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FOREIGN DIRECT INVESTMENTS

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MAN- 400

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ABSTRACT

Foreign investment means ownership of foreign property in exchange for a financial return, such as interest and dividends. Foreign investments take two forms: direct and portfolio. Portfolio investments represent passive holdings of securities such as foreign stocks, bonds, or other financial assets whereas foreign direct investment **(FDI)** is acquisition of foreign assets for the purpose of controlling them.

Nowadays, making foreign direct investment has become the dream of all successful firms in the world.

CONTENTS

INTRODUCTION

This project is about foreign direct investments. It presents a comprehensive explanation about foreign direct investments in the world generally and in Jordan particularly.

In the first chapter we will present the definitions, methods and patterns of FDI. Further, we will clarify the relationship between trade and factor mobility theory. Also we will present the reasons why large companies wish to operate internationally—to expand their markets and acquire foreign resources—and the obstacles they face; through nationalism and trade restrictions.

For chapter two, we are going to explain how to evaluate the impact of FDI through discussing how FDI benefits countries. Moreover, we will present the opinions of opponents and proponents of FDI, and also how MNEs may affect countries' balance-of-payments, growth, and employment objectives.

For chapter three, we will see how successful MNEs choose the best locations for their operations to expand their sales or to compete in new markets through weeding out or scanning countries.

Chapter four explains the Jordanian economy in details. We will notice the developments in the Commodity-Producing Sectors and Service-producing Sectors during 2003.

As for chapter five, we are going to notice how the volume of foreign direct investment (FDI) reached to its peak in 2000 and then declined to become only JD83 million in 2003. Further, we will explain the policies and strategies that Jordan' government and Jordan investment board (JIB) follow to attract foreign investors. In addition, tables and charts are shown in this chapter for the statistics of total foreign direct investments in Jordan since 1996 up to 2003.

We will also explain the attractive sectors in Jordan that could attract foreign firms to invest in Jordan such as; information technology, QIZ and tourism.

There are some recommendations—in the end of chapter five— to make reforms in Jordan to increase the volume of foreign direct investments.

CHAPTER ONE

TRADE & INVESTMENT

1.1 Overview

Foreign investment means ownership of foreign property in exchange for a financial return, such as interest and dividends. Foreign investments take two forms: direct and portfolio. The distinction between the two rests on the question of control: does the investor seek an active management role in the firm or merely a return from a passive investment?

Portfolio investments represent passive holdings of securities such as foreign stocks, bonds, or other financial assets, none of which entails active management or control of the securities' issuer by the investor. Modern finance theory suggests that foreign portfolio investments will be motivate by attempts to seek an attractive rate of return as well as the risk reduction that can come from geographically diversifying one's investment portfolio.

Foreign direct investment (FDI) is acquisition of foreign assets for the purpose of controlling them. Control need not be a 100-percent or even a 50-percent interest if a company holds a minority stake and the remaining ownership is widely dispersed, no other owner may be able to counter the company effectively. When two or more companies share ownership of an FDI, the operation is a joint venture. When a government joins a company in an FDI, the operation is called a mixed venture, which is a type of joint venture. Companies may choose FDI as a way to access certain resources or reach a market. Today, about 63,000 companies worldwide have FDIs that encompass every type of business function ---extracting raw materials from the earth, growing crops, manufacturing products or components, selling output, providing various service and so on (Philip L. Martin and Michael S. Teitelbaum, 2001). FDI is not the domain of large companies only. For example, many small firms maintain sales office abroad to

complement their export efforts, which are FDI along with real estate they own abroad. However, because large companies tend to have larger foreign facilities and operate in more countries, the value of their FDI is higher.

U.S. government statisticians define **FDI** as "ownership or control of 10 percent or more of an enterprise's voting securities or the equivalent interest in an unincorporated business.

According to **OECD** countries **foreign direct investment** is capital invested for the purpose of acquiring a lasting interest in an enterprise, and exerting a degree of influence on that enterprise's operations this is to be distinguished from portfolio investment, which involves purchasing assets to earn a rate of return, without acquiring any control of the institution or establishing a lasting presence therein. The control by an investor of 10 per cent or more of the ordinary share of a corporate enterprise is the normal criteria used by the OECD, but other factors may also be taken into account when measuring FDI (OECD, OCDE, Paris 1992).

1.2 METHODS OF FDI

There are two methods of foreign direct investment: (1) building new facilities (called the greenfield strategy), (2) buying existing assets in a foreign country (called the acquisition strategy).

1.2.1 The Greenfield Strategy

The Greenfield strategy means starting a new operation from the beginning. First, the firm buys or leases a land, and then constructs new facilities, hires or transfers in managers and employees, and then launches the new operation.

Reasons for building; companies frequently make foreign investments in sectors where there are few, if any, companies operating, so finding a company to buy may be difficult. Further, local investments may prevent acquisitions because they want more competitors in

the market and fear market dominance by foreign firms. The acquired companies might have substantial problems. Personnel and labor relations may be both poor and difficult to change, ill will may have to existing brands, or facilities may be inefficient and poorly located. Moreover, the managers in the acquiring and acquired companies may not work well together, particularly if the two companies are accustomed to different management styles and practices or if the acquiring company tries to institute many changes. In addition, a foreign company may find local financing easier to obtain if it builds facilities, particularly if it plans to tap development banks for part of its financial requirements (John Child, David Faulkner, and Robert Pitethly, 2002).

The Greenfield strategy has several **advantages**. For one thing, the firm can select the site that best meets its needs and construct modern, up-to-date facilities. Local communities frequently offer economic development incentives to attract such facilities because they create new jobs; these incentives lower the firm's costs. The firm also starts with a clean slate. Managers do not have to deal with existing debts, or struggle to modify ancient work rules protected by intransigent labor unions. In addition, the firm can acclimate itself to the new national business culture at its own pace, rather than having the instant responsibility of managing a newly acquired, ongoing business. Research indicate that the greater the cultural difference between the home and the host countries, the more likely a firm is to choose to build a new factory rather than purchase an existing firm (Ricky W. Griffin and Michael W. Pustay, 2005).

However, the Greenfield strategy also has **disadvantages**. For one thing, successful implementation takes time and patience. For another, land in the desired location may be unavailable or very expensive. In building the new factory, the firm must also comply with various local and national regulations and oversee the factory's construction. It must also recruit a local workforce and train it to meet the firm's performance standards.

