Discussion

1. Bijit Bora

Terms such as ‘globalisation’, ‘integration’ and ‘internationalisation’ are commonly used to describe events in the global economy during the past decade. Despite a formal definition of each term, they all share the common factor that the economic significance of national borders has been reduced. Various indices can be constructed to measure the extent of this development and we can be sure that one such measure is the flow and stock of foreign direct investment (FDI).

The task that has been set for John Howe is, indeed, a difficult one. He has been asked to examine the effect of foreign direct investment on Australia’s pattern and volume of international trade. The paper begins with an exploratory picture of Australia’s role during the global surge in FDI during the late 1980s. Figure 1 shows quite convincingly that Australia was not left behind. Its inward and outward FDI as a share of GDP rose sharply and then declined at a time when global FDI had also declined rapidly.

Most explanations of the surge in FDI during the late 1980s have focussed on the appreciation of the yen, financial market deregulation and international integration. Howe subscribes to each of these explanations and does not suggest that Australia has responded differently from other countries. He also notes, quite correctly, that during the 1980s Australia was in the midst of its own unilaterally imposed structural adjustment process caused by financial market deregulation and reductions in protection.

When examining the role played by FDI in changing Australia’s trade orientation, Howe is unable to conclude that FDI has had any significant impact. Between 1983 and 1992, the growth in Australia’s trade with Asian countries dominated the growth in trade with developed countries. In contrast, developed countries played a major role as sources of, and hosts for, FDI. Howe is at odds attempting to explain this result. He does suggest that information asymmetry may have been a problem, or possibly the compatibility of the Australian market with other developed country markets.

The primary focus on the structural effects of FDI was on the manufacturing industry. Howe uses revealed comparative advantage (RCA) indices along with changes in import and export shares to measure the effects of FDI. The data presented in this section are exploratory. Howe does not seek to test any particular hypothesis, but tries to deliver evidence of any correlations that may be present in the data.

Howe creates a measure of FDI orientation which is the ratio of FDI assets to liabilities in a particular industry plotted against a RCA index. I’m not sure what to make of Figure 10. We have some industries that have invested offshore and increased their RCA values, but then so have some industries that increased their liabilities relative to their assets. Perhaps the ambiguity arises from the implication that the outward-orientation ratio treats outward and inward flows symmetrically. A dollar of FDI overseas could be cancelled out by the flow of a dollar of FDI into Australia. Such a treatment ignores the difference in technology and asset transfer associated with inward and outward FDI.

Even if the figures showed a clear trend in Australian industries towards one particular quadrant, a more important question is whether or not the methodology adopted by

Howe is robust. Howe's explanation of his results assumes that domestic and foreign firms behave the same way and have the same trade, employment and business conduct practices. Is it possible that only domestic firms have been the explanation of the change in the RCA values?

Ergas and Wright in this Volume go to great lengths to explain the behaviour of domestic firms. Bora (1992) shows that the local sales propensity of American affiliates in Australia is quite high in absolute terms. This would indicate that US affiliates are inward looking. Drysdale (1993) and MITI (1992) examine data on Japanese and American affiliates and find that, in general, Japanese affiliates are more outward looking than American affiliates. Does this result hold for Australia? Does this mean that Australia should encourage outward-looking investors?

In the absence of a more robust theoretical model of how changes in the FDI orientation affect trade patterns, the best that the Howe paper can do is be suggestive. One possible mechanism to explain his results is to examine the role played by FDI in affecting industry structure. The structural approach emphasises industry structure as a rationale for entry into a foreign market.[1] Multinationals possess firm-specific assets that allow them to exploit a degree of monopoly power and also enjoy increasing returns to scale technology. The contrast between this approach and the capital accumulation approach is obvious. It suggests that in order to examine the effects of foreign direct investment on trade one needs to examine, first the effects of multinationals on the domestic market structure and second, how these changes will flow through and affect the pattern and volume of trade.[2]

Howe makes no attempt at all to examine the structural effects of foreign participation in Australian industry. This is not surprising and probably wasn't feasible given the time required to write the paper. However, I am raising this issue since it deserves future attention and in my mind is where the research should be headed.

Market structure is the 'nature of the beast'. Multinationals are prevalent in imperfect markets by virtue of the firm-specific asset that provides them with an advantage in the market place. The most recent paper to address the issue of foreign investment is Caves (1984). Even then his study, despite its comprehensiveness, is targeted at the general issue of scale and productivity. However, scale and productivity are structural issues and they determine the pattern of trade. Caves, using 1977 data, finds that foreign involvement in manufacturing had a positive effect on productivity and scale, which would lead to a more competitive industry.

