GLOBALISATION AND LINKAGE-INTENSIVE DEVELOPMENT
-- A CORPORATE PERSPECTIVE --

by

DeAnne Julius

Chief Economist, British Airways

Introduction

There is no doubt that the OECD corporate world has rediscovered developing countries. I say 'rediscovered' advisedly, because this may be another wave of interest -- as we have seen in the past -- that will fade with disillusionment as sales and profits in those markets fail to live up to expectations, or as negotiating our way through capricious changes in policy becomes too much trouble to be worth the candle. The corporate perspective towards developing country partners and markets is a strange and changeable mixture of enthusiasm and despair.

A glance at history may help to explain this. If we were to caricature the corporate view of the developing world as a mixture of seeing those countries as threats or as opportunities, then the decade-by-decade picture might be along the following lines. During the colonial period, developing countries were viewed as an important source of supply and thus of profit opportunity, carrying relatively little commercial or political threat - at least for companies from the 'mother' country. It was a picture of 'high opportunity-low threat'. The relatively high flows of foreign direct investment (FDI) are testimony to this view, especially prior to the First World War (Dunning, 1983).

All that changed with the entirely laudable success of independence movements. Unfortunately, the association of the foreign private sector with the colonial period resulted in a policy backlash by many developing countries that shifted corporate perceptions to 'high threat-low opportunity' by the early 1970s. The rise of OPEC and the first oil shock in 1973 reinforced this view. The discussion of other producer cartels in the mid-1970s (around the theme of a 'New International Economic Order') and the rising commodity prices of that period shifted corporate perceptions to 'high threat-high opportunity'. Linkages, in terms of FDI flows, were concentrated heavily in the natural resource sectors. Ironically, those are sectors whose internal linkages (to other parts of the host country economy) are much weaker than those of most manufacturing and service industries.

The debt crisis of the early 1980s and the collapse of oil prices in 1985 plunged many developing countries into a decade of weak growth. This, together with the fall in oil and some other commodity prices, meant another dramatic shift in the corporate perception of developing countries to 'low threat-low opportunity'. In terms of FDI flows, the developing countries were marginalised, receiving just 15 per cent of global inflows in 1989 (WIR, 1992).

The dramatic collapse of the planned economy model at the end of the 1980s and the widespread policy change in developing countries since then have again radically altered corporate perceptions.

We have come full circle. Today the developing country markets are again viewed as 'high opportunity-low threat', but in a much healthier and more sustainable socio-political context than in pre-independence days. However, if this potted history has a lesson for us, it is that reversal -- rather than trend continuation -- is to be expected. To reinforce and prolong the current favourable growth in OECD/non-OECD linkages will require a positive effort on all sides: public and private, in rich and poor countries.

What drives the corporate view?

There are two key factors driving the corporate enthusiasm for developing countries in the 1990s: educated and well-motivated work forces and growing domestic demand, especially for consumer durables. Both of these are new phenomena.

The strategic considerations of OECD firms encompass both supply and demand aspects of their markets. For a shrinking but still large percentage of firms, the primary attraction of a developing country link is as a supply source. Whereas this once meant raw material or natural resource supplies, now it more often means lower cost labour supplies. The key reason for this shift is the much larger availability of skilled labour in developing countries. It is now much easier -- not just cheaper -- to recruit trained computer operators and programmers in Bombay than it is in London. That was not true a decade ago. In British Airways I have been struck, again and again, by the very high quality of staff in our airport operations and sales offices in far-flung parts of the world, not to mention their high enthusiasm and commitment to the company. It would be hard to compare them unfavourably on any count with our staff in similar positions at home.

But of even more importance than supply-side linkages are the demand-led ones. The revival of growth in per-capita incomes in developing countries has meant that many countries have reached threshold levels of demand for many goods and services whose production is dominated by OECD firms. For many consumer durables such as refrigerators and washing machines, for some transport products such as motor scooters and small automobiles, and for a few services such as international air travel, the middle-income developing countries are now at levels of per capita income where demand 'take-off' occurs. At the same time, for some of these products, market saturation in the OECD countries is depressing sales and leading to market-share battles that depress prices and margins (Brown and Julius 1993). The result of this scissors effect (stagnant demand and shrinking margins in OECD countries and booming demand in developing countries) is to cause many corporate strategies to refocus their investment and expansion plans on the developing world.

