to erode the coherence of the distinction between international borrowing and direct investment. Borrowing by subsidiaries from the parent is classified as direct investment, but borrowing by the subsidiary from other sources is not, even where the debt is guaranteed by the parent. In the context of transformations in debt and IDI, it now seems that the debt - equity distinction depends more on where a company borrows rather than whether it borrows. These developments raise wider questions about the nature of, and relationship between, IDI and international borrowing in an era when the boundaries between forms of international capital have been blurred. The blurring of earlier distinctions between debt and equity underscores one of the propositions made in the thesis regarding the problems of constituting IDI as a distinct object of analysis, and thus of any theoretical approach internal to IDI.

The recovery of outward IDI flows from Australia in the 1990’s, in a different way, is also an expression of contemporary global developments. Banks and life offices that were drawn into international credit markets in the 1970’s and 1980’s are now the most active outward IDI firms from Australia. It was observed that the general theories of IDI showed a strong emphasis on theorising investment in manufacturing. The manufacturing ‘model’ of IDI is of limited significance in explaining outward IDI from Australia, when three banks, a transport company, and ‘entrepreneurial’ firms were amongst the most important international investors in the last decade and a half. This contrast with the earlier notion of IDI as the relocation of firms in manufacturing, establishes a further area of particularity for 1980’s and 1990’s IDI, and for the Australian component especially.

The Chapter has explored, through a case study of outward IDI from Australia during the 1980’s, how part of the breakdown in the general theory of IDI has been its inability to explain particular national patterns of IDI. In the context of the particularities of outward IDI from Australia, Howe (1994) concluded that “the sort of surge in FDI that was experienced in the second half of the 1980’s may never fully be explained by any particular theory of FDI”. One effect of the breakdown of the general theory of IDI has been that even the notion of constituting IDI as a relation between nations, or as a relation deriving from certain national characteristics, has been eroded.

The Chapter has also shown that the explanation for the pattern of IDI has necessitated engagement with wider transformations and processes, particularly in terms of transformations in international credit markets. While for orthodox theory this has been accommodated by the use of less rigid and institutional concepts of capital and competition, the chapter has suggested an explanation which has served to challenge the notion of an explanatory approach which remains internal to IDI theory. In the particularities of outward IDI from Australia during the 1980’s and 1990’s, the chapter has been able to highlight the particularities of the apparently general theory of IDI. The consequences of the particular and historically specific nature of IDI theory has not simply been its inability to explain recent transformations in IDI, it has also been to structure the explanatory agenda for recent IDI. The Chapter has therefore also served to underscore at an empirical level the contentions made about the historical development of IDI theory in the earlier chapters of the thesis.
The case study of DIA from Australia during the 1980’s and 1990’s has served to reinforce the conclusions discussed at the end of Chapter 6 regarding the alternative notions of capital, competition and internationalisation, and the alternative methodology for IDI research. The growing two-way pattern of Australian IDI, and the greatly increased scale of both inward and outward IDI since the 1980’s has emphasised the increasing degree to which individual capitals are expressing competitive processes on an international level. In the concluding chapter, the implications for the future of IDI research of those concepts and the alternative methodology are discussed in more detail.
APPENDIX 7.1 CORPORATE CASE STUDIES OF 1980’S AND 1990’S DIA

News Corp.

News Corp. was one of the first companies from Australia to embark on a significant international investment program, and has remained a leading overseas investor from Australia. This makes News Corp. an important corporate case study of international investment abroad. The case study also highlights several problems with the attribution of patterns of international capital in terms of both nationality and the corporation.

News Corp. expanded from a daily newspaper in Adelaide in the 1950’s to one of the largest national publishers of newspapers, magazines and producers of television in the 1960’s. News Corp. commenced its international expansion in 1969, when at the request of an embattled board of the publishers of the weekly tabloid News of the World, News Corp. successfully fought off another entrepreneurial newspaper acquirer, Robert Maxwell. Within a year, News Corp. had purchased an ailing daily newspaper the Sun (from IPC Co. for a downpayment of $120,000 and the remainder payable over six years if the paper became profitable). In acquiring the Sun, News Corp. again fought off Maxwell (Deverall and Evans 1982; Tuccille 1989). Both newspapers were transformed into large selling, highly profitable ventures. In late-1970’s, Murdoch acquired a controlling interest in London Weekend Television (LWT), a loss-making commercial broadcaster and subsidiary of England’s General Electric Corporation. By 1974, Murdoch’s growing business and family interests in England led him to approach the Whitlam government for an appointment as Australian High Commissioner to London. However, within three years, Murdoch had moved to New York and by the mid-1980’s had become an American citizen.

In 1973, News Corp. began its expansion in the United States with the acquisition of two small regional papers. This was followed quickly by the launch of a new national magazine, The Star in 1974. In late 1976, News Corp. acquired the ailing New York Post, and had established a significant presence in the United States. By the late 1970’s therefore, News Corp. had already established a large part of its asset base outside of Australia, and had an estimated $95 million invested in the US alone (Korporaal 1986). These investments were located in a growing range of activities, and News Corp. had established a debt-hungry acquisitive reputation. While many of the investments were still lossmaking ventures, “[b]y the beginning of the 1980’s, it was obvious that Murdoch was being seen as much more than an owner of sensational newspapers... While he was hated by the liberal establishment of America, he was gaining respect in business and financial circles. Murdoch had become one of the people proprietors would automatically approach to buy out their ailing newspapers [and to whom merchant bankers would approach with takeover proposals in media:MR]” (Korporaal 1986).

---

1 By contrast with most News Corp international acquisitions since, funds for the acquisition were obtained from the capital market in Australia.
2 And one of the first people merchant banks would approach if their research found suitable target firms.
During the 1980’s, News Corp’s diversified international interests grew at a spectacular rate, based on extensive borrowings\(^3\). Between 1982, News Corp official liabilities increased by more than $10.5 billion (Statex), and its off-balance sheet borrowings by by several billion also. The fact that a company can borrow around $10 billion in a short space of time largely to acquire the assets of other companies is one of the better illustrations of the fact that formal corporate accounts are not to be taken as a statement of that company’s actual activities, even in the narrow accounting sense\(^4\). It has also been noted that News Corp. has not one but several sets of accounts, drawn up to meet the various (national) regulatory requirements concerned. This raises the question of which account represents the ‘real’ News Corp., or, given the extent to which significant activities of News Corp. occur off-balance sheet, whether an analysis of News Corp. can begin within the notion of News Corp. as an institutionally defined entity.

In the 1980’s, News Corp’s diversified growth was concentrated in expansion into broadcasting and film production, although growth continued in newspaper, book and magazine publication. Whereas at the beginning of the 1980’s, News Corp. was mostly a newspaper publisher, with interests in magazines and television, by the end of the 1980’s less than one third of its revenue was being derived from newspaper publishing, with almost the same proportion being derived from film production and television broadcasting\(^5\). While the industry composition of News Corp. growth became increasingly diverse, growth was being spatially concentrated in the areas already mapped out in the 1970’s, that is the US, UK and Australia. Growth in the 1980’s was particularly concentrated outside of Australia, especially in the United States, such that by the mid-1980’s, Australia and the Pacific Basin already represented only around one fifth of sales and around one seventh of reported profits. By the early-1990’s, News Corp. had assets of more than $25 billion, with $14.5 billion invested in activities in the United States, $5.4 billion in the United Kingdom and just $4.1 billion in Australia and the Pacific basin. Some two-thirds of News Corp profits are now earned outside of Australia and the Pacific basin.

The case of News Corp raises several problems for IDI theory. By the historical criteria and the location of registered head office, News Corp. would be identified as an Australian company. Yet the scale of News Corp’s overseas assets, the fact that most of its activities are located in the US, that its corporate headquarters (rather than nominal registered office in Adelaide) is in New York, and its principal shareholder is a US citizen may lead to the conclusion that News Corp. is not really an ‘Australian’ company at all, but rather a ‘US’ company. Its nominal Australian

---

\(^3\) News Ltd was the second largest borrower from Australia between 1983 and 1988 (McFarlane 1993). Debt was particularly desirable for Murdoch, since like with the other entrepreneurs, it allowed control to be maintained during a period of spectacular growth in the size of the firm.

\(^4\) Many of News Corp’s accounts are presumably designed for obscuring the international activities of News Corp from the scrutiny of national tax regulators and for minimising the potential supervision of financiers. This situation was highlighted in the early 1990’s, when News Corp ran into a financial crisis, and it took almost 6 months for the bank appointed financial supervisor to reconstruct the News Corp. Accounts. One of the conditions imposed by bankers was that Murdoch was forced to switch accounting standards from the “wild and largely unchartered world of Australian accounting standards” to those of the US (Lesly 1994).

\(^5\) Part of the restructuring imposed on News Corp by its bankers in the early 1990’s was the requirement to sell assets. The bulk of its sales were of magazines and newspapers, and this has therefore accentuated the shift of News Corp out of publishing. As The Economist (1991) noted, “The strategy rests on the idea that the most promising future for a global media company lies not in publishing, but in movies and television”.
nationality now seems more a residue of corporate history, than a reflection of the company's organisational structure and spatial pattern of accumulation. Certainly, the fact that News Corp has funded so much of its international expansion in international capital markets and that its activities in Australia are such a small part of its total global activities, makes the attribution of Australian nationality extremely dubious.

However, the case of News Corp. raises the problem not only of which nationality should be ascribed, but of any definition of corporate nationality in an era when individual corporations operate explicitly on a global scale of reckoning. The problem here is that any notion of IDI by companies such as News Corp. as an attribute of the nation of origin of the investing firm is rendered suspect, his problem of nationality is now pervasive, amongst all the major firms with IDI abroad.

The assumptions inherent in the existing definition of corporate nationality are not surprisingly a topic of much contemporary debate in Australia as elsewhere. However, the case of News Corp. raises the problem not only of which nationality should be ascribed, but of any definition of corporate nationality in an era when individual corporations operate on a global scale of reckoning.