While Caves's findings are interesting, the use of 1977 data does not allow us to extend his conclusions to 1994. More work based on the Caves study using recent data

1. An alternative approach is to emphasise the foreign capital element of FDI, which is the approach that Howe seems to be have adopted. This approach is consistent with the treatment of foreign capital flows used in the traditional two-sector model of trade. The papers by Bhagwati and Brecher (1980) and Brecher and Bhagwati (1981) have examined many of these issues. Markusen (1983) addresses the issue of whether or not factor flows and trade flows are complements. However, one would question the application of the basic trade model to examining the effects of multinational corporations because of its reliance on constant returns to scale and perfect competition. For a general treatment and proposed framework for analysing multinational corporations see Markusen (1991).

2. The latter approach is contained in Helpman and Krugman (1985). Bora (1994) applies these basic concepts when he illustrates the effects of Australia's attempt to induce foreign factor flows by using trade policy.

could yield some interesting results. A comparison of these results with Caves (1984) would also indicate to what extent scale, productivity and openness have impacted on the structural adjustment of Australian industries during the past decade of 'globalisation'.

A study based on this approach would provide an insight into Figures 10,12 and 13 in Howe's paper.[3] These tables suggest interesting correlations. However, the revealed comparative advantage index is calculated for the industry and does not distinguish between foreign and domestic firms. Therefore, changes in the index could be attributed to a change in orientation of domestic firms.[4] But, to what extent has openness motivated these changes?

This issue is also taken up in the paper by Ishida in his examination of Japanese investment in East Asia. Ishida has the advantage of using superior data and is quite convincing in his argument that FDI has had a structural effect in East Asia and in Japan. The most prominent finding in his paper is to confirm that Japanese multinationals shift capital goods and production equipment and then follow that with exporting intermediate goods. The net effect is a shift in the composition of trade caused by the establishment of a production facility overseas. I would agree with this finding and would argue that similar data are required to study the effects of multinationals on Australia's trade structure.

Conclusions

The Howe paper is an important contribution to an area that is of increasing significance to the Australian economy. He has adequately completed the first step which is to ensure that economists have an indication of the general trends and flows of foreign direct investment. There are questions about his methodology that would indicate some reservations about drawing implications about the effects of these flows for Australia. Nevertheless, he has set the stage for future work.

Howe concludes that foreign direct investment has not impeded Australia's structural adjustment process. I would argue that further work in this area will rephrase this conclusion in a more positive manner and show that foreign direct investment unambiguously complements the structural adjustment process.

Policy Implications

Howe did not summarise with any policy implications so I shall conclude by attempting to draw three to attention:

- the current focus of targeting the Asia-Pacific region;
- the implications for competition policy; and
- Australia's foreign investment policy.

3. A parallel issue is how these structural changes will affect the response of Australian industries to exogenous changes and whether or not foreign and domestic firms will respond differently. Caves (1991) analyses this issue for the Canadian manufacturing sector and concludes that foreign ownership does have some effect.

4. Ergas and Wright in this Volume show that foreign firms in the Australian manufacturing industry tend to be more outward looking than domestic firms.

It is no secret that the Australia's current foreign and trade policy is aimed at the Asia-Pacific region. There are few who would argue against this policy. What is at issue is the sequence of trade and investment initiatives that are required for a consistent policy. One unique finding of Howe's paper is to show that while Australia's trade has expanded rapidly in the Asia-Pacific region, it has not been complemented by outflows of capital. This would suggest that foreign direct investment would not complement trade flows.

Such a conclusion would be erroneous. Howe's selected time period was between 1982 and 1992. Most of the surge in exports to the Asia-Pacific region occurred in the latter half of the 1980s. One possible explanation is that exports precede FDI flows as a form of market entry. Accessing a foreign market by exporting allows a firm to establish a market share and learn more about the foreign country as a potential host. The latter half of the 1990s may see a huge rise in Australian FDI flows in the region as the next step in market access. Therefore, the current bias against FDI flows to the region should not deter the government from continuing its efforts to liberalise trade and investment flows in the Asia-Pacific region in a non-discriminatory manner.

The second policy implication flows directly from the structural approach to the study of foreign direct investment. Multinational firms operate in markets with a small number of competitors and produce under increasing returns to scale conditions. As a result, they are frequently targets for anti-competitive claims. An increasingly integrated Australia will require a continued vigilance on new firms.

This perceived threat of multinationals also needs to be balanced by the pro-competitive effects of a new entrant into an industry. A liberalised foreign investment regime will lead to greater access of the Australian market to prospective firms. New firms and a more open industry policy will combine to impose a market discipline on domestic firms.

