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For Session 3 of module
Managing and Planning for Development: International and National Dimensions **(Academic year 2011-2012)**

3 - International division of production. The creation of specialized economies in the periphery. The role of foreign direct investment, aid and lending.

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Since the 1980s

the international division of production

have created the **fragmentation of production across borders**

and the economic integration of national economies

creating production networks

under the **economic dominance of big corporations** (TNCs) mainly from United States, European Union and Japan.

Some factors explaining this fragmentation are:

•**reduce costs by off-shoring sub-processes to countries where unit labour costs are lowest**;

•**locate production near sources of consumer demand and input supply;**

•**centralize production of finished goods or inputs to benefit from scale and other agglomeration economies, including thicker labour markets, and more rapid learning of new technologies.**

Source: World Bank, "An East Asian Renaissance: ideas for economic growth", 2006

The international division of production (1)

"**Transnational corporations** (TNCs) are incorporated or unincorporated enterprises comprising parent enterprises and their foreign affiliates. A parent enterprise is defined as an enterprise that control assets of other entities in countries other than its home country, usually by owning a certain equity capital stake."

(UNCTAD, **World Investment Report 2008**, Definitions and Sources, p. 249)

(For example: General Electric (U.S.A); British Petroleum (U.K.); Toyota Motor Corporation (Japan); Royal Dutch (U.K.); Exxonmobil (U.S.A.); Ford Motor (U.S.A.); Vodafone (U.K); Microsoft (U.S.A.), and others.

The international division of production (2)

What is the economic power of TNCs foreign affiliates?

	assets as % of world GDP	**sales** as % of world GDP	**Gross product** as % of world GDP	**Exports** as % of world exports	**Employment** in millions
1982	18.3	22.7	5.6	28.7	21.5
1990	27.2	24.4	6.8	34.5	25.1
2006	114.1	52.8	10.3	33.3	70.0
2007	125.9	57.2	11.1	33.3	80.3

Source: UNCTAD, World Investment Report 2008

The international division of production (4)

TNCs and the world economy (current dollars)

Year 2007	GDP (millions)	% of total		Labour force (mill.)	% of total	Value added per worker – US$
Developing economies	14,055,191	25.9		2,470	79.2	5,690
Economies in transition	1,782,155	3.3		148	4.7	12,042
Developed economies	38,436,541	70.8		501	16.1	76,720
TNCs	**10312038**	**19.0**		**140**	**4.5**	**73,657**
(foreign affiliates)	**6024401**	**11.1**		**80**	**2.6**	**75,305**
All economies	**54,273,887**	**100.0**		**3119**	**100.0**	**17,402**
Africa	1,252,565	2.3		358	11.5	3,498
Latin America & Caribbean	3,534,208	6.5		266	8.5	13,286
Asia (less China)	5,957,928	11.0		1046	33.5	5,696
China	3,286,881	6.1		796	25.5	4,129

Source: UNCTAD, “World Investment Report 2009” and “Handbook of statistics 2009”

World inward FDI flows to developed and developing countries by sector and industry – 2005-07 – World Investment Report 2009 – p. 220

Sector/Industry	Devel-oped cts. %	Devel-oping cts. %		% by sector dvped.	% by sector dvping.
Total	72.0	28.0		**100.0**	**100.0**
Primary sector	73.0	27.0		**11.7**	**11.4**
Manufacturing (secondary)	65.7	34.3		**21.9**	**29.5**
Services (terciary)	73.4	26.6		**60.0**	**56.2**
Private buying and selling of property	99.9	0.1		**0.9**	**0.0**
Unspecified	82.2	17.8		**5.5**	**3.0**
Agriculture, hunting, forestry and fishing	1.2	98.8		0.0	0.8
Unspecified secondary	0.8	99.2		0.0	16.7

World inward FDI flows to developed and developing countries by region and countries – 2007 – World Investment Report 2009 – Annexes Table B.1

Region/country	FDI inflows	FDI outflows	
World	100.0	100.0	
Developed countries	**68.7**	**84.3**	
European Union	42.6	55.5	
North America	19.2	20.4	
Japan	1.1	3.4	
Developing countries	**26.7**	**13.3**	
Africa	3.5	0.5	
Latin America & Caribbean	6.4	2.4	
Asia & Oceania	16.8	10.4	
China	2.7	1.0	
Former bureaucratic socialist countries	**4.6**	**2.4**	

--The international division of production is not new, what is new is the **complex network** on which international division of production is based today.