The second problem posed by the News Corp. case regards the institutional definition of capital. The problems of understanding the activities of News Corp. by its official accounts, its growth by several large acquisitions, funded by large packages of debt, and its near liquidation all highlight the fragility of the notion that the activities of News Corp can be understood as attributes of the particular company officially defined as News Corp.
<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>United States</th>
<th>United Kingdom</th>
<th>Australia &amp; Pacific basin</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>Profit</td>
<td>272.9</td>
<td>163.8</td>
<td>66.7</td>
<td>503.5</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,873.4</td>
<td>1,126.5</td>
<td>814.9</td>
<td>3,814.9</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1987</td>
<td>Profit</td>
<td>348.0</td>
<td>332.2</td>
<td>112.3</td>
<td>792.5</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,842.2</td>
<td>1,351.1</td>
<td>1,109.0</td>
<td>5,302.3</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1988</td>
<td>Profit</td>
<td>352.0</td>
<td>364.6</td>
<td>233.3</td>
<td>949.9</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,516.7</td>
<td>1,678.1</td>
<td>1,781.2</td>
<td>5,975.9</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1989</td>
<td>Profit</td>
<td>654.9</td>
<td>441.0</td>
<td>475.9</td>
<td>1,571.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,739.2</td>
<td>1,691.6</td>
<td>2,382.4</td>
<td>7,813.2</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1990</td>
<td>Profit</td>
<td>880.4</td>
<td>225.9</td>
<td>484.9</td>
<td>1,591.2</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>4,930.2</td>
<td>1,738.6</td>
<td>2,094.6</td>
<td>8,763.3</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1991</td>
<td>Profit</td>
<td>1,122.3</td>
<td>325.5</td>
<td>395.3</td>
<td>1,843.1</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>12,509.7</td>
<td>5,171.7</td>
<td>4,167.3</td>
<td>24,848.2</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>6,559.7</td>
<td>2,248.5</td>
<td>2,162.3</td>
<td>1,843.1</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>69.8</td>
<td>437.3</td>
<td>216.7</td>
<td>723.8</td>
</tr>
<tr>
<td>1992</td>
<td>Profit</td>
<td>964.9</td>
<td>471.2</td>
<td>379.7</td>
<td>1,815.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>12,857.8</td>
<td>6,039.6</td>
<td>3,785.9</td>
<td>26,220.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>6,475.5</td>
<td>1,966.5</td>
<td>1,747.0</td>
<td>10,189.0</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>47.9</td>
<td>144.8</td>
<td>245.4</td>
<td>438.1</td>
</tr>
<tr>
<td>1993</td>
<td>Profit</td>
<td>1,056.8</td>
<td>502.2</td>
<td>374.3</td>
<td>1,933.3</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>14,517.2</td>
<td>5,409.7</td>
<td>4,077.2</td>
<td>27,272.2</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>7,227.0</td>
<td>1,942.8</td>
<td>1,515.7</td>
<td>10,685.5</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>86.2</td>
<td>86.2</td>
<td>414.2</td>
<td>573.7</td>
</tr>
<tr>
<td>1994</td>
<td>Profit</td>
<td>1,175</td>
<td>391</td>
<td>267</td>
<td>1,833</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>13,891</td>
<td>5,193</td>
<td>4,466</td>
<td>23,550</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>8,068</td>
<td>1,980</td>
<td>1,573</td>
<td>11,621</td>
</tr>
<tr>
<td></td>
<td>Investment</td>
<td>171</td>
<td>79</td>
<td>199</td>
<td>449</td>
</tr>
</tbody>
</table>

Source: News Corp Annual reports, various years.
Table 7.5 News Corporation - Industry Segment Data - 1983-1995

<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>Newspapers</th>
<th>Magazines &amp;</th>
<th>Television</th>
<th>Films</th>
<th>Book Publish.</th>
<th>Corp.</th>
<th>Other</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Profit</td>
<td>362.4</td>
<td>102.6</td>
<td>115.5</td>
<td>130.3</td>
<td></td>
<td></td>
<td>63.0</td>
<td>792.5</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,019.8</td>
<td>570.9</td>
<td>686.8</td>
<td>1,388.3</td>
<td></td>
<td></td>
<td>459.4</td>
<td>5,302.3</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,568.8</td>
<td>609.7</td>
<td>563.6</td>
<td>1,184.5</td>
<td></td>
<td></td>
<td>789.8</td>
<td>5,975.9</td>
</tr>
<tr>
<td>1988</td>
<td>Profit</td>
<td>485.0</td>
<td>106.4</td>
<td>83.0</td>
<td>83.6</td>
<td></td>
<td></td>
<td>169.3</td>
<td>949.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,904.1</td>
<td>1,171.9</td>
<td>745.0</td>
<td>1,208.2</td>
<td></td>
<td></td>
<td>1,311.0</td>
<td>7,813.2</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,695.5</td>
<td>9.8</td>
<td>167.4</td>
<td>12.6</td>
<td></td>
<td></td>
<td>36.2</td>
<td>620.5</td>
</tr>
<tr>
<td></td>
<td>K exp.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>Profit</td>
<td>694.8</td>
<td>276.3</td>
<td>100.3</td>
<td>120.8</td>
<td></td>
<td></td>
<td>152.1</td>
<td>1,394.4</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>4,839.7</td>
<td>3,755.5</td>
<td>3,499.3</td>
<td>1,495.8</td>
<td></td>
<td></td>
<td>1,791.4</td>
<td>19,070.6</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,904.1</td>
<td>1,171.9</td>
<td>745.0</td>
<td>1,208.2</td>
<td></td>
<td></td>
<td>1,311.0</td>
<td>7,813.2</td>
</tr>
<tr>
<td></td>
<td>K exp.</td>
<td>369.5</td>
<td>9.8</td>
<td>167.4</td>
<td>12.6</td>
<td></td>
<td></td>
<td>36.2</td>
<td>620.5</td>
</tr>
<tr>
<td></td>
<td>EXP.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>Profit</td>
<td>656.2</td>
<td>318.6</td>
<td>6.9</td>
<td>109.2</td>
<td></td>
<td></td>
<td>17.6</td>
<td>215.1</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>7,973.4</td>
<td>3,868.5</td>
<td>4,926.4</td>
<td>1,665.1</td>
<td>2,717.6</td>
<td>3449.4</td>
<td>1,177.3</td>
<td>26,141.6</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,015.6</td>
<td>1,444.7</td>
<td>1,171.6</td>
<td>1,265.2</td>
<td></td>
<td></td>
<td>1,349.7</td>
<td>8,763.3</td>
</tr>
<tr>
<td></td>
<td>K exp.</td>
<td>1,187.9</td>
<td>11.5</td>
<td>456.2</td>
<td>23.2</td>
<td></td>
<td></td>
<td>41.6</td>
<td>1,768.0</td>
</tr>
<tr>
<td></td>
<td>EXP.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>Profit</td>
<td>522.6</td>
<td>280.7</td>
<td>123.4</td>
<td>210.6</td>
<td>205.4</td>
<td></td>
<td>22.3</td>
<td>160.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>7,632.6</td>
<td>3,412.4</td>
<td>4,232.2</td>
<td>2,270.5</td>
<td>2,660.8</td>
<td></td>
<td>2999.4</td>
<td>1,332.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,088.2</td>
<td>1,308.5</td>
<td>1,331.5</td>
<td>2,199.0</td>
<td>1,554.9</td>
<td></td>
<td>993.2</td>
<td>10,970.5</td>
</tr>
<tr>
<td></td>
<td>K exp.</td>
<td>522.8</td>
<td>8.0</td>
<td>101.8</td>
<td>30.2</td>
<td></td>
<td></td>
<td>32.2</td>
<td>723.8</td>
</tr>
<tr>
<td></td>
<td>EXP.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>Profit</td>
<td>590.5</td>
<td>381.8</td>
<td>259.7</td>
<td>127.0</td>
<td>204.2</td>
<td>(36.6)</td>
<td>27.5</td>
<td>621.1</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>8,595.3</td>
<td>3,451.2</td>
<td>4,287.3</td>
<td>2,399.2</td>
<td>2,892.1</td>
<td>3,537.4</td>
<td>1,056.7</td>
<td>26,220.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,954.8</td>
<td>1,643.9</td>
<td>1,243.9</td>
<td>2,423.6</td>
<td>1,452.8</td>
<td></td>
<td>479.0</td>
<td>10,189.0</td>
</tr>
<tr>
<td></td>
<td>K exp.</td>
<td>385.5</td>
<td>11.6</td>
<td>7.8</td>
<td>16.7</td>
<td></td>
<td></td>
<td>12.6</td>
<td>438.1</td>
</tr>
<tr>
<td></td>
<td>EXP.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1993</td>
<td>Profit</td>
<td>671.4</td>
<td>401.6</td>
<td>373.1</td>
<td>52.6</td>
<td>201.5</td>
<td>196.1</td>
<td>2.1</td>
<td>1,026.3</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>8,335.3</td>
<td>3,907.4</td>
<td>5,011.3</td>
<td>2,622.9</td>
<td>3,160.2</td>
<td>3,268.1</td>
<td>1,205.1</td>
<td>27,272.1</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,069.8</td>
<td>1,656.2</td>
<td>1,614.0</td>
<td>2,384.8</td>
<td>1,513.0</td>
<td></td>
<td>209.6</td>
<td>10,685.5</td>
</tr>
<tr>
<td></td>
<td>K exp.</td>
<td>385.5</td>
<td>11.6</td>
<td>7.8</td>
<td>16.7</td>
<td></td>
<td></td>
<td>17.8</td>
<td>438.1</td>
</tr>
</tbody>
</table>

Source: News Corp Annual Reports, various years.
TNT Ltd

TNT is a transport company with its origins in the early post-Second World War period. When listed as a public company in the early 1960’s, TNT was principally a freight forwarding company, but subsequently developed its own transport operations through the purchase of a fleet of trucks and by the acquisition of existing transport companies. By the mid-1960’s, this expansion and acquisition program had made TNT the largest non-government freight transport group in Australia.

TNT began investment outside Australia in the mid-1960’s, more than a decade before the surge of outward IDI from Australia. In this way, TNT represents an early example of what would be widely referred to as ‘entrepreneurial’ investment abroad.