An element of the competition policy implications of multinational corporations is the emerging issue of extra-territoriality. Allowing foreign firms to operate in Australia with control overseas requires a high degree of cooperation, consultation and harmonisation with the competitive bureaux in the various home countries. Australia and New Zealand have moved towards harmonisation of their *Trade Practices Act*, but there are forces present, led by the soaring number of multinationals in Australia, to extend this initiative to a regional level.

The third and final policy implication is, of course, for Australia's foreign investment policy. Australia in general has not had a xenophobic attitude towards foreign investment. It does have a Foreign Investment Review Board, but this Board, by and large, has encouraged foreign investors. Although major changes to Australia's foreign investment policy were made in 1992, there has yet to be a systematic policy review in light of the recent trend towards internationalisation and regional integration.

Howe's results show that Australia's receptiveness to foreign direct investment has not retarded the structural adjustment process. I have no doubt that future studies will show that foreign direct investment will have enhanced the structural adjustment process and raised its overall competitiveness in the global market place. In order to ensure that this process continues, Australia will have to embrace a more liberal and less uncertain foreign investment regime. This approach could be along the lines suggested by Bora (1995) of a non-discriminatory set of investment principles for the Asia-Pacific region.

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2. General Discussion

The discussion revolved around three broad topics:

- the determinants of Australian foreign direct investment abroad;
- the benefits of inward foreign direct investment in Australia; and
- a number of issues relating to US and Japanese foreign direct investment.

One participant argued that much of the outward foreign direct investment (FDI) undertaken by Australian firms was significantly different from the type of foreign direct investment performed by firms from other countries. It was argued that Australian firms that undertake FDI tend to be 'multi-domestic' firms, rather than multinational firms.

The distinction here is that multi-domestic firms replicate their domestic operations abroad, while multinational firms engage in different activities in different countries, often vertically integrating their operations around the world. While multinational firms might generate increased intra-firm international trade, this is much less likely to be the case for multi-domestic firms. If Australian outward FDI is concentrated in these multi-domestic firms, there is unlikely to be any trade bonanza from FDI, but the FDI could generate increased dividends at some point in the future. It was also suggested that the increase in exports that Australia has experienced in recent years is particularly encouraging, as it is not driven by increased intra-firm trade, as is the case for some other countries.

The notion that much of Australian outward FDI represents firms replicating themselves abroad was not universally accepted. Some participants noted that there has been a substantial movement offshore of firms whose production processes are highly labour intensive. This FDI has not been generated by a desire to take advantage of superior technology on a world scale, but rather to take advantage of cheaper factor prices abroad.

A number of participants took up the issue of the high degree of inward orientation of US manufacturing firms in Australia. It was suggested that many of the firms established operations in the 1950s and 1960s, and were encouraged to set up in Australia by the tariff wall. As a result, they had an inward orientation from birth. Some participants thought that FDI encouraged by a tariff wall in conjunction with government policies that did not emphasise training and innovation meant that Australia had not received the full benefits of FDI.

On the other hand, it was suggested that in today's more open environment, the inward orientation of US firms in Australia may not represent a problem, as it may stimulate competition in the domestic market. It was also noted that Japanese foreign direct investment in Australia tends to be more outward focussed than US investment in Australia. In large part, this was thought to reflect the fact that Japanese investment has occurred more recently.

One participant argued that Australia had for far too long been obsessed with the 'technology fix' approach to inward FDI; that is, the idea that FDI gives the technology to generate rising living standards. It was noted that thinking has moved quite a lot in recent years, with a number of participants reiterating the conclusion of previous papers that the trade regime and domestic policies were important factors in generating improvements in technology.

The ferocity of the US debate concerning FDI was commented on by a number of speakers. Some US commentators argue that the US has a large trade deficit with Japan because Japan limits US FDI, and that the lifting of these restrictions was important. On the other side, some argue that FDI represents the exporting of jobs, and thus it should be subject to some sort of limit. It was suggested that such pressures, however inappropriate, will continue as long as unemployment remains a problem and real wages are stagnant. There was also a brief discussion of the role that exchange rate changes play in generating FDI. One participant reported that recent research suggested that real factors, other than the exchange rate, were capable of explaining international trends in FDI. A number of participants also expressed their surprise at the low trade elasticities reported in the paper by Kazuhiko Ishida and wondered whether the elasticities were only temporarily low.

Finally, there were numerous calls for increased research effort to be devoted to foreign direct investment in the services industry.