-- The complex network embraces not only different stages of production in different geographical locations, but also the **international management by TNCs** of gigantic areas of economic activity.

-- **TNCs decisions bypass host countries development policies**. And, in many cases restrictions are imposed by international agreements on policy autonomy.

The international division of production (6)

--As UNCTAD noted in its **Trade and Development Report 2006**, page 167:

"…the rules and commitments of the international trading regime restrict the de jure ability of developing nations to adopt national development policies"…and…

"rules and commitments, which in legal terms are equally binding for all countries, in economic terms might impose more binding constraints on developing countries"…

transnational corporations control the integrated international production system, and that make of financial aid and lending to developing countries yet another tool for corporate capital having a stronger grip on the world economy.

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A complex international production network

From	To	Hard disk drive parts
U.S.A.	Thailand	disk, head, suspension
Mexico	Thailand	head
Japan	Thailand	cover, disk, screw, seal, ramp, top, filter, PCBA
China	Thailand	carriage, base, head, suspension, PCBA
Hong Kong	Thailand	filter, cap
Taiwan	Thailand	top, clamp
Philippines	Thailand	damping plate, coil support, PCBA
Indonesia	Thailand	suspension, voltage control mask (VCM)
Singapore	Thailand	cover, screw, pivot, pulse convert doppler profiler (PCADP), disk
Malaysia	Thailand	Base, pivot, spacer, VCM, base card, top clamp, disk
Thailand	Thailand	Spindle motor, base, carriage, flex cable, pivot, seal, PCBA, cover
Thailand	U.S.A., EU, Japan	Assembled hard disk drives to insert in personal computers

Source: World Bank, "**An East Asian Renaissance: ideas for Economic Growth**", 2006, p. 74

Manufacturing workers' wage rates in some countries - 2005

countries	Monthly wage (US$)	As % of U.S. wage	countries	Monthly wage (US$)	As % of U.S. wage
U.S.A.	2,898	100.0	Mexico	342	11.8
Japan	2,650	91.4	Brazil	309	10.7
South Korea	2,331	80.4	Peru	238	8.2
Hungary	733	25.3	China	141	4.9
Czech Rep.	612	21.1	Thailand	134	4.6
Poland	586	20.2	Philippines	99	3.4
Chile	432	14.9	India	23	0.8

Source: International Labour Office, "**Yearbook of Labour Statistics 2006**"

The international division of production (7)

-- Through economic and political means (military action is a political mean), transnational corporations secure <u>access to and control of markets (domestic and international)</u>

-- in doing the above, those gigantic corporations benefit from

a) economies of scale;

b) locational specialization of activities along the value-added chain;

c) reduced costs and improved efficiency;

d) enlarging the financial base of enterprises (they can borrow from both home and host country financial institutions)

”the international production system of a TNC constitute an internal market for the flow of its goods and services…a market to which its individual members firms have PRIVILIGED ACCESS” (UNCTAD, **WIR 1995**, p. 192)

-- the markets that TNCs systems service are:

1) International markets serviced by intra-firm exports;
2) International markets serviced by arm's length exports;
3) Domestic markets serviced by parent firms and their domestic affiliated in home countries, and by foreign affiliates in host countries.

The most important feature of this type of markets is that the transactions of good and services in them "<u>are not entirely determined by market forces or valued at market prices</u> but represent the internationally integrated production and distribution operations of a TNC."

"They are valued at TRANSFER PRICES set for internal accounting purposes and used for customs declaration".

--TRANSFER PRICES allow TNCs to reduce the amount of taxes they pay to the host country and/or home country.

(see for example, "**Why pay more? Corporate tax avoidance through transfer pricing in OECD countries**", E. J. Bartelsman and R.M. Beetsma, 2000) available at http://www.rrojasdatabank.info/wir2006/pricetransfer.pdf.