TNT’s first overseas investment was the establishment of a small subsidiary in New Zealand, which subsequently grew by acquisitions of existing transport firms in New Zealand. In the late-1960’s, TNT entered the North American market by the acquisition of Walkup Merchants Express, a loss making trucking firm in California. The company required several years of rationalisation to reach breakeven. TNT also undertook subsequent acquisitions of inter-state trucking firms. In the early 1970’s, TNT began an overnight freight forwarding business in England and Europe.

These ventures were followed up by further acquisitions in Brazil, Singapore, the United Kingdom and Europe during the 1970’s, including diversification into container shipping services and significant expansion in the US and Canada. In the early 1970’s, TNT also acquired a significant interest in Ansett Transport Industries, one of the two major domestic airlines.

By the mid-to-late 1970’s TNT was already earning a significant proportion of its revenue and profits in offshore activities. In 1976, TNT was earning almost 40% of its profits from international activities, and revenue earned abroad had already exceeded 50% of total revenue. Despite ongoing losses, TNT continued to expand via acquisition in North America. Increasingly, however, TNT was restructuring the base of its future growth toward Europe.

TNT therefore entered the 1980’s with a significant international presence, and a high proportion of its activities abroad. During the 1980’s, TNT undertook a significant expansion in domestic and international transport activities, funded heavily from international capital markets. Between 1982 and 1989, TNT’s long term debt and other liabilities increased from around $500 million to more than $2500 million (Sydney Stock Exchange Statex Service). This formal balance sheet

---

6 The following summary of the early development of TNT is taken from Ables (1978).
7 In 1973, TNT acquired Acme Fast Freight, one of the largest freight forwarders in the US. Since Acme had been a loss making firm for several years, the firm was sold for virtually nothing (Korporal 1986).
8 This differential related partly to the difficulties still being encountered by its US operations, where according to Korporal (1986) losses of around $1 million a year were still occurring, and that until the mid-1980’s its total losses in the US had totalled about $100 million.
9 It will be recalled that McFarlane (1992) estimated that between 1983 and 1988, TNT was one of the top ten corporate borrowers.
calculation of debt significantly understates the actual level of debt commitments. An estimate by Baring Securities suggested that by the early 1990’s, in addition to this debt, TNT had off-balance sheet commitments approaching $2,000 million (cited in Stevens and Stewart 1991).

Whereas in 1984 TNT had investments in North America amounting to less than $380 million in 1984, by 1990, it had accumulated more than $870 million in North America. Even more rapid expansion was experienced in TNT’s European operations. In 1984, TNT had activities in Europe valued at around $189 million, and by 1990, this had expanded to $1,634 million. Unlike the two other firms with operations in the transport industry, which internationalised their operations during the 1980’s through diversified investment (Mayne Nickless and Brambles) almost all of TNT’s expansion was based within the transport industry. By 1989, TNT had become the sixth largest international revenue earner from Australia, and was the seventh largest international profit earner (IBIS).

In the wake of the 1987 stockmarket crash, and particularly as a consequence of the recession of the early 1990’s, TNT entered a period of rapidly deteriorating profit performance. The rapid debt-funded expansion of TNT during the 1980’s now became a serious structural problem\(^\text{10}\). Whereas in 1990 TNT’s net reported profits amounted to $343.8 million, by 1994 it had fallen to $115 million (which included large contributions from assets sales\(^\text{11}\)). By 1991, the profit slump had seen TNT fall to 28th in terms of international profits of firms from Australia (IBIS).

In the 1990’s, the financial difficulties encountered by TNT exposed it to increased scrutiny by lenders, and in 1996, to a successful takeover bid by the post and telecommunications firm KPN Ltd, with which TNT had shared a joint venture in the Netherlands\(^\text{12}\).

Both the fact that so much of TNT’s international expansion was derived from international capital markets, and occurred by way of takeover of existing activities, and its demise by international takeover, raises a number of significant problems for analysing IDI. IDI outflow required a consequent inflow in national Balance of Payments statistics, even though both activities were occurring offshore. The subsequent takeover of TNT, which will appear as a large IDI inflow in Balance of Payments, poses similar difficulties. This takeover highlights the problem of attributing national characteristics to the outflow, and subsequent inflow, when takeovers can rapidly change the shape, ownership, and nationality of even quite large firms with an apparent ‘home’ base.

---

\(^{10}\) Stevens and Stewart (1991) captured the nature of the transition “TNT’s rapid growth is at the core of the present crisis. Throughout the second half of the 1980’s, when credit was easy and asset values were rising, [former managing director] Abeles had TNT on the fast track to international expansion. But like his long-term ally Rupert Murdoch, Abeles is now facing the unhappy task of having to accept that TNT must shrink. The company simply doesn’t have the financial resource to support the expansion orchestrated by Abeles”.

\(^{11}\) For details of the asset sales, see Knight (1993) and Thomas (1994).

\(^{12}\) For details of the buy-out see See Ries (1996).
### Table 7.6 TNT - Geographic Segment Data 1983-1994

<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>Australia + SE Asia</th>
<th>North America</th>
<th>Europe</th>
<th>Other</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>Employees</td>
<td>11,497</td>
<td>8,004</td>
<td>4,748</td>
<td>3,505</td>
<td>27,754</td>
</tr>
<tr>
<td></td>
<td>Profit</td>
<td>11,999</td>
<td>10,067</td>
<td>6,493</td>
<td>3,590</td>
<td>32,149</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>47.2</td>
<td>(28.7)</td>
<td>22.4</td>
<td>0.5</td>
<td>41.5</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>661.0</td>
<td>377.8</td>
<td>189.5</td>
<td>7.7</td>
<td>1,235.9</td>
</tr>
<tr>
<td></td>
<td>Profit</td>
<td>754.3</td>
<td>238.9</td>
<td>253.3</td>
<td>32.9</td>
<td>1,750.0</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>64.0</td>
<td>35.0</td>
<td>18.6</td>
<td>5.0</td>
<td>122.6</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>786.5</td>
<td>553.4</td>
<td>291.7</td>
<td>12.8</td>
<td>1,644.4</td>
</tr>
<tr>
<td>1985</td>
<td>Profit</td>
<td>870.6</td>
<td>1,066.3</td>
<td>301.0</td>
<td>54.2</td>
<td>2,262.0</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>77.0</td>
<td>20.8</td>
<td>25.7</td>
<td>7.5</td>
<td>131.1</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,065.8</td>
<td>710.6</td>
<td>413.3</td>
<td>23.5</td>
<td>2,213.2</td>
</tr>
<tr>
<td></td>
<td>Profit</td>
<td>1,013.1</td>
<td>1,240.1</td>
<td>501.2</td>
<td>68.1</td>
<td>2,822.4</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>70.2</td>
<td>51.9</td>
<td>35.3</td>
<td>9.6</td>
<td>167.0</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,177.2</td>
<td>815.7</td>
<td>434.3</td>
<td>21.8</td>
<td>2,449.0</td>
</tr>
<tr>
<td>1987</td>
<td>Profit</td>
<td>1,082.2</td>
<td>1,195.7</td>
<td>709.8</td>
<td>100.0</td>
<td>3,087.6</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>135.8</td>
<td>42.0</td>
<td>86.7</td>
<td>24.4</td>
<td>288.8</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,662.0</td>
<td>745.9</td>
<td>1,381.3</td>
<td>98.5</td>
<td>3,887.8</td>
</tr>
<tr>
<td></td>
<td>Profit</td>
<td>1,372.6</td>
<td>1,083.7</td>
<td>1,336.3</td>
<td>113.5</td>
<td>3,906.2</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>162.7</td>
<td>43.0</td>
<td>106.2</td>
<td>31.8</td>
<td>343.8</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,737.2</td>
<td>873.9</td>
<td>1,634.4</td>
<td>60.8</td>
<td>4,366.3</td>
</tr>
<tr>
<td>1989</td>
<td>Profit</td>
<td>1,441.1</td>
<td>1,176.4</td>
<td>1,677.7</td>
<td>187.5</td>
<td>4,842.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>54.5</td>
<td>60.0</td>
<td>47.5</td>
<td>(2.2)</td>
<td>159.8</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,983.0</td>
<td>796.9</td>
<td>1,545.9</td>
<td>42.3</td>
<td>4,367.5</td>
</tr>
<tr>
<td></td>
<td>Profit</td>
<td>1,404.5</td>
<td>1,277.0</td>
<td>2,009.5</td>
<td>142.9</td>
<td>4,833.6</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>48.4</td>
<td>31.4</td>
<td>72.7</td>
<td>(10.4)</td>
<td>142.4</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,492.0</td>
<td>348.9</td>
<td>1,203.8</td>
<td>61.2</td>
<td>3,105.9</td>
</tr>
<tr>
<td>1991</td>
<td>Profit</td>
<td>1,218.1</td>
<td>834.8</td>
<td>1,501.9</td>
<td>68.7</td>
<td>3,623.5</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>42.2</td>
<td>(3.4)</td>
<td>89.5</td>
<td>4.9</td>
<td>133.2</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,492.4</td>
<td>287.5</td>
<td>1,103.6</td>
<td>25.4</td>
<td>2,909.0</td>
</tr>
<tr>
<td>1992</td>
<td>Profit</td>
<td>1,166.9</td>
<td>220.1</td>
<td>1,432.2</td>
<td>33.2</td>
<td>2,852.4</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>39.4</td>
<td>8.0</td>
<td>64.8</td>
<td>2.9</td>
<td>115.1</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,276.8</td>
<td>252.9</td>
<td>1,153.8</td>
<td>27.8</td>
<td>2,711.4</td>
</tr>
<tr>
<td></td>
<td>Profit</td>
<td>1,153.6</td>
<td>243.4</td>
<td>1,353.8</td>
<td>104.6</td>
<td>2,855.5</td>
</tr>
</tbody>
</table>