Disney managers faced several of these difficulties in building Disneyland Paris. Although the French government sold the necessary land to Disney at bargain prices, Disney was not fully prepared to deal with French construction contractors. For example, Disney executives had numerous communications difficulties with a painter that applied 20 different shades of pink to a hotel before the firm approved the color. The park's grand opening was threatened when local contractors demanded an additional $150 million for

extra work allegedly requested by Disney. And Disney clashed with its French employees, who resisted the firm's attempt to impose its U.S. work values and grooming standards on them (Ricky W. Griffin and Michael W. Pustay, 2005).

1.2.2 The Acquisition Strategy

A second FDI strategy is acquisition of an existing firm conducting business in the host country.

Reasons for acquisition; by acquiring a going concern, the purchaser quickly obtains control over the acquired firm's factories, employees, technologies, brand names, and distribution networks. The acquired firm can continue to generate revenues as the purchaser integrates it into its overall international strategy. And, unlike the Greenfield strategy, the acquisition strategy adds no new capacity to the industry.

There are many other reasons for seeking acquisitions. One is the difficulty of transferring some resource to a foreign operation or acquiring that resource locally for a new facility, especially if the company feels it needs to adapt substantially to the local environment or operate through a multidomestic strategy (Anne-Wil Harzing, 2002). Personnel are a resource that foreign companies may find difficult to hire, especially if local unemployment is low. Instead of paying higher compensation than competitors do to entice employees away from their old jobs; a company can buy an existing company, which gives the buyer not only labor and management but also an existing organizational structure (Jaideep Anand and Andrew Delios, 2002).

Through acquisitions, a company may also gain the goodwill and brand identification important to the marketing of mass consumer products. Moreover, a company that depends substantially on local financing rather than on the transfer of capital may find it easier to gain access to local capital through an acquisition. Local capital suppliers may be more familiar with an ongoing operation than with the foreign enterprise.

Sometimes international business acquires local firms simply as a means of entering a new market. For example, Proter & Gample chose to enter the Mexican tissue products market by purchasing Loreto Y Pena Pobre from its owner, Group Carso SA. By so doing,

it acquired Loreto's manufacturing facilities, its well-known tissue and toilet paper brand names, and its existing distribution system (Ricky W. Griffin and Michael W. Pustay, 2005).

At other times, acquisitions may be undertaken by a firm as a means of implementing a major strategic change. For example, the state-owned Saudi Arabian Oil Co., has tried to reduce its dependence on crude oil production by purchasing "downstream" firms, such as Petron Corporation, the largest petroleum refiner in the Philippines, and South Korea's Ssangyong Oil Refining Company. Similarly, after its privatization in 1994, Konikklijke PTT Netherlands, the Netherlands 'formerly state-owned postal and telephone company, determined that it would need to expand internationally if it were to survive in the European Union's market. To improve its competitiveness, it purchased Australia's TNT Ltd., allowing it to combine its postal operations with TNT's express package delivery services (Ricky W. Griffin and Michael W. Pustay, 2005)

The acquisition does have some **disadvantages**, however. The acquiring firm assumes all the liabilities---financial, managerial, and otherwise---of the acquired firm. For example, if the acquired firm has poor labor relations, unfunded pension obligations, or hidden environmental cleanup liabilities, the acquiring firm becomes financially responsible for solving the problems.

The acquiring firm usually must also spend substantial sums up front. For example, when Matsushita purchased U.S. entertainment conglomerate MCA for $6.6 billion, it had to pay out this vast sum shortly after the deal was closed. The Greenfield strategy, in contrast, may allow a firm to grow slowly and spread its investment over an extended period.

Finally, by buying a company, an investor avoids inefficiencies during the start-up period and gets an immediate cash flow rather than the problem of tying up funds during construction.

1.3 THE PLACE OF FDI IN INTERNATIONAL BUSINESS

A phenomenon of great importance to international business developed during the colonial period and the subsequent Age of Imperialism: the growth of foreign direct investments (FDI) which involve foreigners supplying and controlling investment in a host country. European capitalists from such imperialist powers as the United Kingdom, France, the Netherlands, Spain, Belgium, and Portugal nurtured new business in their colonial empires in the Americas, Asia, and Africa, establishing networks of banking, transportation, and trade that persist to this day. The earliest of these firms included the Dutch East India Company (established in 1600), the British East India Company (1602), and the Hudson's Bay Company (1670). These and latter-day trading companies, such as Jardine Matheon Holdings, LTD., owned copper mines, tea and coffee estates, jute and cotton mills, rubber plantations, and the like as part of their global trading empires.

During the nineteenth century the invention and perfection of the steam engine, coupled with the spread of railroads, dramatically lowered the cost of transporting goods over land and thereby made larger factories more economical. This development in turn broadened the extent of FDI. The forerunners of such large contemporary MNCs as Unilever, Ericsson, and Royal Dutch/Shell took their first steps on the path to becoming international giants by investing in facilities throughout Asia, Europe, and the Americas during this period (Dunning John H., 1993).

At the present, the place of FDI in the international business is very important, where most of the global giant corporations have been investing internationally.

1.4 THE RELATIONSHIP OF TRADE AND FACTOR MOBILITY

Whether capital or some other asset is transferred abroad initially to acquire a direct investment, the asset is a type of production factor. Eventually, the direct investment usually involves the movement of various types of production factors as investors infuse capital, technology, personnel, raw materials, or components into their operating facilities abroad. Therefore, it is useful to examine the relationship of trade theory to the movement

of production factors.

- **The Trade and Factor Mobility Theory**

Trade often occurs because of differences in factor endowments among countries. A country such as Canada, with abundant arable land relative to its small but educated labor force, may cultivate wheat in a highly mechanized manner. This wheat may be exchanged for handmade sweaters from Hong Kong, which require abundant semiskilled labor and little land.

Historical treatises on trade assumed that the factors of production were nearly immobile internationally and that trade could move freely. In actuality, there are many natural and imposed barriers that make both finished goods and production factors partially mobile internationally. Factor movement is an alternative to trade that may or may not be a more efficient allocation of resources. If the factors of production were not free to move internationally as assumed by early economic theorists, then trade would ordinarily be the most efficient way of compensating for differences in factor endowments. If neither trade nor the production factors could move internationally, a country would often have to forgo consuming certain goods. Alternatively, countries could produce them differently, which would usually result in decreased worldwide output and higher prices. We can only speculate on the astronomical cost of coffee if it were produced, say, in hothouses in Arctic regions. In some cases, however, the inability to utilize foreign production factors may stimulate efficient methods of substitution, such as the development of new materials as alternatives for traditional ones or of machines to do hand work. The development of synthetic rubber and rayon was undoubtedly accelerated because wartime conditions made it impractical to move silk and natural rubber, not to mention silkworms and rubber plants.