-" a particularly interesting example is BMW, the German car producer, whose tax payments in Germany as a share of its worldwide tax payments dropped from 88% in 1988 to 5% in 1992… BMW's financial director publicly stated that his corporation tried to shift costs to where taxes were highest, which was Germany"-

-<u>Strategies of TNCs</u>

Like any firm, TNCs have to purchase capital goods and services, purchase raw materials and intermediate goods, hire and train labour force, combine those inputs to create goods and services, and, of course, distribute and market those goods and services to buyers.

The above involve stages in what is called the GLOBAL VALUE CHAIN of the corporation. These stages are the functions handled by the different **divisions of a corporation** in different geographical locations.

-Strategies of TNCs

A basic list of FUNCTIONS could be:

1.- manufacturing and assembly;

2.- marketing and distribution;

3.- administration;

4.- supervision, service and control;

5.- internal transportation and inventory management;

6.- direct work scheduling;

7.- human resources development;

8.-work preparation (i.e. retooling);

9.- research, development and design.

The international division of production (13)

The FUNCTIONAL SCOPE of international production(1)

With improvements in transport, communications and extensive use of information technology, TNCs are now locating some of the **functions** in different countries when in need of reducing costs…

This is what is called the functional scope of international production under the common governance of the firm.

The FUNCTIONAL SCOPE of international production(2)

3 strategies for this:

1.- Stand-alone strategy (linkages based on ownership and technology);

2.- Simple integration strategies (linkages based on ownership, technology, markets, finance and some inputs: the parent firm will outsource affiliates in host countries;

3.- *Complex integration strategies* (based upon the firm's ability to shift production or supply wherever it is most profitable). Complex integration strategies need **capitalist globalisation** for being efficient.

The international division of production (15)

the main functional components of a **global value chain:**

Technology	Production	Marketing
Design	Procurement logistic	Distribution logistic
Research & Development	Module production	Wholesale sales
Organizational practices	System production	Retail sales
Product technology	Final assembly	Advertising
Process technology	Testing	Testing
Training	Quality control	Brand management
	Packaging	After-sales service
	Inventory management	

The GEOGRAPHICAL SCOPE of international production(1)

The geographical dimension here is linked to political and economic influence on countries or regions, which tend to create clusters like in the case of the TRIAD.

3 strategies for this:

1.- Multi-country strategies: when there are trade barriers, TNCs tend to establish one affiliate serving the market in the host country. Thus, the basic form of this strategy is the parent corporation controlling several affiliates in diverse countries;

The GEOGRAPHICAL SCOPE of international production(2)

2.- Regional strategies: "changes in policies have spurred TNCs to adopt regional strategies, especially in Europe and North America…

The lowering of tariff barriers, the liberalization of FDI regimes, the deregulation of many industries (especially in services) and the privatization of state-owned companies –all have helped to boost Foreign Direct Investments"… with a regional strategy . (UNCTAD, WIR 1995, p. 129)

The GEOGRAPHICAL SCOPE of international production(3)

3.- Global strategies: "TNCs are frequently able to serve global markets with networks that are concentrated on a regional or subregional basis…

Each network is linked to the parent corporation through ownership and technology, and obtain materials and components from affiliates and non-affiliated firms outside the region. All sell some of their output outside their regions, and their products are quite similar across regions. However, the bulk of the value added (chain) remains within the primary region of operations". (UNCTAD, WIR 1995, p. 131)

TNCs utilise an array of anticompetitive practices

There are four main types of business practices that can have anticompetitive effects:

1.- practices undertaken by a single firm (when a firm enjoys a dominant position);

2.- anticompetitive mergers and acquisitions;

3.- horizontal restraints (.e., arrangements between competitors to restrain competition);

4.- vertical restraints (anticompetitive arrangements between firms along the production-distribution-marketing chain)

(WIR 1997, "**TNCs, market structure and competition policy**", p. 191)

The international division of production (20)

"Apart from development objectives, there are a number of other objectives that **may not be well served by market forces** and that therefore may motivate **governments to play a more active role in markets**. They include:

1.- Safeguarding national security;

2.- Protecting labour rights;

3.- Safeguarding culture;

4.- Avoiding negative externalities;

4.- Protecting consumers."