Source: TNT Annual Reports, various years.
<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>Transport &amp; Related Services</th>
<th>Group Admin. &amp; Finance</th>
<th>Associated Companies</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>Profit</td>
<td>1,396.4</td>
<td>137.8</td>
<td></td>
<td>1534.2</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>1,184.2</td>
<td>51.8</td>
<td></td>
<td>1,541.6</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,658.9</td>
<td>91.1</td>
<td></td>
<td>1,750.0</td>
</tr>
<tr>
<td>1984</td>
<td>Profit</td>
<td>37.2</td>
<td>4.3</td>
<td></td>
<td>43.4</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>1,184.2</td>
<td>51.8</td>
<td></td>
<td>1,541.6</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,658.9</td>
<td>91.1</td>
<td></td>
<td>1,750.0</td>
</tr>
<tr>
<td>1985</td>
<td>Profit</td>
<td>117.9</td>
<td>4.7</td>
<td></td>
<td>101.6</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>1,584.7</td>
<td>58.7</td>
<td></td>
<td>1,620.5</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,138.8</td>
<td>122.2</td>
<td></td>
<td>2,262.0</td>
</tr>
<tr>
<td>1986</td>
<td>Profit</td>
<td>123.5</td>
<td>7.5</td>
<td></td>
<td>153.3</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>1,795.0</td>
<td>418.1</td>
<td></td>
<td>2,213.1</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,822.4</td>
<td></td>
<td></td>
<td>2,822.4</td>
</tr>
<tr>
<td>1987</td>
<td>Profit</td>
<td>152.7</td>
<td>14.3</td>
<td></td>
<td>222.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,027.7</td>
<td>421.3</td>
<td></td>
<td>2,508.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,087.6</td>
<td></td>
<td></td>
<td>3,087.6</td>
</tr>
<tr>
<td>1988</td>
<td>Profit</td>
<td>302.1</td>
<td>(13.2)</td>
<td></td>
<td>300.2</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,944.5</td>
<td>943.3</td>
<td></td>
<td>3,944.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,906.1</td>
<td></td>
<td></td>
<td>3,906.1</td>
</tr>
<tr>
<td>1989</td>
<td>Profit</td>
<td>337.9</td>
<td>5.9</td>
<td></td>
<td>223.4</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>3,201.6</td>
<td>1104.7</td>
<td></td>
<td>4,374.6</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>4,482.8</td>
<td></td>
<td></td>
<td>4,482.8</td>
</tr>
<tr>
<td>1990</td>
<td>Profit</td>
<td>152.0</td>
<td>7.8</td>
<td></td>
<td>(42.6)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>3,386.4</td>
<td>981.2</td>
<td></td>
<td>4,379.8</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>4,833.6</td>
<td></td>
<td></td>
<td>4,833.6</td>
</tr>
<tr>
<td>1991</td>
<td>Profit</td>
<td>142.5</td>
<td>(0.2)</td>
<td></td>
<td>(75.0)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,561.9</td>
<td>549.9</td>
<td></td>
<td>3,030.3</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,719.9</td>
<td></td>
<td></td>
<td>3,719.9</td>
</tr>
<tr>
<td>1992</td>
<td>Profit</td>
<td>135.3</td>
<td>(2.0)</td>
<td></td>
<td>14.2</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,341.3</td>
<td>567.7</td>
<td></td>
<td>2,717.5</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,851.4</td>
<td>1.0</td>
<td></td>
<td>5,517.8</td>
</tr>
</tbody>
</table>

Source: TNT Ltd Annual reports, various years
BHP Ltd

BHP began large scale international investment relatively late by both international and Australian standards. This lateness partly related to the domestic opportunities afforded to BHP by the protected access into participation in the (internationalised) development of large scale export-oriented mineral and mineral processing ventures in Australia during the late-1960's and 1970's. Thus, while BHP was by far the largest firm within Australia throughout the 1970's and for most of the 1980's, and has emerged as a large exporter for several decades, its formal international expansion into investment and production abroad has been relatively recent in origin. When BHP began to invest abroad on a large scale, it was also linked to its restructuring into mining and mineral processing.

Even its first major entry into international investment occurred largely as a result of the attempt to increase its domestic involvement in the mining industry. In 1984, BHP purchased the Utah Coal company, from the diversified US-based firm GEC, which made acquisition of other activities abroad a condition of the purchase of the coal mines in Australia. Utah owned extensive open cut mines and coal deposits in Queensland, but also owned significant steaming coal operations in the United States, a copper mine in Canada and a half share in an iron ore mine in Brazil, and exploration rights for copper in Chile (Stewardson 1995). In some ways therefore, BHP fell into overseas production. As Korporal (1986) put it, in ‘buying back the farm’, BHP had also acquired an important slice of their assets in the Americas.

Similarly, BHP’s rapid expansion during the 1980’s was in part at least, related to ‘domestic’ factors. The emergence of entrepreneurial firms such as EldersIXL, Bell Group and Bond Corp., with access to large pools of international credit, made even the largest firms vulnerable to takeover activity. In the late-1970’s and early 1980’s BHP had responded to the global recession, and particularly the slump in the world steel industry, by increasing its profile in resource-based industries, and trimming costs. This process both reduced the profitability of BHP (and therefore its share price), but cost cutting also reduced the gearing of BHP to very low levels. The Bell Group, and other like firms were therefore able to borrow large amounts offer the BHP shares acquired with that credit as security for that debt. In a rising

---

13 The then BHP Chairman, Brian Loton, explicitly observed in 1985 that the main reason BHP had not gone offshore earlier was the abundance of opportunities that existed within Australia in the 1960’s and 1970’s. He said that in Australia during that time there were few countries like Australia as a site for minerals production. Certainly there were few that offered such protected access to companies designated as Australian (cited in Korporal 1986).

14 Stewardson (1995) captures the qualitative change in orientation, in noting that during the 1970’s its acquisition of John Lysaght Australia included acquisition of a number of small steel roll forming mills in Asia. As he noted ‘These small plants represented BHP’s first overseas operations and indeed, throughout the 1970’s and 1980’s, were virtually its only operations overseas’. When the next phase of international investment began in the early 1980’s, however, mining and mineral processing investments had become the centre of the company’s key future accumulation strategy.

15 The Chilean copper deposits, in Escondida, came into production in 1990 and along with the acquisition of other copper interests, has become the basis of one of BHP’s major centres of accumulation.

16 In this one investment, the BIE observed, the size of the international investment from Australia doubled.

17 BHP’s balance sheet data shows that in 1982 around 70 percent of the firm’s total capital was in the form of equity.
stockmarket, those shares were therefore almost as good as a first mortgage on BHP property. While at political and public relations levels, BHP defended itself through the image of BHP as the 'Big Australian', the defence of BHP from corporate raiders forced the management of BHP to become more like the Bell Group and Elders IXL. In an effort to defend itself from potential takeover, BHP was forced to resort to raising large amounts of debt and becoming an (international) acquirer of other firms (including eventually becoming a key shareholder of one of the potential acquirers. This was one of the pressures that saw BHP become both a large-scale borrower on international capital markets, and a large scale investor abroad 18.

The scale of the transformation in the explicit internationalisation of BHP's activities can be seen in the following figures. In 1984/85 more than three-quarters of BHP's assets were located in Australia. By 1993/94, this figure had fallen to around two thirds (BHP 1996). Whatever the factors that drew BHP into international investment, the implication of the internationalisation of BHP is that all investment proposals are now and in the future considered on a global scale of reckoning. As Stewardson noted "we simply have no choice but to operate globally if we want to grow. Today we can, and will, fund projects anywhere in the worlds so long as they meet our criteria with due regard for their risk-return tradeoff" (1995).

The case of BHP highlights, as Bryan (1989) noted, that not simply failure, but even the success of any large individual capital is likely to be expressed negatively in the balance of payments of the 'home' nation. Bryan noted that "there is an increasing tendency for the capital account of the [Australian] balance of payments, including foreign debt, to be more a reflection of the international activities of 'Australian' companies than a reflection of the state of the Australian economy" (1989,p13). Had the Bell Group acquired BHP in the mid-1980's, it is likely that some activities would have been sold, and possibly sold to international firms. This would have been expressed in 'negative' terms in the balance of payments, as an increase in overseas investment, even though there would have been a change only in ownership rather than any increase in total investment in Australia. But it is equally clear that BHP's success in fending off Bell, and its subsequent growth are also being expressed negatively, as a rise in 'foreign' debt, and in an increasing proportion of the investment, production and employment funded by that debt, that are located outside of Australia. What is good for the global interests of a company may no longer be good for the particular interests of the home state. But more significantly, what is good for the global interests of that capital can appear as either good, bad or indifferent to the interests of the home state in terms of its implications for the balance of payments. It is this 'problem' as much as any other that has made it difficult, if not impossible to draw any balance of payments implications from the internationalisation of individual companies.