- **Substitution**

Whenever the factor proportions vary widely among countries, there are pressures for the most abundant factors to move to countries of greater scarcity so that they can command a better return. Thus in countries with an abundance of labor relative to land and capital, there is a tendency for laborers in that country to be unemployed or poorly paid; if

permitted, these workers will gravitate to countries with relatively full employment and higher wages. Likewise, capital will tend to move away from countries where it is abundant to those where it is scarce. Mexico is thus a net recipient of capital from the United States, and the United States is a net recipient of labor from Mexico.

If finished goods and production factors were both completely free to move internationally, then the comparative costs of transferring goods and factors would determine the location of production. Let us take the following example that clarifies the substitutability of trade and labor movements under different scenarios.

Assume: (1) that the United States and Mexico have equally productive land available at the same cost for growing tomatoes; (2) that the cost of transporting tomatoes between the United States and Mexico is $0.75 per bushel; and (3) that workers from either country pick an average of two bushels per hour during a 30-day picking season. The only differences in price between the two countries are due to variations in labor and capital cost. The labor rate in the United States is assumed to be $20.00 per day, or $1.25 per bushel; in Mexico it is assumed to be $4.00 per day, or $0.25 per bushel. The cost of capital needed to buy seeds, fertilizers, and equipment costs the equivalent of $0.50 per bushel in Mexico and $0.30 per bushel in the United States.

If neither tomatoes nor production factors can move between the two countries, then the cost of tomatoes produced in Mexico for the Mexican market would be $0.75 per bushel ($0.25 of labor plus $0.50 of capital), whereas those produced in the United States for the U.S. market would be $1.55 per bushel ($1.25 of labor plus $0.30 of capital). If trade restrictions on tomatoes were eliminated between the two countries, the United States would import from Mexico because the Mexican cost of $0.75 per bushel plus $0.75 of transportation cost to move them to the United States would be less than the $1.55 cost of growing them in the United States.

Consider another scenario in which neither country allows the importation of tomatoes but in which both countries allow certain movements of labor and capital. An investigation shows that Mexican workers can enter the United States on temporary work permits for an incremental travel and living expense of $14.40 per day per worker, or $0.90 per bushel. At the same time, U.S. capital can be enticed to invest in Mexican tomato production provided that it receives a payment equivalent to $0.40 per bushel, less than the

Mexican going rate but more than it would earn in the United States. In this situation, Mexican production costs per bushel would be $0.65 ($0.25 of Mexican labor plus $0.40 of American capital). U.S. production costs would be $1.45 ($0.25 of Mexican labor plus $0.90 of travel and incremental costs plus $0.30 of American capital). Note that each country would be able to reduce its production costs (Mexico from $0.75 to $0.65 and the United States from $1.55 to $1.45) by bringing in abundant production factors from abroad.

With free trade and the free movement of production factors, Mexico would produce for both markets by importing capital from the United States. According to the above assumptions, that would he a cheaper alternative than sending labor to the United States. In reality, neither production factors nor the finished goods that they produce are completely free to move internationally. Some slight changes in imposing or freeing restrictions can greatly alter how and where goods may be produced most cheaply.

In the case of the United States, in recent years there has been more legal freedom for capital to flow out than for labor to flow in. As a result, there has been an increase in U.S.-controlled direct investment to produce goods that are then imported back into the United States. In fact, capital moves globally more easily than does labor. Furthermore, technology, particularly in the form of more efficient machinery, is generally more mobile internationally than labor. The result is that differences in labor productivity and cost explain much of trade and direct investment movements.

- **Complementarity of Trade and Direct Investment**

In spite of the increase in direct investments to produce goods for re-import, firms usually export substantially to their foreign facilities; thus FDI is not usually a substitute for exports (Masaaki kotape, 1989). Many of these exports would not occur if overseas investments did not exist. In these cases, factor movements stimulate rather than substitute for trade. One reason for this phenomenon is that domestic operating units may ship materials and components to their foreign facilities for use in a finished product. For example, the Mexican government requires that automobiles sold in Mexico be assembled there. Chrysler therefore has an investment in Mexico to which parts are shipped from the

United States. Yet the quantity of parts from the United States has varied as Mexico has changed requirements for local parts (Stephen Baker, 1989). The foreign subsidiaries or affiliates also may buy capital equipment or supplies from home-country firms because of their confidence in performance and delivery or to achieve maximum worldwide uniformity. A foreign facility may produce part of the product line while serving as sales agent for exports of its parent's other products. Bridgestone, for instance, continued to export its automobile tires from Japan for several years while using the sales force from its U.S. truck-tire manufacturing operations to handle the imports.

1.5 MOTIVATION

The reasons that firms engage in direct investment ownership are no different from the reasons for their pursuit of international trade. They are:

1. To expand markets by selling abroad, and
2. To acquire foreign resources (e.g., raw materials, production efficiency, knowledge).

When governments are involved in direct investment, an additional motive may be to attain some political advantage. These three objectives in turn may be pursued by any one of three forms of foreign involvement. One of these, the sale of services (e.g., licensing or management contracts), often is avoided either for fear of loss of control of key competitive assets or because of greater economies from self-ownership of production. The following discussion will concentrate on the remaining two forms: trade and direct investment. We will emphasize why direct investment is chosen in spite of the fact that most firms consider it riskier to operate a facility abroad than at home.

1.5.1 MARKET-EXPANSION INVESTMENTS

- **Transportation**

Early trade theorists usually ignored the cost of transporting goods from one place to another. More recently, location theorists have considered total landed cost (cost of production plus shipping) to be a more meaningful way of comparing where production

should be situated. When transportation is added to production costs, some products become impractical to ship over a great distance. One of the factors influencing Bridgestone's decision to invest in the United States was the high cost of transporting tires relative to the production price of tires. Numerous other products that are impractical to ship great distances without a very large escalation in the price quickly come to mind: A few of these products and their investing companies include newspapers (Thompson Newspapers, Canadian), margarine (Unilever, British-Dutch), dynamite (Nobel, Swedish), and soft drinks (PepsiCo, U.S.). For these firms, it is necessary to produce abroad if they are to sell abroad. When firms move abroad to produce basically the same products that they produce at home, their direct investments are known as **horizontal expansions.**

Lack of Domestic Capacity As long as a company has excess capacity at its home-country plant, it may be able to compete effectively in limited export markets in spite of the high transport costs. This could be because the fixed operating expenses are covered through domestic sales, thus enabling foreign prices to be set on the basis of variable rather than full cost. Such a pricing strategy may erode as foreign sales become more important or as output nears full plant capacity utilization. This helps to explain why firms, even those with products for which transport charges are a high portion of total landed costs, typically export before producing abroad. Another major factor is that companies want to get a better indication that they can sell a sufficient amount in the foreign country before committing resources for foreign production. Finally, they may want to learn more about the foreign operating environment by exporting to it before investing in production facilities within it. Once they have experience in foreign production, they are more apt to shorten the export-experience time before they produce abroad.