(WIR 1997, "TNCs, market structure and competition policy", pp. 231-32)

Macroeconomic effects of TNCs practices.

Data for year 2006	GDP growth % per year	Factor Payments to Abroad % of GDP	Gross Domestic Product as % of World GDP	Gross National Income as % of World GNI
Developing economies	7.1	-4.2	24.9	23.7
Econ. in transition	7.2	-6.4	2.8	2.3
Developed economies	2.8	+2.2	72.4	74.0

(Sources:, UNCTAD, "Handbook of Statistics 2008" and WORLD BANK, "World Development Indicators 2008")

Financial flows from developing countries to industrialised countries (current dollars)

Year 2006 (US$ millions)	Inflow to dev. cts.	Outflow from dev. cts. (FPA)	Net flow from dev. cts.	Net flow as % of dev. cts. GDP	US$ mill. per hour
Foreign Direct Investment *	72403				
Aid	104421				
Other private flows (NGOs, etc)	70362				
Total inflow/outflow	247186	-865175	-617989	-4.8	-70.5

***Total FDI is composed of 56% equity, 26% reinvested earnings and 18% loans from host country banks. Total = 129291, of which equity = 72403**

Source: World Bank, "**World Development Indicators 2008**" , table 6.12

The international division of production (22)

Exports of high-technology products by China by ownership of production. 1996-2000

Year	Total (million US dollars)	State-owned enterprises (%)	Foreign Investment Enterprises(%)
1996	7.681	39	60
1997	16.310	..	..
1998	20.251	25	74
1999	24.704	23	76
2000	37.040	18	81

Source: **UNCTAD (office in Beijing) and China Ministry of Science and Technology**.

The international division of production (23)

TNCs share of China domestic market

Year	Foreign Investment Enterprises(%)
1993	8.64
1996	18.66
2000	26.79
2002	28.49
2004	30.79

Source: **China Statistic Yearbook 1993-2004**.

The international division of production (24)

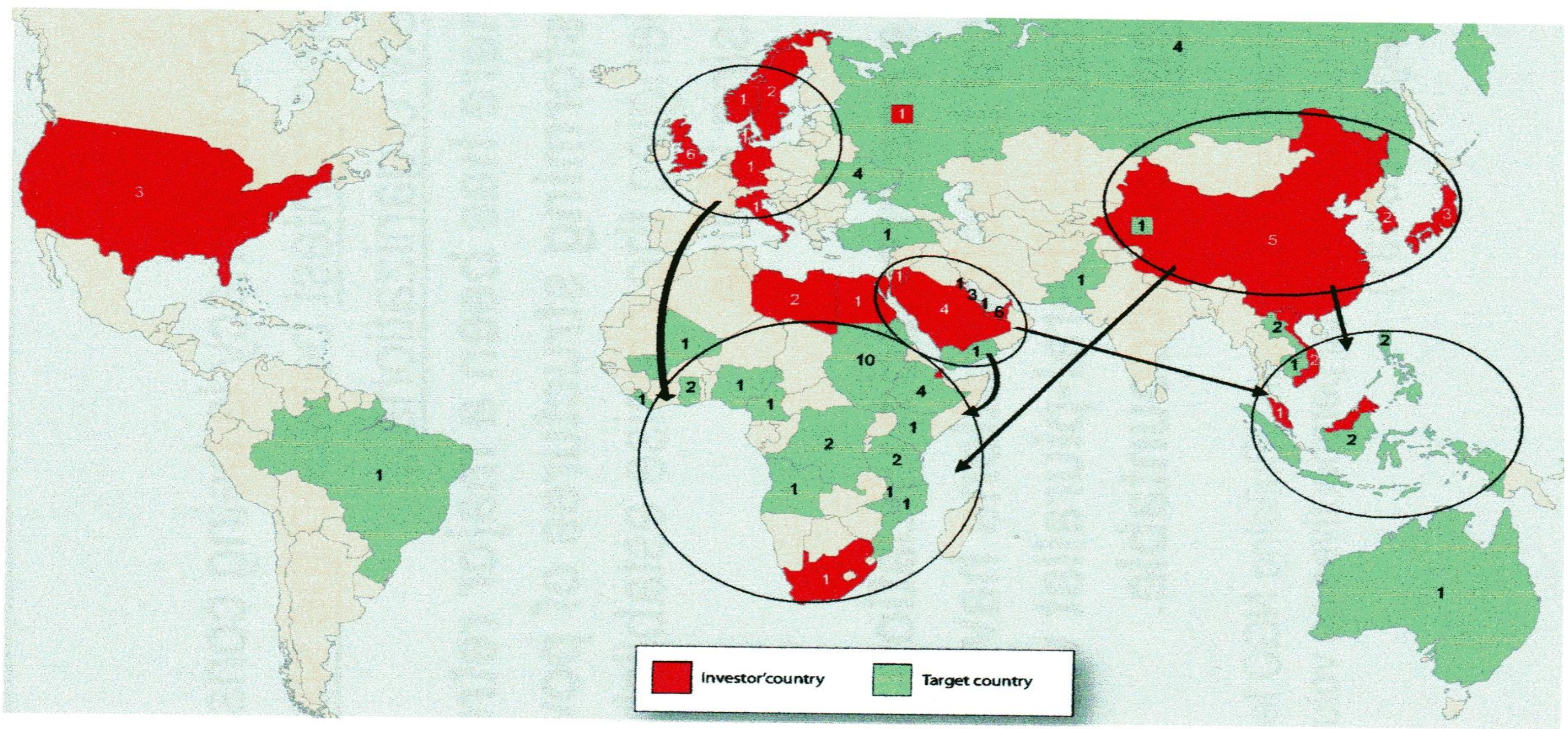
From our research it follows that international economic activities are increasingly dominated by Transnational Corporation.