18 Between 1983 and 1988, only New Ltd and Bond Corp borrowed more than BHP. As a consequence of this large borrowing, by 1989, less than 43 percent of BHP's capital was provided by equity holders (down from 70 percent in the early-1980's). By 1994, three-quarters of BHP's debt was non-Australian sourced (Stewardson 1995).
<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>Australia</th>
<th>North America</th>
<th>United Kingdom</th>
<th>South America</th>
<th>Other</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>Profit</td>
<td>679.4</td>
<td>(9.6)</td>
<td></td>
<td></td>
<td></td>
<td>(31.1)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>7305.8</td>
<td>729.7</td>
<td></td>
<td></td>
<td></td>
<td>135.1</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>5200.8</td>
<td>116.8</td>
<td></td>
<td></td>
<td></td>
<td>74.5</td>
</tr>
<tr>
<td>1984</td>
<td>Profit</td>
<td>791.6</td>
<td>25.0</td>
<td></td>
<td></td>
<td></td>
<td>(42.5)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>7574.9</td>
<td>1955.8</td>
<td></td>
<td></td>
<td></td>
<td>152.5</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>6255.0</td>
<td>722.8</td>
<td></td>
<td></td>
<td></td>
<td>124.3</td>
</tr>
<tr>
<td>1985</td>
<td>Profit</td>
<td>984.8</td>
<td>36.4</td>
<td></td>
<td></td>
<td></td>
<td>(12.5)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>12493.6</td>
<td>3702.0</td>
<td></td>
<td></td>
<td></td>
<td>353.0</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>7439.6</td>
<td>1167.3</td>
<td></td>
<td></td>
<td></td>
<td>136.0</td>
</tr>
<tr>
<td>1986</td>
<td>Profit</td>
<td>779.2</td>
<td>37.3</td>
<td></td>
<td></td>
<td></td>
<td>23.7</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>13732.8</td>
<td>3289.1</td>
<td></td>
<td></td>
<td></td>
<td>497.8</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>7826.3</td>
<td>1362.5</td>
<td></td>
<td></td>
<td></td>
<td>183.7</td>
</tr>
<tr>
<td>1987</td>
<td>Profit</td>
<td>385.3</td>
<td>47.3</td>
<td></td>
<td></td>
<td></td>
<td>46.1</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>14322.8</td>
<td>3334.9</td>
<td></td>
<td></td>
<td></td>
<td>144.8</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>10491.8</td>
<td>1477.0</td>
<td></td>
<td></td>
<td></td>
<td>7.0</td>
</tr>
<tr>
<td>1988</td>
<td>Profit</td>
<td>843.4</td>
<td>114.6</td>
<td></td>
<td></td>
<td></td>
<td>49.5</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>13480.4</td>
<td>4579.3</td>
<td></td>
<td></td>
<td></td>
<td>1934.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>9378.3</td>
<td>1973.2</td>
<td></td>
<td></td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>1989</td>
<td>Profit</td>
<td>960.5</td>
<td>122.0</td>
<td></td>
<td></td>
<td></td>
<td>6.7</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>15981.6</td>
<td>3446.6</td>
<td></td>
<td></td>
<td></td>
<td>6.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3060.1</td>
<td>3143.5</td>
<td></td>
<td></td>
<td></td>
<td>10359</td>
</tr>
<tr>
<td>1990</td>
<td>Profit</td>
<td>1144.0</td>
<td>105.4</td>
<td></td>
<td></td>
<td></td>
<td>(82.5)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>16305.0</td>
<td>3235.5</td>
<td></td>
<td></td>
<td></td>
<td>920.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>11664.6</td>
<td>3666.2</td>
<td></td>
<td></td>
<td></td>
<td>1065.</td>
</tr>
<tr>
<td>1991</td>
<td>Profit</td>
<td>735.9</td>
<td>63.5</td>
<td></td>
<td></td>
<td></td>
<td>(91.5)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>16194.4</td>
<td>2806.0</td>
<td></td>
<td></td>
<td></td>
<td>1726.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>10212.0</td>
<td>2855.9</td>
<td></td>
<td></td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>1992</td>
<td>Profit</td>
<td>1224.0</td>
<td>(53.7)</td>
<td></td>
<td></td>
<td></td>
<td>34</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>18576.4</td>
<td>2761.2</td>
<td></td>
<td></td>
<td></td>
<td>2061.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>11329.7</td>
<td>2639.7</td>
<td></td>
<td></td>
<td></td>
<td>1493</td>
</tr>
<tr>
<td>1993</td>
<td>Profit</td>
<td>1365.2</td>
<td>4.0</td>
<td></td>
<td></td>
<td></td>
<td>34</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>18765.1</td>
<td>2384.8</td>
<td></td>
<td></td>
<td></td>
<td>3295.</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>11314.9</td>
<td>2585.8</td>
<td></td>
<td></td>
<td></td>
<td>1830</td>
</tr>
</tbody>
</table>

Source: BHP Annual Reports, various years.
Bond Corp. Ltd

Bond Corp. was probably the best known entrepreneurial firms, partly because of the retrospective exposure of financial and personal profligacy, and partly because the case of Bond Corp. is illustrative of a number of features of outward IDI from Australia. Bond Corp grew rapidly during the 1960’s and 1970’s through exposure to a growing range of corporate takeovers and property developments (Maher 1990; Barry 1990).

The financing of Bond Corp’s takeover activity and property development was also notable for the extent to which it was derived from borrowings obtained increasingly on international capital markets. An example of the association between Bond Corp’s takeover activity and large scale borrowing was its takeover of the Swan Brewing Company in 1980. The acquisition was funded with borrowings obtained from Wardleys, the newly-formed merchant banking arm of the Hong Kong and Shanghai Bank. The Swan Brewing Co. would become the basis for a series of further international brewing takeovers during the 1980’s. The significance of the acquisition here, however, is that by the late-1970’s Bond Corp. had already established an orientation to, and a reputation for corporate takeovers, and as a willing borrower.

However, in the early-1980’s, Bond Corp. faced a financial crisis related to the repayment of borrowings related to its 1970’s expansion. The success of Bond’s America’s Cup campaign in early-1983 helped to restore Bond Corp’s fortunes, and introduced the company to US financial institutions. By the mid-1980’s, Bond Corp had embarked on an explosive period of growth, based on diversified international and domestic corporate takeovers (in such areas as brewing, mining, broadcasting and communications) and property development. Bond Corp’s willingness and ability to borrow large amounts of credit became critical in the 1980’s, when corporate borrowing by firms such as Bond Corp. helped to underpin the growth of international credit markets. Whereas in 1980, Bond Corp had a recorded debt of about $80 million, by 1989 this had grown to at least $7.5 billion (Statex).

The particular nature of corporate growth (highly geared acquisition) was premised upon continuing growth in stock and property prices, and upon ever greater takeovers. It therefore also required larger and larger borrowings. The unwinding of the stock market boom and subsequent collapse of the property boom exposed Bond Corp. to a severe financial crisis in the late-1980’s and early 1990’s. By 1992, receivers had been appointed to Bond Corp. and its assets were subsequently sold (including to international firms). The rise and fall of Bond Corp. therefore highlights the point that the circumstances of international expansion and contraction by Bond Corp. make its characterisation in terms of the corporate attributes of Bond Corp. extremely limited. It is only possible to understand Bond Corp. in relation to global developments in capital markets, corporate restructuring and asset prices. This incompatibility of the Bond Corp. case with orthodox IDI theory therefore highlights the need for the international expansion of investment to be understood in terms of a wider theory of accumulation.
<table>
<thead>
<tr>
<th>Category</th>
<th>Australia*</th>
<th>UK and Europe</th>
<th>United States</th>
<th>Hong Kong</th>
<th>Other</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>Profit</td>
<td>308.8</td>
<td>-</td>
<td>33.7</td>
<td></td>
<td>342.5</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>3,410.1</td>
<td>55.3</td>
<td>650.3</td>
<td></td>
<td>4,115.7</td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td>2,420.2</td>
<td>-</td>
<td>68.6</td>
<td></td>
<td>2,488.9</td>
</tr>
<tr>
<td>1987</td>
<td>Profit</td>
<td>578.3</td>
<td>83.0</td>
<td>116.3</td>
<td>8.10</td>
<td>777.6</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>5,995.9</td>
<td>158.6</td>
<td>2,139.6</td>
<td>n.a.</td>
<td>5,008.5</td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td>3,108.0</td>
<td>1,513.0</td>
<td>879.9</td>
<td>10.8</td>
<td>9015.3</td>
</tr>
<tr>
<td>1988</td>
<td>Profit</td>
<td>(472.8)</td>
<td>(69.7)</td>
<td>301.6</td>
<td>108.1</td>
<td>-132.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>7,384.9</td>
<td>578.2</td>
<td>2,198.9</td>
<td>1,081.1</td>
<td>11,703.8</td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td>6,342.9</td>
<td>1,232.7</td>
<td>644.2</td>
<td>262.1</td>
<td>8,481.9</td>
</tr>
<tr>
<td>1989</td>
<td>Profit</td>
<td>228.6</td>
<td>(507.1)</td>
<td>-482.5</td>
<td>-761.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>1,301.8</td>
<td>679.2</td>
<td>-23.1</td>
<td>459.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td>6,925.0</td>
<td>1,688.2</td>
<td>866.8</td>
<td>9,480.0</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>Profit</td>
<td>(419.4)</td>
<td>(16.5)</td>
<td>-23.1</td>
<td>-459.0</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>475.3</td>
<td>42.6</td>
<td>8.90</td>
<td>526.8</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td>306.4</td>
<td>40.9</td>
<td>99.3</td>
<td>446.6</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>Profit</td>
<td>(241.8)</td>
<td>(3.1)</td>
<td>0.80</td>
<td>-244.1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>323.8</td>
<td>n.a.</td>
<td>10.8</td>
<td>334.6</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sales</td>
<td>101.8</td>
<td>58.6</td>
<td>2.0</td>
<td>162.4</td>
<td></td>
</tr>
</tbody>
</table>