This reluctance to expand total capacity while there is still substantial excess capacity is not unlike a domestic expansion decision. Internationally as well as domestically, growth is incremental. To understand this process, it is useful to draw a parallel of how growth may take place domestically. The simplest example is the firm that makes only one product. Most likely, this firm will begin operations near the city where its founders are already residing and will begin selling in only the local or regional area. Eventually, sales may be expanded to a larger geographic market. As capacity is reached, the firm may build

a second plant in another part of the country to serve that region and save on transportation costs. Warehouses and sales offices may be located in various cities in order to assure closer contact with customers. Purchasing offices may be located close to suppliers in order to improve the probability of delivery at low prices. In fact, the company may even acquire some of its customers or suppliers in order to reduce inventories and gain economies in distribution. Certain functions may be further decentralized geographically, such as by locating financial offices near a financial center. As the product line evolves and expands, operations continue to disperse. In the pursuit of foreign business it is not surprising that growing firms eventually find it necessary to acquire assets abroad.

Scale Economies Transportation costs must be examined in relation to the type of technology used to produce a good. The manufacture of some products necessitates plant and equipment that use a high fixed-capital input. In such a situation, especially if the product is highly standardized or undifferentiated from competitors, the cost per unit is apt to drop significantly as output increases. Products such as ball bearings, alumina, and semiconductor wafers fall into this category. Such products are exported substantially because the cost savings from scale economies overcome the added transport expenses to get goods to foreign markets.

The needed scale of production must be considered in relation to the size of the foreign market being served. For example, many European firms have production facilities in both the United States and Canada. They are more apt to sell the U.S. output only in the United States because of the large market, whereas much of the Canadian output is sold in their home countries to gain large- scale production (Masaaki Kotape and Glenn Omura, 1989).

Products that are more differentiated and labor intensive, such as pharmaceuticals and certain prepared foods, are not as sensitive to scale economies. For these types of products, transportation costs may dictate smaller plants to serve national rather than international markets (Yves Doz, 1978). David's Cookies, for example, first entered the Japanese market with ingredients mixed in the United States. However, because there was little cost reduction obtained by mixing bigger batches of batter, David's switched to Japanese ingredient preparation to overcome the transport cost incurred when exporting (Clyde Haberman, 1978).

- **Trade Restrictions**

We have shown that for various reasons there are numerous ways in which a government can make it impractical for a firm to reach its market potential through exportation alone. The firm may find that it must produce in a foreign country if it is to sell there. For example, Mexico announced that within five years locally produced microcomputers would have to comprise 70 percent of the market. Although many producers questioned whether the same prices and quality could be maintained as when they exported, they nevertheless were reluctant to abandon a growing market (Laurence Rout, 1982). Such governmental pronouncements are not unusual. They undoubtedly favor large companies that can afford to commit large amounts of resources abroad and make foreign competitiveness more difficult for the smaller firms, which can afford only exportation as a means of serving foreign markets.

How prevalent are trade restrictions as an enticement for making direct investments? There is substantial anecdotal evidence of firms' decisions to locate within protected markets, yet studies of aggregate direct investment movements are inconclusive regarding the importance of trade barriers (Sanjaya Lall and N. S. Siddharthan, 1982). A possible explanation for the fact that some studies have not found import barriers to be an important enticement is that the studies have had to rely on actual tariff barriers as the measure of restrictions. This reliance overlooks the importance of nontariff constraints, indirect entry barriers, and potential trade restrictions. Almost certainly import barriers are a major enticement to direct investment, but they must be viewed alongside other factors, such as the market size of the country imposing barriers.

For example, import trade restrictions have been highly influential in enticing automobile producers to locate in Mexico. Similar restrictions by Central American countries have been ineffective because of their small markets. However, Central American import barriers on products requiring lower amounts of capital investment and therefore smaller markets (e.g., pharmaceuticals) have been highly effective at enticing direct investment.

- **Consumer-Imposed Restrictions**

Government-imposed legal measures are not the only trade barriers to otherwise competitive goods: Consumer desires also may dictate limitations. For example, consumers may prefer buying domestically made goods, even though they are more expensive. They also may demand that merchandise be altered so substantially that scale economies from exporting are infeasible. The reasons for preferring domestically made products may include nationalism, a belief that foreign-made goods are inferior, or a fear that service and spare parts will not be easily obtainable for imported wares.

Nationalism The impact of nationalistic sentiments on investment movements is not assessed easily; however, some evidence does exist. There have been active campaigns at times in many countries to persuade people to buy locally produced goods. In the United States, for instance, attempts have been made to boycott Polish hams, Japanese Christmas ornaments, and French wines. Some U.S. manufacturers have promoted "made in the USA' to appeal to consumers in areas that have been hit with import competition (Kenneth Dreyfack, 1986). Fearful that adverse public opinion might lead to curbs on television imports, some Japanese firms announced the establishment of production plants in the United States (Wall Street Journal, April 5, 1977).

Product Image The link between product image and direct investment is clearer than the one just discussed between nationalism and direct investment. The image may stem from the merchandise itself or from beliefs concerning after-sales servicing. In tests using commodities that were identical except for the label of country origin, consumers were found to view products differently on the basis of product source (Philippe Cattin, Alain Jolibert and Coleen Lohnes, 1982). Although there are examples of eventual image changes, such as the general improvement in the image of Japanese products that occurred concomitantly with the decline in image for U.S. products, it may take a long time and be very costly for a company to try to overcome image problems caused by manufacturing in a country that has a lower-image status for a particular product. Consequently, there may be advantages to producing in a country with an already-existing high image.

Delivery Risk Many consumers fear that parts for foreign-made goods may be difficult to obtain from abroad. Industrial customers often prefer to pay a higher price to a producer located nearby in order to minimize the risk of nondelivery due to distance and strikes. For instance, Hoechst Chemical of Germany located one of its dye factories in North Carolina because the textile industry in that region feared that delivery problems would plague the cheaper German imports.