Demand-led strategies do not always focus on the largest developing countries. While it might seem obvious that larger markets would be more attractive to an investor than smaller ones, the absolute size of a market is only one of many considerations. (If this were not the case it would be hard to explain Singapore's extreme success in attracting international investment.) In the air transport industry, for example, the attraction of markets is based much more on cities than on countries. The key infrastructural determinant is the airport which is clearly city-related. Demand patters too, at least for international air travel, tend to be focused around city-pairs. Even in well-served OECD markets, international flights agglomerate in a small number of cities (airports). Thus it would be inappropriate, in general studies at the OECD or elsewhere, to focus undue attention on the 'big five' of Brazil, China, India, Indonesia and Russia.

Thoughts on the future

How might linkages develop in the future? Few firms have a grand strategic design for their sales or investment patterns beyond the next three to five years. Particularly in new market areas, the approach is very much a pragmatic, step-by-step one. Accumulated experience with local partners and governments will drive future decisions. For many firms now active in developing countries, those activities are still a very small percentage of total sales and profits. Yet decisions about them often take a disproportionate amount of top management time. This means they are vulnerable to shifts in the perceptions of corporate leaders.

The corporate sector is progress- and profit-driven. The status quo is not its benchmark. For companies to succeed in the competitive arena requires continuous progress in the products offered to customers, in the efficiency with which they are produced and in the profits earned for shareholders. This future-oriented and rather impatient perspective is often very far from that of government officials. If the pace of policy change is too slow -- even when its direction is right -- if the weight of red tape remains heavy, if too many commercial contacts with officials require side-payments to ensure action, then the current enthusiasm for developing country markets will be short-lived.

In thinking about future FDI flows, I thought it might be interesting to take off my corporate hat and revisit some projections I made of global FDI when I was still an academic thinking about such linkages (Julius 1990). Using a 25 year database of FDI (1962-1988) I fitted a GDP-based equation for the five largest investing countries and used the resulting elasticities to predict global FDI in the year 1995. The moment of truth for those projections has now arrived. They were produced towards the end of a major cyclical boom in FDI flows with the rise of Japan as a big international investor. Since then there has been a widespread recession in the OECD countries and Japan's outward investment last year was still well below its peak level in 1990. Given these vagaries of the global macroeconomy, how did my simple GDP based regression perform?

Final data are not yet available but the OECD's preliminary view is that 1995 outflows from OECD countries "will exceed ... $250 billion" (OECD 1996). My prediction was $242 billion. On the inward side, I was further off: I predicted an inflow of investment into OECD countries of $153 billion, compared to the OECD's recent estimate of greater than $200 billion. This discrepancy on inflows reflects my more optimistic view at that time of a bigger inflow into developing countries than has actually occurred'. While the share of FDI going to developing countries has risen impressively from 15 per cent in 1989 to 37 per cent in 1994, it has not reached the 48 per cent that my GDP based extrapolation yielded.

Why is this and what could be done to support and stimulate linkage-intensive development? The difficulties firms face in the developing countries could be broadly summarised as (i) policy divergence and (ii) policy capriciousness. The corporate perspective suggests that the objective of OECD-based activities should be (i) policy convergence and (ii) policy binding. International models of best practice, international codes of agreement, international dispute settlement processes that are open to direct investor-to-state adjudication (Julius 1994) are all ideas whose time has come.

References

BROWN, Richard and DeAnne JULIUS. 1993. "Is Manufacturing Still Special in the New World Order" in Richard O'Brien (editor), *Finance and the International Economy: 7.* Oxford: Oxford University Press

DUNNING, John. 1983. "Changes in the Level and Structure of International Production: The Last One Hundred Years" in Mark Casson, *The Growth in International Business*. London: George Allen & Unwin.

JULIUS, DeAnne. 1990. *Global Companies and Public Policy: The Growing Challenge of Foreign Direct Investment*. London: Pinter Publishers for the Royal Institute of International Affairs.

JULIUS, DeAnne. 1994. "International Direct Investment: Strengthening the Policy Regime" in Peter B Kenen (editor), *Managing the World Economy: Fifty Years after Bretton Woods*. Washington: Institute for International Economics.

OECD. 1996. "International Direct Investment: Trends and Policies". Paper prepared for the Emerging Market Economy Forum, April 1996.

World Investment Report, 1992 and 1995. New York and Geneva: United Nations.

Notes

1. My prediction of global IDI in 1995 was $293 billion, which is 30% larger than the most recent estimate for 1994 flows ($226 billion according to WIR 1995).