* and non-material operations

Source: Bond Corp Annual reports, various years.
<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>Brewing &amp; Hotels</th>
<th>Property</th>
<th>Energy &amp; Minerals</th>
<th>Coal</th>
<th>International</th>
<th>Media</th>
<th>Corporate &amp; Other</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>Profit</td>
<td>37.7</td>
<td>2.8</td>
<td>(1.2)</td>
<td>5.2</td>
<td>-</td>
<td>2.8</td>
<td>(4.6)</td>
<td>38.9</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>280.5</td>
<td>37.5</td>
<td>35.1</td>
<td>74.4</td>
<td>-</td>
<td>73.3</td>
<td>214.0</td>
<td>725.4</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>278.6</td>
<td>11.8</td>
<td>-</td>
<td>32.9</td>
<td>-</td>
<td>19.1</td>
<td>16.6</td>
<td>365.3</td>
</tr>
<tr>
<td>1984</td>
<td>Profit</td>
<td>43.3</td>
<td>3.0</td>
<td>(775)</td>
<td>5.2</td>
<td>0.8</td>
<td>10.4</td>
<td>12.1</td>
<td>74.3</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>359.3</td>
<td>26.5</td>
<td>118.1</td>
<td>79.0</td>
<td>33.5</td>
<td>166.6</td>
<td>33.5</td>
<td>1,262.1</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>301.4</td>
<td>14.7</td>
<td>-</td>
<td>39.4</td>
<td>9.5</td>
<td>58.3</td>
<td>86.6</td>
<td>517.8</td>
</tr>
<tr>
<td>1985</td>
<td>Profit</td>
<td>191.1</td>
<td>1.4</td>
<td>23.7</td>
<td>5.7</td>
<td>(3.3)</td>
<td>13.1</td>
<td>61.3</td>
<td>292.9</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>1,320.0</td>
<td>52.4</td>
<td>209.8</td>
<td>78.0</td>
<td>182.7</td>
<td>992.3</td>
<td>2,835.3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,447.5</td>
<td>9.0</td>
<td>43.4</td>
<td>42.4</td>
<td>42</td>
<td>85.2</td>
<td>560.2</td>
<td>2,191.9</td>
</tr>
<tr>
<td>1986</td>
<td>Profit</td>
<td>202.0</td>
<td>21.2</td>
<td>12.2</td>
<td>10.6</td>
<td>39.2</td>
<td>7.3</td>
<td>50.0</td>
<td>342.5</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>1,230.9</td>
<td>143.7</td>
<td>226.2</td>
<td>82.1</td>
<td>650.3</td>
<td>1782.5</td>
<td>4,115.7</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,207.9</td>
<td>43.6</td>
<td>55.6</td>
<td>41.0</td>
<td>69.4</td>
<td>73.1</td>
<td>521.6</td>
<td>2,488.8</td>
</tr>
<tr>
<td>1987</td>
<td>Profit</td>
<td>287.2</td>
<td>141.7</td>
<td>19.1</td>
<td>7.7</td>
<td>116.3</td>
<td>30.3</td>
<td>175.3</td>
<td>777.6</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>3,116.5</td>
<td>822.8</td>
<td>458.5</td>
<td>72.6</td>
<td>879.9</td>
<td>1,791.7</td>
<td>1,873.3</td>
<td>9,015.3</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,207.9</td>
<td>291.1</td>
<td>67.7</td>
<td>46.8</td>
<td>387.5</td>
<td>122.3</td>
<td>885.2</td>
<td>5,008.5</td>
</tr>
<tr>
<td>1988</td>
<td>Profit</td>
<td>123.8</td>
<td>244.2</td>
<td>26.8</td>
<td>*</td>
<td></td>
<td>56.3</td>
<td>176.3</td>
<td>777.6</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,792.2</td>
<td>1,382.6</td>
<td>1,423.8</td>
<td>*</td>
<td></td>
<td>3,562.5</td>
<td>2,542.7</td>
<td>11,703.8</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,648.7</td>
<td>975.4</td>
<td>114.6</td>
<td>*</td>
<td></td>
<td>1,414.4</td>
<td>3,160.9</td>
<td>8,481.9</td>
</tr>
<tr>
<td>1989</td>
<td>Profit</td>
<td>(431.3)</td>
<td>(247.8)</td>
<td>(146.3)</td>
<td>(64.4)</td>
<td>(761.0)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>646.4</td>
<td>351.7</td>
<td>393.8</td>
<td>824.0</td>
<td>2215.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>1,440.6</td>
<td>777.1</td>
<td>308.5</td>
<td>6753.8</td>
<td>9480.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>Profit</td>
<td>(15.1)</td>
<td>(29.8)</td>
<td>12.2</td>
<td>(426.3)</td>
<td>(459.0)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>40.3</td>
<td>163.7</td>
<td>-</td>
<td>322.8</td>
<td>526.8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>36.9</td>
<td>115.6</td>
<td>114.4</td>
<td>179.7</td>
<td>446.6</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* 1989 onwards oil gas & coal are combined into one (1) resources

Source: Bond Corp Annual reports, various years.
Elders IXL

The controlling company that later became the core of Elders IXL was Henry Jones (IXL), a company acquired by a management team led by John Elliott in the early 1970's. Henry Jones was transformed by Elliott and the management team into a vehicle for further mergers and acquisitions during the 1970's.

Elders IXL Ltd. was formed in 1981, by the merger of a food processing company, Henry Jones (IXL) and the leading rural trading firm, Elders Smith Goldsborough Mort. In 1983, Elders acquired Carlton & United Breweries (CUB), the largest brewer in Australia, after a takeover battle with Bond Corp. That single acquisition doubled the size of Elders and involved the rapid assembly of a financing package totalling $980million.

Elders IXL made its first international acquisition in 1982 when it acquired the Wood Hall Trust PLC for $115million. The Wood Hall Trust had interests in the pastoral industry in Australia, but was based in Britain, and had extensive international interests. The pastoral interests of Wood Hall were merged with Elders' own pastoral interests, while its overseas activities became the basis of Elders International Group.

During 1984 and 1985, Elders restructured its operations to absorb the newly acquired operations (including selling activities in processed foods, and transferring its mining interests into Elders Resources). In October 1985, Elders launched a $3.6 billion bid for Allied Lyons, a diversified food and drinks conglomerate. The bid was to be funded largely by way of a $2.6 billion syndicated loan facility, and the subsequent sale of many divisions of Allied Lyons. The bid was, however, frozen for nine months by the British Monopolies and Merger Commission (MMC). During that investigation, not only did Allied Lyons expand its own operations abroad, it did so on the basis of extensive borrowings. Thus while the MMC found no public interest reasons to stop the bid, Allied Lyons had been given nine months to make the Elders bid unviable (MMC 1986; Gray and McDermott 1989).

Furthermore, in early 1986 Elders became involved in a cross shareholding with BHP as a takeover defence against the Bell Group. The BHP defence required Elders to purchase a 20 percent share of BHP, financed by a further $1.7 billion in syndicated borrowings. In return, BHP purchased $1 billion in redeemable preference shares and $220 million in Elders convertible bonds.

In November 1986, Elders acquired the brewing interests of the Hanson Trust by takeover of the Courage Group. In April 1987, Elders purchased Carling O'Keefe Breweries of Canada, and in January 1989, Elders announced plans to merge this company with the Molson group of companies.

---

19 For a biography of Elliott, see Denton (1987).
20 Hewart (1987) celebrates the development of Elders IXL.
Through this rapid international expansion, Elders increased its international investments from less than $200 million in the mid-1980’s, to more than $5 billion in the early 1990’s. At its peak in the late 1980’s Elders had become the single largest investor abroad from Australia. Yet since then Elders has undergone an equally spectacular crisis.

While Elders IXL was affected by the aftermath of the collapse of the stockmarket boom in late-1987, it was the coincidence of the problems of resolving the problems of Elders debt-funded growth (including problems associated with its attempted takeover of the brewing firm in Britain, the Scottish and Newcastle breweries21, and Grand Metropolitan22), with the attempted debt-funded management buyout led by Elders, that would finally plunge Elders into turmoil in 1993. The subsequent restructuring of Elders has seen Elliott and other former managers leave, and BHP and several banks as a major shareholders in Elders, the sale of large sections of the company, and its renaming as Fosters Brewing Ltd.

The case of Elders/Fosters highlights the significance of changes in ownership that 1980’s M&A activity and the critical role played by credit in 1980’s IDI. The scale of Elders expansion in only several years, and its subsequent retreat highlight, in another way the problems of identifying national causes for the pattern of IDI.

---

21 See MMC (1989).
22 See Kilgore and Alchin (1990)
Table 7.11 Elders - Fosters Group Segment Results 1983-1994

<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>Australia and Pacific</th>
<th>UK/ Europe</th>
<th>USA/ Canada</th>
<th>Asia and other</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>Profit</td>
<td>217.1</td>
<td>6.6</td>
<td>5.8</td>
<td>7.3</td>
<td>236.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>4,595.1</td>
<td>21.5</td>
<td>69.1</td>
<td>109.7</td>
<td>4,795.4</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>7,088.4</td>
<td>176.2</td>
<td>225.8</td>
<td>168.3</td>
<td>7,658.7</td>
</tr>
<tr>
<td>1984</td>
<td>Profit</td>
<td>556.6</td>
<td>37.7</td>
<td>12.0</td>
<td>7.6</td>
<td>610.1</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>4,911.0</td>
<td>4,014.6</td>
<td>789.9</td>
<td>79.3</td>
<td>9,794.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>7,897.5</td>
<td>1,958.3</td>
<td>610.6</td>
<td>93.9</td>
<td>10,560.3</td>
</tr>
<tr>
<td>1985</td>
<td>Profit</td>
<td>615.7</td>
<td>235.5</td>
<td>103.0</td>
<td>100.7</td>
<td>1,054.8</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>4,323.0</td>
<td>3,036.5</td>
<td>1,321.0</td>
<td>17.5</td>
<td>9,298.0</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>9,619.8</td>
<td>2,698.6</td>
<td>2,513.6</td>
<td>518.8</td>
<td>15,350.3</td>
</tr>
<tr>
<td>1986</td>
<td>Profit</td>
<td>298.6</td>
<td>119.8</td>
<td>191.6</td>
<td>129.7</td>
<td>739.7</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>7,749.0</td>
<td>3,983.9</td>
<td>2,429.1</td>
<td>1,121.6</td>
<td>15,283.7</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>11,106.2</td>
<td>2,573.1</td>
<td>3,566.3</td>
<td>401.5</td>
<td>17,647.1</td>
</tr>
<tr>
<td>1987</td>
<td>Profit</td>
<td>158.9</td>
<td>49.7</td>
<td>(48.3)</td>
<td>79.8</td>
<td>240.0</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>5,936.8</td>
<td>3,196.9</td>
<td>1,081.8</td>
<td>2,14.6</td>
<td>10,577.0</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>10,227.3</td>
<td>2,355.8</td>
<td>2,416.7</td>
<td>362.5</td>
<td>15,214.0</td>
</tr>
<tr>
<td>1988</td>
<td>Profit</td>
<td>182.4</td>
<td>23.4</td>
<td>52.2</td>
<td>(2.2)</td>
<td>255.7</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>3,906.7</td>
<td>3830.5</td>
<td>1,330.2</td>
<td>142.7</td>
<td>9,101.6</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>6,050.1</td>
<td>3168.0</td>
<td>1,221.8</td>
<td>84.0</td>
<td>10,632.3</td>
</tr>
<tr>
<td>1989</td>
<td>Profit</td>
<td>(632.3)</td>
<td>(371.3)</td>
<td>45.3</td>
<td>(0.1)</td>
<td>(949.4)</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,814.9</td>
<td>4130.9</td>
<td>1,194.3</td>
<td>17.3</td>
<td>8,157.3</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>4,921.8</td>
<td>4,012.7</td>
<td>1,492.9</td>
<td>6.2</td>
<td>10,370.5</td>
</tr>
<tr>
<td>1990</td>
<td>Profit</td>
<td>165.3</td>
<td>46.8</td>
<td>109.8</td>
<td>3.6</td>
<td>325.5</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,497.8</td>
<td>3,756.4</td>
<td>1,101.1</td>
<td>15.1</td>
<td>7,370.4</td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>3,030.3</td>
<td>2,413.0</td>
<td>1,045.6</td>
<td>5.3</td>
<td>6,494.2</td>
</tr>
<tr>
<td>1991</td>
<td>Profit</td>
<td>652.8</td>
<td>(456.0)</td>
<td>39.7</td>
<td>236.5</td>
<td>6,303.7</td>
</tr>
<tr>
<td></td>
<td>Assets</td>
<td>2,739.0</td>
<td>2,600.4</td>
<td>964.3</td>
<td>6,068.4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Revenue</td>
<td>2,197.3</td>
<td>2,202.6</td>
<td>668.5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Elders Annual Reports, various years.
## Table 7.12 Elders (Fosters’ Brewing) Group - Industry Segment Results - 1983-1995