Product Change Often a company must alter a product to suit local tastes or requirements, and this may compel the use of local raw materials and market testing. Test marketing and altering a product at a great distance from the production is most difficult and expensive. Coca-cola, for example, sells some drinks (made from local fruits) abroad that are not available in the United States. It is definitely much cheaper to make these drinks overseas.

The need for a product alteration has two other effects on company production. Initially, it means an additional investment; as long as an investment is needed to serve the foreign market anyway, management might consider locating facilities abroad. Next, it may mean that certain economies from large-scale production will be lost, which may cause the least-cost location to shift from one country to another. The more the product has to be altered for the foreign market, the more likely that the production will be shifted abroad. Two of the factors influencing the decision of Volkswagen to set up U.S. production facilities, for example, were the ever-increasing safety requirements set by the U.S. government and the desire for new options by U.S. consumers, which were different from those needed to sell in other parts of the world. But these changes were not sufficient to garner a large share of the U.S. market, and Volkswagen announced the closing of its U.S. assembly operations in 1987 (business week, Oct.7, 1987).

- **Following Customers**

There are many examples of companies that sell abroad indirectly: that is, they sell products, components or services that their domestic customer then exports. Bridgestone for example, sold tires to Toyota and Honda, which in turn exported fully assembled cars (including the tires) to foreign markets. In these situations the indirect exporters commonly follow their customers when those customers make direct investments. Bridgestone's

decision to make automobile tires in the United States was based partially on a desire to continue selling to Honda and Toyota once those companies initiated U.S. production. Bridgestone's truck-tire investment was in turn instrumental in Yasuda Fire & Marine Insurance Co.'s decision to establish a U.S. investment in order to provide workman's compensation insurance to Bridgestone's operations in the United States (Wall Street Journal, April 12, 1984).

- **Following Competitors**

Within oligopoly industries (those with few sellers), several investors often establish facilities in a given country within a fairly short time period (Edward B. Flowers, 1976). Much of this concentration may be explained by internal or external changes, which would affect most oligopolists within an industry at approximately the same time. For example, in many industries, capacity-expansion cycles are similar for most firms. Thus the firms would logically consider a foreign investment at approximately the same time because their domestic capacity would be approached at approximately the same time. Externally, they might all be faced with changes in import restrictions or market conditions that indicate a move to direct investment in order to serve consumers in a given country. In spite of the prevalence of these motivators, much of the movement by oilgopolists seems better explained by defensive motives.

Much of the research done in game theory shows that people often make decisions based on the "least-damaging alternative." The question for many firms is, "Do I lose less by moving abroad or by staying at home?" Let's say that some foreign market may be served effectively only by an investment in the market, but the market is large enough to support only one producer. One way of facing this problem would be for competitors to set up one joint operation and divide profit among them; however, antitrust laws might discourage or prevent this. If only one firm decides to establish facilities, it will have an advantage over its competitors by garnering a larger market, spreading its R&D costs, and making a profit that can be reinvested in other areas of the world. Once one firm decides to produce in the market, competitors are prone to follow quickly rather than let the firm gain advantages. Thus the decision is based not so much on the benefits to be gained, but rather

on the greater losses sustained by not entering the field. In most oligopoly industries (e.g., automobiles, tires, petroleum), this pattern emerges and helps to explain the large number of producers relative to the size of the market in some countries.

Closely related to this is the decision to invest in a foreign competitor's home market to prevent that competitor from using high profits obtained therein to invest and compete in other parts of the world.

- **Changes in Comparative Costs**

A company may export successfully because its home country has a cost advantage. The home-country cost advantage depends on the price of the individual factors of production, the size of operations, transportation of finished goods, and the productivity of the combined production factors. None of these conditions affecting cost is static; consequently, the least-cost location may change over time. The factor affecting Bridgestone's decision to locate in the United States was the fact that Japanese costs (measured in dollars) grew much faster than those in the United States, owing largely to a rise in the value of the yen relative to the dollar.

The concept of shifts in comparative costs of production is closely related to that of resource-seeking investments. A firm may establish a direct investment to serve a foreign market but eventually import into the home country from the country to which it was once exporting.

1.5.2 RESOURCE-SEEKING INVESTMENTS

There is a cartoon showing Santa Claus speaking to his elves. The caption reads, "I'm sorry to report that after the first, I'll be moving operations to Taiwan (Wall Street Journal, Dec 15, 1983). This cartoon is consistent with the popular image of direct investments motivated by cheap foreign labor used to make imported products. While this does take place, the explanation overlooks some of the costs of producing abroad. For example, Lionel Trains moved from the United States to Mexico but had so many problems with

training and communications that it moved back home after a few years. Furthermore, there are cost advantages from direct investment that are not fully encompassed in the popular labor-oriented image.

- **Vertical Integration**

Vertical integration involves the control of different stages as a product moves from raw materials through production to its final distribution. As products and their marketing become more complicated, there is a greater need to combine resources located in more than one country. If one country has the iron, a second has the coal, a third has the technology and capital for making steel and steel products, and a fourth has the demand for the steel products, there is a great interdependence among the four and a strong need to establish tight relationships in order to ensure the continuance of the production and marketing flow. One way of adding assurance to this flow is by gaining a voice in the management of one of the foreign operations by investing in it. Most of the world's direct investment in petroleum may be explained by this concept of interdependence. Since much of the petroleum supply is located in countries other than those with a heavy petroleum demand, the oil industry has become integrated vertically on an international basis.

Certain economies also may be gained through vertical integration too. The greater assurance of supply and/or markets may allow a firm to carry smaller inventories and spend less on promotion. . It may also permit considerably greater flexibility in shifting funds, taxes, and profits from one country to another.

Advantages of vertical integration may accrue to a firm by either market-oriented or supply-oriented investments in other countries. There are examples of both: Of the two, however, there have been more examples in recent years of supply-oriented investments designed to obtain raw materials in other countries than vice versa. This is because of the growing dependence on LDCs for raw materials and the lack of resources by LDC firms to invest substantially abroad. This movement of capital and technology to LDCs is consistent with a theory that holds that factor mobility is most efficient when the more mobile factors, such as capital, move so as to be combined with the less mobile ones, such as natural resources. Without the capital movement the natural resources otherwise might not be exploited efficiently (London: Croom Helm, 1978).

- **Rationalized Production**

Companies increasingly produce different components or different portions of their product line in different parts of the world—**rationalized production**—to take advantage of the varying costs of labor, capital, and raw materials. An example of rationalized production is the more than 1800 plants in Mexico, known as *magui/adores,* which are integrated with operations in the United States. Semifinished goods can be exported to Mexico duty free, as long as they will be reexported from Mexico. Once the labor-intensive portion of the production is accomplished in Mexico—such as sewing car seats for General Motors or building television cabinets for Panasonic—duties in the United States are charged only on the amount of value added in Mexico (Business Week, June 18, 1990).