If TNCs are the planners and managers of world production a question arises:

How developing countries could attempt national <u>planning for development</u> under this very restrictive situation?

Land grab. Source: World Investment Report 2009, page 123

Figure III.14. Investor and target regions and countries in overseas land investment for agricultural production, 2006–May 2009
(Number of signed or implemented deals)



Source: UNCTAD.

Notes: This map covers only confirmed deals that have been signed, some of which have been implemented. However, not all signed deals have been implemented, and all signed deals that were rescinded by one or both parties before the end of May 2009 are excluded. Prospective deals reported in the press, but which have not progressed to the stage of agreement are excluded. The total number of deals was 48, shown by both source and destination countries.

Main agricultural produce targeted by TNCs in foreign locations, up to 2009.

Source: World Investment Report 2009, page 117

South America	**Floriculture, fruits, rice, sugarcane, wheat and grain, meat and poultry, soya beans**
Central America	**Fruits, sugar cane**
North America	**Maize, meat and poultry , floriculture, dairy, cotton, fruits**
Africa	**Rice, oil crops (west) – wheat and grain, floriculture, rice (east) – sugarcane, cotton (south)**
Western Europe	**Floriculture, fruits, dairy, vegetables**
Eastern Europe	**Dairy, wheat and grain**
South Asia	**Wheat and grain, rice**
China	**Fruits, meat and poultry, vegetables, floriculture**
South East Asia	**Fruits, oil crops**
Australia	**Meat and poultry**

Produce:
1. Cotton
2. Dairy
3. Floriculture
4. Fruits
5. Maize
6. Meat and poulttry
7. Oil crops
8. Rice
9. Soya beans
10. Sugarcane
11. Vegetables
12. Wheat and grain

Inward FDI stock in agriculture by developing region, 2002 and 2007
Source: World Investment Report 2009, page 116

region	**2002**	**2007**
Asia and Oceania	77%	78%
Africa	7%	7%
Latin America and the Caribbean	16%	15%

Production networks as defined above have been given various terms.
For example:

- Slicing up the value chain
- Outsourcing
- Disintegration of production
- Fragmentation of production
- Intra-product specialization

All the above terms point at contemporary international division of production under the control (absolute or relative) of
Transnational Corporations.