<table>
<thead>
<tr>
<th>Year</th>
<th>Category</th>
<th>Brewing</th>
<th>Agriculture</th>
<th>Finance</th>
<th>Resources</th>
<th>Investments &amp; other</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1984</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1985</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1986</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1987</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1988</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1989</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1990</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1991</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1992</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1993</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
<tr>
<td>1994</td>
<td>Profit Assets</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
<td>Revenue</td>
</tr>
</tbody>
</table>

Source: Elders Annual Reports, various years.
SUMMARY AND CONCLUSIONS
8.0 SUMMARY AND CONCLUSIONS

The thesis has traced the rise and fall of the post-war general theory of International Direct Investment (IDI). The modern theory of IDI only emerged in the 1950’s and 1960’s to explain the particular pattern of international investment in the early post-war period. In contrast with the pre-war pattern of international capital, post-war IDI had a number of different and seemingly unique characteristics. It was shown how the particular pattern and characteristics of IDI in the 1950’s and 1960’s helped to generate a particular conceptual approach to IDI theory. In this way, the ‘stylised facts’ of IDI in the 1950’s and 1960’s became constituted by the emerging theory as a ‘new’ international economic phenomenon.

The particular characteristics of one form of international capital in one era were presented as the basis of a new theory which could explain all subsequent IDI. It was in these circumstances, that post-war IDI theory came to be presented as a general theory, not as an explanation of historically specific processes. The thesis has explored the historical development of the general IDI theory in terms of a conceptual framework of capital, competition and internationalisation. Through these concepts, the thesis has shown the distinctiveness of IDI theory (as well as characterising divisions within the theory), and explaining the evolution of the theory.

The constitution of a new era of international investment in the 1950’s and 1960’s was developed in terms of the concepts of capital, competition and internationalisation. One of the distinctive features of this new form of investment was that it seemed to be motivated more by the profit opportunities of industrial firms, than the interest-rate or exchange-rate arbitrage opportunities of portfolio investors in different countries. The explanation of post-war IDI therefore seemed to require a concept of capital which could explain the institutional structure firms and the activities occurring within them. Similarly, post-war IDI was occurring in industries not well described by perfect markets, the prevailing concept of competition inherent in neoclassical economics. The new post-war theory was established largely on the terrain of a concept of competition derived from neoclassical economics, but IDI came to be understood as a product of market failure. The requirements of explaining post-war IDI also necessitated a different concept of internationalisation. Post-war IDI was flowing in the wrong direction to the predictions of portfolio capital theory. IDI came to be conceptualised in terms of the outgrowth of national firms into similar markets abroad.

While the categories and definitions of IDI have continued to evolve over the post-war period, the 1950’s and 1960’s-derived theory of IDI has been the basis upon which the analysis of all subsequent IDI has been understood. The thesis has shown that one effect of this focus has been to dictate a particular understanding of IDI, and to embed an analytical inflexibility into the underlying understanding of IDI. The

---

1 The new theory has also applied to the explanation of international capital in the pre-war period. The thesis found that economic historians encountered a number of difficulties in attempting to retrospectively apply the mid twentieth century-derived concepts and categories to international capital in the nineteenth century.
1950’s and 1960’s did not represent a new analytical era of international capital, and
the thesis has examined historically how certain features of international capital in
that period, which were assumed to be new and distinctive to that era, were in fact
part of a longer process.

IDI researchers in the 1960’s and 1970’s were confident that they had discovered (or
were discovering) a new general theory of IDI. There was indeed vigorous debates
between IDI researchers about which model constituted the proper basis of that
general theory, but there was also general agreement about the analytical importance
of this new form of investment. IDI theory thus emerged from the particular
circumstances of the 1950’s and 1960’s with a new and fairly distinct conceptual
agenda. But the inherently ahistorical nature of the new theory has been exposed by
the requirements of explaining of subsequent changes, and integrating them into the
general theory. The thesis has shown, through an analysis of the developments of IDI
theory in the 1970’s and 1980’s, how those historically specific patterns that were
initially thought to be general and universal, had to be modified. These developments
required the retrospective modification of some of the concepts of the general theory.
Indeed, it has even prompted many to declare an end to the possibility of a
conceptual framework of the general theory.

The thesis therefore explored the areas where IDI theorists were attributing
permanence to patterns that we now know were temporary and conjunctural. The
wider question that has also been considered was how the particular forms of IDI in
the 1950’s and 1960’s gave rise to what was then thought to be a general theory of
IDI. Central to the development of the new theory are the categories of capital
competition and internationalisation (introduced in Chapter 2). In Chapter 3, the
categories were developed in some detail to show how the new theory developed in
terms of the requirements of explaining the particular pattern of IDI in the 1950’s
and 1960’s.

Chapter 4 examined the way that the changing stylised facts of IDI in the 1970’s
forced IDI theory to modify aspects of the conceptual basis the new general theory.
Less restrictive and more fluid elements were added to the theory in an attempt to
preserve the claims of the theory to generality and universality. By the close of the
1970’s, however, in the context of a continuing evolution in international capital, the
general IDI theory had reached something of a hiatus.

In Chapters 5 and 6, the thesis examined how further changes in international capital
during the 1980’s and early 1990’s transformed a theoretical hiatus at the beginning
of the decade into a crisis for the general theory\(^2\). Chapter 6 confirmed that crisis in
IDI theory related in part to the challenges posed by the requirements of explaining
many of the transformations in 1980’s and 1990’s IDI, changes which have been
beyond the explanatory range of the existing theory. While modifications in the
concepts of IDI theory have been picking up aspects of change, it is only through the

\(^2\) It bears noting here that some of these transformations and problems that have confronted IDI theory have
confronted other branches of economics. For instance, the concept of competition in other branches of economics
has come under close scrutiny. Nalebuff and Stiglitz (1983), have claimed that a major problem exists for
neoclassical economics because of the inherently static form of pure price competition embodied in the Arrow-
Debreu model\(^3\). Yet what is now at stake is not simply the static nature of neoclassical concepts of competition
but the entire conceptual approach to competition.
analysis of the complex interplay between capital, competition and internationalisation, and not one aspect alone, which is the key to understanding the evolution of IDI.

During the 1980’s, the notion of post-war IDI theory as a general theory was finally undermined. Chapter 6 also considered the theoretical responses to the crisis brought about by developments in international investment during the 1980’s and 1990’s. The responses were considered in terms of various attempts to re-constitute the conceptual framework of the earlier general theory of IDI. It was shown that to the extent that these responses can be said to represent continuity with the post-war theoretical tradition, a conceptual inversion can now often be discerned. For instance, where once it was a central assumption of IDI theory that there was an inherent disadvantage of operating abroad, the generalisation of the TNC as the institutional form of capital has prompted many IDI researchers to suggest that there are now inherent advantages to internationality. Similarly, whereas competitive processes leading to IDI were once understood to be quite rare and a feature of particular forms of market structure (or the ownership of special advantages by firms), it is now proposed that IDI and the TNC can arise from almost any competitive situation. There is now even a suggestion that IDI is an expression of (the increasingly international nature of) competitive processes. And whereas the establishment of wholly-owned ‘foreign’ subsidiaries by TNCs within a hierarchical organisation was understood as the institutional form of post-war international capital, cross border forms of organisation are now understood to be much more disparate. The institutional nature of, and boundaries between, firms are now understood to be much less immutable than in the 1950’s and 1960’s.

The thesis has also contended that the 1980’s has also served to highlight the limitations of an ‘internal’ theory of IDI. The thesis contends therefore that the theoretical crisis does not derive simply from the limitations of the concepts of IDI theory themselves. Rather, a general theory of IDI is not possible because IDI needs to be conceptualised within a general theory of accumulation. A central methodological contention of the thesis has been that IDI needs to be understood in aggregate in the context of global transformations in capital accumulation in general, and individually in the context of the particular circumstances of ‘each’ IDI3.

The theoretical crisis during the 1980’s has therefore served to undermine the distinctiveness of the concepts themselves. Nevertheless, these concepts provide a useful way of proposing an alternative analysis of IDI in terms of a different research methodology. Whereas IDI theory has developed an analytical focus on the internal structures of international capital, an alternative concept of capital begins from the perspective of capital as a social relation of accumulation. Similarly, IDI theory began with a concept of internationalisation which assumed the prior coherence of nations as economic units. Firms engaging in investment and production abroad were

3 Existing theory has been developing in this direction, and increasingly IDI is being considered within a wider analysis of ‘international business’. In this regard, the usefulness of event-type (or announcement effect) studies seeking to confirm a general theory is surely open to serious challenge, a conclusion which has been reached in other areas of economics where this research method has been critical. See for instance, Jensen and Warner (1988). However, for a recent example in IDI research, see Gross (1988).
therefore assumed to require the possession of a special advantage or be in control of a monopolistic position in their home market.