Many companies shrug off the possibility of rationalized production of parts because of the risks of work stoppages in many countries because of strikes or a change in import regulations in just one country. An alternative to parts rationalization is the production of a complete product in a given country, but only part of the product range within that country (Doz, *loc. Cit*). A U.S. subsidiary in France, for example, may produce only product A, another subsidiary in Brazil only product B and the home plant in the United States only product C. Each plant sells worldwide so that each can gain scale economies and take advantage of differences in input costs that may affect total production cost differences. Each may get concessions to import because of demonstrating that jobs and incomes are developed locally. A possible different advantage of this type of rationalization is smoother earnings when exchange rates fluctuate. Take the value of the Japanese yell relative to the U.S. dollar. Honda produces some of its line in Japan, which is then exported to the United States. Honda also produces some of its line in the United States, which is then exported to Japan. If the yen strengthens Honda may have to cut its profit margin to stay competitive with exports to the United States. But this cut may be offset with a higher profit margin on the exports to Japan (Sarkis Khoury, David Nickerson, 1991).

- **Access to Production Factors**

The concept of seeking abroad some input not easily or inexpensively available in the

home country closely resembles vertical integration. Many foreign firms have offices in New York in order to gain better access to what is happening within the U.S. capital market or at least to what is happening within that market that can affect other worldwide capital occurrences. The search for knowledge may take other forms as well. It may be a U.S. pharmaceutical firm in Peru conducting research not allowed in the United States. It may be C.F.P. (French), which bought a share in Leonard Petroleum to learn U.S. marketing in order to compete better with other U.S. oil firms outside the United States. It may be McGraw-Hill, which has an office in Europe to uncover European technical developments.

- **The Product Life Cycle Theory**

This theory shows how, for market and cost reasons, production of many products moves from one country to another as a product moves through its life cycle. During the introductory stage production occurs in only one (usually industrial) country. During the growth stage production moves next to other industrial countries, and the original producer may decide to invest in the foreign facilities to earn profits there. In the mature stage, when production shifts largely to developing countries, the same firm may decide to control those operations as well (Raymond Vernon, 1966).

- **Governmental Investment Incentives**

In addition to placing restrictions on imports, countries frequently encourage direct investment inflows by offering tax concessions or a wide variety of other subsidies. Such incentives are offered by many central governments. Direct-assistance incentives include tax holidays, accelerated depreciation, low-interest loans, loan guarantees, subsidized energy or transport, and the construction of rail spurs and roads to serve the plant facility (Robert Weigand, 1983). These incentives affect the comparative cost of production among countries, enticing companies to invest there to serve national or international markets.

- **Political Motives**

Sometimes trade is undertaken to serve political motives. During the mercantilist period, for example, European powers sought colonies in order to control the colonies' foreign trade and extend their own sphere of influence. With the passing of colonialism, some have sought to accomplish many of the old colonial aims by establishing company control of vital sectors in the economies of LDCs (New York: JAI Press, 1977). For instance, if a U.S. firm controls the production of a vital raw material in an LDC, it can effectively prevent unfriendly countries from gaining access to the production. It may also be able to hold down prices to the home country, prevent local processing, and dictate its own operating terms. Observers have pointed out, for example, that Great Britain, Franc& Italy, and Japan established national oil companies with governmental participation (B.P., C.F.P., E.N.I., and J.P.D.C., respectively) in order to lessen their reliance on U.S. multinational petroleum firms, which might give preference to the United States in the allocation of supplies (Harvard University Press, 1976). In the process of gaining control of resources, much political control is transferred to the industrial nations.

Governmental encouragement of MNE expansion to other developed countries may be aimed toward gaining greater control over vital resources. Japan, for example, is highly dependent on foreign sources for certain food-stuffs, lumber, and raw materials; therefore, Japanese governmental agencies have assisted national companies that undertake foreign investments in these sectors in order to protect supplies in Japan (Terutomio Ozawa, 1977).

The control of resources is not necessarily the political aim for encouraging direct investors. During the early 1980s, for example, the U.S. government instituted various incentives designed to increase the profitability of U.S. investment in Caribbean countries unfriendly to Cuba's Castro regime. The reasoning was that the incentives would lure more investment to the area, causing the economies of the friendly nations to strengthen. This would in turn make it difficult for unfriendly leftist governments to gain control.

Where there is governmental ownership and control of companies, not all of these governmental enterprises have become multinational. There are simply too many objectives for government ownership other than control over foreign economies. Even if the governmental enterprise has foreign facilities, it does not necessarily mean that political motives just described prompted the investment (New York: Willey, 1979).

1.6 RISK MINIMIZATION OBJECTIVES

Companies may reduce risks by operating internationally, such as through sales diversification. Their choice of foreign direct investment as the means of reducing risk is due primarily to the same factors we have discussed for market expansion and resource acquisition motives. For example, Johnson Controls, a U.S. manufacturer of automobile parts and control systems for buildings, expanded into Europe largely to minimize its exposure to cyclical downturns in the United States (Peter Marsh, 1998). One of LUKoil's FDI motives has been to move assets out Russia. Further, much of the FDI by Latin American companies in the United States has been motivated by a desire to move funds from their risky home environments (Jeffrey A. Krug and John D. Daniels, 1994). Transportation costs, foreign import restrictions, and foreign consumer desires for product alterations may make FDI the preferred operating mode for sales diversification. Let's now examine some specific reasons for using FDI to minimize risk.

Following Customers Many companies' customers are other companies. They sell products, components, or services to those customers domestically, which then become embodied in a product or service that their customers sell. If an important customer makes a foreign direct investment, the supplier may have compelling reasons to make a foreign direct investment as well. First, it would like to get that customer's business. Second, if a competitor becomes the supplier in the foreign location, that competitor may improve its chances of serving the customer in the domestic market as well. Third, there may be prohibitions to serving the foreign market through exports. For example, Tredegar Industries sells plastic materials, primarily to Procter & Gamble (P&G), for use in paper diapers. When P&G decided to produce in China using JIT, Tredegar had little choice but to make an investment in China as well (G. George, D. Wood, 2000).

Preventing Competitors' Advantage Within oligopolistic industries (those with few sellers), several investors often establish facilities in a given country within a fairly short time of each other, and they thus often overcrowd the market (Edward B. Flowers, 1976).

For example, 10 different automobile companies have made investments in China, leading one analyst to say, 'The number of entrants is so great, it's difficult to see where the profits could accrue (David Murphy and David Lague, 2002). In many industries, most companies experience capacity-expansion cycles concurrently. Thus, they would logically consider a foreign investment at approximately the same time. Externally, they might all be faced with changes in import restrictions or market conditions that indicate the wisdom of making a move to direct investment to serve consumers in a given country. In spite of the prevalence of these motivators, many movements by oligopolists seem better explained by defensive motives.

Much of the research in game theory shows that people often make decisions based on the "least-damaging alternative." Similarly, many companies ask, 'Do I lose less by moving abroad or by staying at home?" Assume that some foreign market may be served effectively only by an investment in the market, but the market is large enough to support only one producer. To solve this problem, competitors could set up a joint operation and divide the profits among themselves if antitrust laws permit this kind of partnership. If only one company establishes a direct investment, it will have an advantage over its competitors by garnering a larger market, spreading its R&D costs, and making a profit it can reinvest elsewhere. Once one company decides to produce in the market, competitors are prone to follow quickly rather than let that company gain advantages. The company decision to invest depends not so much on the benefits it gains but rather on what it could lose by not entering the field. In most oligopolistic industries (such as automobiles, tires, and petroleum), this pattern helps explain the large number of producers compared to the size of the market in some countries. Along these same lines, company will sometimes invest in a foreign competitor's home market to prevent that competitor from wing the high profits it makes in that market to invest and compete elsewhere (*E. M. Graham*, 1990).

1.7 INVESTORS' ADVANTAGES

Companies invest directly only if they think they hold some supremacy over similar companies in countries of interest. The advantage results from a foreign company's ownership of some resource—patents, product differentiation, management skills, access to markets—unavailable at the same price or terms to the local company. This edge is often called a monopoly advantage. Because of the increased cost of transferring resources abroad and the perceived greater risk operating in a different environment, the company will not move unless it expects a higher return than it can get at home and unless it can outperform local firms.

Companies from certain countries may enjoy a monopoly advantage if they can borrow capital at a lower interest rate than companies from other countries.

Another advantage is when the foreign company's currency has high buying power. During the two and a half decades following World War II, the U.S. dollar was very strong by converting dollars to other currencies; U.S. companies could purchase more in foreign countries than they could in the United States. This advantage was an incentive for U.S companies to make foreign investments. They could add production capacity more cheaply abroad than at home. Further, non-U.S. companies could not as easily make FDIs in the United States. Currency values do not, however, provide a strong explanation for direct investment patterns because investors see a strong currency as an indicator of a strong economy that will enhance their sales.

To support the high costs necessary to maintain domestic competitiveness, companies frequently must sell on a global basis. To sell most efficiently, many companies establish direct investments abroad. In contrast to less internationally oriented companies, the advantage accruing to more internationally oriented companies from spreading out some of the costs of product differentiation, R&D, and advertising is apparent.

1.8 DIRECT INVESTMENT PATTERNS

Although foreign direct investment began centuries ago its biggest growth has occurred since the middle of the twentieth century. Recent growth has resulted from several factors, particularly the more receptive attitude of governments to investment inflows, the process of privatization, and the growing interdependence of the world economy. By 2000, about 63,000 companies owned about 800,000 FDIs. These FDIs produced about 10 percent of global output (*New York and Geneva: United Nations,* 2001). Let's now look at where FDI is owned and located and the industries in which it exists.

- **Location of Ownership**

The industrial countries account for a little over 90 percent of all direct investment outflows (*United Nations Conference on Trade and Development*, 2000). This is understandable, because more companies from those countries are likely to have the capital, technology, and managerial skills needed to invest abroad. Nevertheless, hundreds of firms from emerging economies have FDIs, although the holdings from individual developing countries remain small compared to investments from industrial nations. For example, of the 100 companies that own the most FDI, only five are from developing or newly industrialized countries, Hutchinson Whampoa (Hong Kong), Cemex (Mexico), LG Electronics (Korea), Petroven (Venezuela), and Petronas (Malaysia). Table 1.1 shows the top 25 direct investors in terms of their foreign assets.

During much of the post—World War II period, the United States was the dominant investor. However, its share has been falling as the share from other industrial countries, especially the United Kingdom and Japan, has increased. Recently, FDI has been flowing more rapidly into the United States than out of it. Much of this development has resulted from the large foreign purchases of U.S. companies, such as British Petroleum's $61 billion acquisition of Amoco in 1998 and Vodaphone Group's (also from the United Kingdom) $58 billion acquisition of AirTouch in 1999 (*Wall Street Journal*, 1999).

- **Location of Investment**

largest investors in the United States are the United Kingdom, Japan, and the Netherlands, accounting in 2001 for about 16, 12, and 12 percent, respectively, of FDI there (*BEA Current and Historical Data*, 2003). The largest locations of U.S-owned FDI in 2001 were in the United Kingdom, Canada and the Netherlands, which held 18, 10, and 10 percent of the value of U.S-owned FDI. The major recipients of FDI are developed countries, which received about 79 percent of the world's total in 2001. However, for 2001 a larger share went to developing countries, primarily because of a drop in inflows to developed countries from 2000 to 2001 of more than half because of an economic slowdown (*www.oecd.org*, 2002). Nevertheless, inflow to developing countries also fell, but not by as much. The small share going to emerging economies has caused concern about how those economies will meet their capital needs.

The interest in developed countries has come about for three main reasons:

1. More investments have been market seeking, and the markets are larger in developed countries.

1. Political turmoil in many emerging economies has discouraged investors.
2. The industrial nations, through the Organization for Economic Cooperation and Development (OECD), are committed to liberalizing direct investment among their members.

The OECD operates (with exceptions) under a principle that member countries should treat foreign-controlled companies no less favorably than domestic ones in such areas as taxes, access to local capital, and government procurement. The OECD member countries also have agreed on procedures through which direct investors can resolve situations that may result from conflicting laws between their home and host countries.

TABLE 1.1

THE WORLD'S 25 LARGEST TNCS, RANKED BY FOREIGN ASSETS, 2000

(Billions of dollars and number of employees)

Note that all the companies are from developed or newly industrialized countries.