In the context of the breakdown of the general theory, there is a need to return to the examination of the particularities of IDI - particular national patterns and particular company patterns. The thesis developed this proposition by way of a case study of outward IDI from Australia during the 1980’s and 1990’s and of several key investing companies from Australia during that time. The case study of IDI from Australia during the 1980’s and 1990’s highlighted a number of themes developed in the thesis. It was established that Australia provides a useful nation for a case study, both because the study of IDI inflow into Australia in the 1950’s and 1960’s was critical in the development of the new theory, and because the recent growth of IDI from Australia has displayed many of the global characteristics of IDI at an exaggerated level. One dimension addressed in the case study was to explain why the data on Australia displayed a pattern of expansion and contraction that was different from other industrial countries. By such an explanation, the thesis was able to focus on particular cases of IDI rather than resting with some general institutional postulates.

The case study chapter showed that a significant reason for the distinctive and volatile pattern of outward IDI from Australia was the particular way companies operating in Australia were integrated into international financial markets during the 1980’s. Yet an examination of several key investing companies has revealed that their international growth by debt-funded acquisition resists easy explanation in terms of national determinants or characteristics. Indeed, the subsequent demise of many of these firms (and the takeover of several others) challenges explanations in terms of the characteristics or attributes of the firms themselves. The wider proposition developed in the case study is that the determinants and patterns of international capital have become so diverse that the study of IDI can no longer be encompassed by the sorts of IDI-specific theoretical determinants which were so confidently enunciated in the post-war period. Hence, IDI itself needs to be understood within a broader context of the multiple and diverse forms in which capital moves internationally, and this validates the current focus on ‘globalisation’ as a broader concept than IDI. Nonetheless, much of the current literature on globalisation has uncritically accepted from IDI theory, the institutional notion of the TNC as the conceptual centre-piece of understanding the world economy in the late-twentieth century.

In the final part of this concluding chapter, an attempt is made to provide some speculative comments on contemporary debates about recent ‘globalisation’, on the basis of insights derived from the examination of the evolution of IDI theory. The debate about globalisation is broader than simply IDI, but it has been established that there are aspects of recent debate which can be seen to have antecedents in IDI theory.

Whereas IDI theory began on the basis that investment and corporations were inherently national in nature, recent theories of globalisation have been based on the proposition that economic processes are now globally determined. It did not require individual capitals to begin investing, producing and trading on a global scale of
reckoning for the global nature of capital (as a social relation of accumulation) to be discerned. To paraphrase Kay (1991), until the post-war period, with the increasing extent to which individual capitals were producing, trading and investing on an explicitly global spatial scale, the global nature of capital could be perceived largely only through an examination of theoretical categories.

Where it was assumed that the classic organisational unit of capital existed in a national form, the international growth of individual capital tended to be perceived initially as a development beyond its classic form⁴. Indeed, this was the initial assumption that became incorporated into the conceptual framework of IDI theory, and international investment and production by individual firms was conceived as an aberration, requiring those corporations engaging international operations possess some sort of ‘compensating advantage’.

In a similar way, the initial internationalisation of capital in the post-war period could be perceived as an intrusion into this inherently national system of organisation. International investment was understood in terms of ‘foreignness’ and international capital in terms of foreign control. But with the growth of international capital from many ‘home’ nations, and its generalisation as the form of existence of individual capital, labour increasingly confronts capital less in terms of its nationality, and more in terms of its universality.

In retrospect, it is now possible to see that the internationalisation of individual capitals has not been part of an evolution of capitalism beyond its classic form. Rather, the growing internationalisation of individual capitals represents their more explicit integration into the global circuit of capital. In this sense, the post-war period has been marked by a transition from one form of organisation of individual capital toward another, better suited to accumulation in increasingly global conditions of production.

From the perspective of relations between capital and labour, the transition from national to international corporations has a number of dimensions. The increasing internationalisation of production since the Second World War has seen the increasing dispersion of various stages of (intermediate) production throughout the world. Whereas Adam Smith’s classic description the pin factory in industrialising Edinburgh signalled the new productive potential of collective labour within one factory, the power of collective labour must now increasingly be grasped in global terms. In the early twentieth century, before internationalised individual capitals became the general form of existence of capital, the opposition to capital could be posed abstractly in global terms, but action was generally structured within the bounds of nation-states (and a national scale of reproduction of individual capitals). The political incorporation of labour, through Keynesianism, the welfare state and even limited nationalisation could be conducted in terms compatible with accumulation (Kay 1991).

Despite this development, there is still a strong desire to cast internationalisation in national terms, and the ‘problem’ of the nationality of capital continues to pervade

⁴ At its extreme, this assumption of nationality led to the suggestion that international investment was as a signal of a decaying capitalism.
the analysis of international capital. For some economists, such as Ohmae (1991; 1995a, 1995b) and others, the growing ‘territorial non-coincidence’ between the scale of reproduction of individual capitals and the boundaries of the nation-state are cast in terms of the eclipse of nation-states in the face of increasingly global (or more particularly regional) forms of economic organisation. Certainly, on the basis of an assumed prior coherence of nation-states this position has merit. For others, however, internationalisation is being understood not only negatively, but also as disorder. This conception of globalisation is illustrated in the debate amongst several US economists over ‘who is us?’ (Reich 1990, 1991, 1993; Tyson 1991). The formal terms of the debate is about globalisation of capital and the implications for the nation-state. In the context of the above discussion, that debate can be reposed in terms of the reabsorption of labour at a national level into the increasingly global nature of capitalist production. For Reich, the internationalisation of capital signals that the nation-state needs to discard the earlier distinctions between capital in terms of the nationality of that capital. He notes that “today, the competitiveness of American-owned corporations is no longer the same as American competitiveness” (1990, p.54). In place of an ownership criteria, Reich seeks to redefine capital in terms of its behaviour - where a capital locates its investment, research and production. In the face of the increasingly explicit global scale of reproduction of individual capitals which developed from the United States, Reich concludes that distinctions between capital based on corporate nationality are increasingly arbitrary and meaningless. In place of capital nationality, however, Reich seeks to invoke another subjective distinction on the basis of where a capital invests its ‘core’ or high value added activities.

Tyson (1991) has criticised Reich on the basis that he overstated the scale of the recent internationalisation. She argues that while there are indeed many more firms that operate on a global scale of reckoning, “the competitiveness of the U.S. economy remain tightly linked to the competitiveness of U.S. firms” (1991, p.38). In this sense, Tyson’s criticism is that Reich is not wrong, but ‘premature’. Reich correctly points to the long-term trend, but at present most company’s still operate within a U.S. scale of reckoning, and ensuring the profitability of U.S. capital therefore remains a more than useful goal for state policy. The problem for Tyson’s attempted rebuttal of Reich is two-fold. Firstly, Tyson reproduces the institutional notion of capital, so that globalisation can be read-off from the number of TNCs operating from that nation and the scale of their international operations. This focus allows Tyson to neglect the parallel globalisation of capital markets during the 1980’s which have explicitly not only increased the global circulation of capital, but also imposed global calculation on capital advance.

Yet the case study of outward IDI from Australia showed that it is not the global nature of individual capital per se which is critical. Competition associated with recent internationalisation means that even domestic developments cannot be understood outside of their relation to global forces. In the case of BHP, for instance, its ‘late’ entry into international investment, its initial international investment, and its later rapid growth were developments driven by apparently domestic factors.

---

5 Tyson concludes that “Engine Charlie Wilson may have been right for the 1950’s [in asserting that what was good for American companies was good for America], and Reich may well be right for the next century. But, for now, we need to improvise in a world that fits no ideal model” (1991, 49).
(domestic investment opportunities, and domestic threats of takeover) which can be better understood as moments of a global rather than local process. And as Stewardson noted of BHP, "having become a global company, we will remain one... we simply have no choice but to operate globally if we want to grow" (1995,p59). The point here is that understanding that individual capitals now operate on a global scale of reckoning, makes its redefinition in terms of subjectivity even more problematic. The case study also established how the growth and decline of several key investing firms (such as TNT Ltd, Bond Corp, and Elders IXL) related directly to developments not in the firms themselves, but to in international capital markets.

More significant perhaps is Reich's attempt to displace the focus of nationality of individual corporations altogether from state policy and replace it with an understanding of the social function of capital (and the nation-state). According to Reich, "American ownership of corporations is profoundly, less relevant to America's economic future than the skills, training, and knowledge commanded by American workers... government policies should promote human capital in this country" (1990,p54). With individual capitals operating on an increasingly global scale, the role of nation-states cannot be to guarantee the global profitability of any individual capital. The function of nation-state must, as Holloway has observed, be developed in terms of "ensuring favourable conditions for the reproduction of capital within its boundaries (through the provision of infrastructure, the maintenance of law and order, the education and regulation of labour power, etc) and also to give international support (through trade policy, monetary policy, military intervention etc) to the capital operating within its boundaries, largely irrespective of the citizenship of the legal owners of that capital" (1995,p35). Reich's attempt is therefore more an attempt to replace a concept of corporate nationality with one of corporate nationalism (companies are national if they act in a way that the state wants). Whereas the debate on 'globalisation' has been attempting to reconceptualise the increasingly global nature of individual capitals in terms of the nation-state, an alternative analysis of capital needs to begin with the nation-state as an expression of the global nature of accumulation, and in terms of a social relation of accumulation.

The thesis has shown that these debates about globalisation have their antecedents in the development and evolution of IDI theory during the post-war period. An understanding of that history may not produce a detailed alternative analytic (let alone national policy) agenda. It does however, help to show that there are underlying problems and themes which have structured both those debates - the themes of the tendency for capital to expand, and the perception of that expansion as politically confronting. While the theories of IDI and globalisation have emerged in response to the evolving forms of international capital, it is the underlying themes, rather than the theories which remain the enduring analytical and political dilemmas of our epoch.
Bibliography


(1995b) Investment Abroad by Australian Companies Issues and Implications, Report 95/19, AGPS, Canberra.


Department of Foreign Affairs and Trade (DFAT) (1992a) Australia and North-East Asia: Accelerating Change, AGPS, Canberra.

(1992a) Australia's Business Challenge - South East Asia in the 1990's, AGPS, Canberra.


Mergerstat Review, various issues.


(1991b) 'Who Do We Think They Are?' The American Prospect, Winter.


and Dunning, J. (1979) The World Directory of Multinational Enterprises, Sijithoff and Noordhoff,