RANKING 2000 BY FOREIGN ASSETS	CORPORATION	COUNTRY	INDUSTRY	ASSETS. FOREIGN	SALES FOREIGN	EMPLOYMENT FOREIGN
1	Vodaphone	United Kingdom	Telecommunications	221.2	7.4	24,000
2	General Electric	United States	Electronics	159.2	49.5	145,000
3	ExxonMobil	United States	Petroleum expl./ref./distr.	101.7	143.0	64,000
4	Vivendi Universal	France	Diversified	93.3	39.4	210,084
5	General Motors	United States	Motor vehicles	75.2	48.21	65,300
6	Royal Dutch/Shell Group	The Netherlands/ United Kingdom	Petroleum expl./ref./distr.	74.8	81.1	54,337
7	BP	United Kingdom	Petroleum expl./ref./distr.	57.5	105.6	88,300
8	Toyota Motor	Japan	Motor vehicles	56.0	622	
9	TelefOnica	Spain	Telecommunications	56.0	12.9	71,292
10	Fiat	Italy —	Motor vehicles	52.8	35.9	112,224
11	IBM	United States	Computers	43.1	51.2	170,000
12	Volkswagen Group	Germany	Motor vehicles	42.7	57.8	160,274
13	Chevron Texaco	United States	Petroleum expl./ref/dist.	42.6	65.0	21,693
14	HutchinsonWhampoa	Hong Kong	Diversified	41.9	2.8	27,165
15	Suez	France	Diversified/utility	38.5	24.1	117,280
16	DaimlerChrysler AG	Germany/United States	Motor vehicles	...	48.7	83,464
17	News Corporation	Australia	Media	36.1	12.8	24,500
18	Nestlé 5.A.	Switzerland	Food/beverages	35.3	48.9	218,112
19	Total Fina SA	France	Petroleum expl./ref/dist.	33.1	82.5	30,020
20	Repsol YPF	Spain	Petroleum expl./ref/dist.	29.8	9.1	
21	BMW	Germany	Motorvehicles	31.2	26.1	23,759
22	Sony Corporation	Japan	Electronics	30.2	42.8	109,080
23	E.On	Germany	Electricity, gas and water		41.8	83,338
24	ABB	Switzerland	Electrical equipment	28.6	22.5	151,340
25	Phillips Electronics	Netherlands	Electrical & Electronic equipment	27.9	33.3	1 84,200

Note: United Nations Conference on Trade and Development, *The World Investment* Report (Geneva and New York: United Nations, 2002), p. 86. Measurements are based on 10 percent ownership or more. Only nonfinancial companies are included. In some companies, foreign investors may hold a minority share of more than 10 percent.

expl./ref/dist.= exploration, refining, and distribution

CHAPTER TWO

GOVERNMENT ATTITUDES TOWARD FOREIGN DIRECT INVESTMENT

2.1 EVALUATING THE IMPACT OF FDI

Developing and industrial countries have deregulated their markets, privatized national enterprises, liberalized private ownership, and encouraged regional integration in an effort to create more favorable settings for foreign investments. Total worldwide FDI flows surged in this environment, rising from $202 billion in 1990 to a record $1.3 trillion in 2000 (*Geneva: UNCTAD*, 2001).

Now we are going to discuss how FDI benefits countries. FDI has come to be seen as a major contributor to growth and development, bringing capital, technology, management expertise, jobs, and wealth. However, FDI is not without controversy (*Northampton, MA: Edward Eglar*, 1999). Many countries that opened their markets to FDI experienced economic and social disruptions; they also watched investments by MNEs constrain existing or potential domestic companies. MNEs have also run into problems; many made big foreign investments that have performed poorly. As a result, the first years of the twenty-first century saw declining volume of FDI worldwide (*Louis Uchetelle,* 2002).

As MNE managers and as national citizens, we need to understand the costs and benefits of FDI. Companies, in the quest to optimize their performance, allocate resources among different countries. However, this allocation is influenced by governments' interpretation of the relative costs and benefits of FDI. As managers, we must be aware of these interpretations and, at times, try to clarify them. As citizens, we need to argue for government policies that will enhance national interests. Both responsibilities require understanding why countries would react to FDI, like China, with opposition, suspicion, or cooperation.

2.1.1 Trade-offs Among Constituencies

To prosper and survive, a company must satisfy different groups, which we call stakeholders. Stakeholders include stockholders, employees, customers, and society. In the short term the aims of these groups conflict. Stockholders want additional sales and increased productivity, which result in higher profits and higher returns for them. Employees want safer workplaces and higher compensation. Customers want higher quality products at lower prices. Society would like to see increased corporate taxes, more corporate support for social services, and trustworthy behavior. In the long term, all of these aims must be achieved adequately because each stakeholder group is powerful enough to cause a company's demise.

Pressure groups lobby governments to restrict MNEs' activities at home and abroad. Although management must be aware of these competing interests, it has to serve them unevenly at any given period. At one time, gains may go to consumers; at another, to stockholders. Making necessary tradeoffs is difficult in the home environment. Abroad, managers' poorer familiarity with customs and stakeholders complicates the challenge of choosing the best alternative—particularly if dominant interests differ among countries.

The principal difficulty for MNEs in overseas relationships is not so much trying to serve conflicting interests within various countries. Rather, it is the challenges that arise from MNEs' attempts to handle cross-national controversies in ways that let them still achieve global objectives. That is, MNEs' choice of where to locate their plants influences which countries will prosper. Consequently, stakeholders in any given country seek to achieve their own, rather than global, objectives. For example, laborers in the United States have shown little concern for the number of jobs that their employers create in foreign markets. They have pushed for legislation to increase the number of jobs in the United States. Managers' tasks, then, are complicated because the decisions they make in one country most likely have repercussions in another. The fact that these decisions determine the destination of jobs, profits, taxes, and capital flows attracts the interests of stakeholders and governments.

2.1.2 Trade-offs Among Objectives

An MNE's actions may affect a country's economic, social, and political objectives. However, a positive effect on one objective, such as technology transfer, may accompany a negative effect on another objective, such as unemployment. Therefore, although a country hopes that an MNE can solve a given problem, it has to prepare for the costs created by the benefit. Naturally, governments want benefits with little or no costs; this, though, is seldom possible (Ashish Arora, 2002). Therefore, countries must rank their objectives, somehow resolving the unavoidable tradeoffs among objectives.

Similar ideas influence how people see FDI. People sometimes mistakenly assume one stakeholder gains from FDI, and then another must lose (Jean J. Boddewyn and Thomas L. Brewer.). They might also assume that if there are gains in one country from FDI, then there must be losses in another country. Either may happen, but it is also possible that multiple stakeholders in more than one country will either gain or lose. In theory, no party would participate willingly in FDI pacts with the belief that the investment would harm its priorities. Controversies develop because agreements fail to work as planned, the weight given to the objectives changes, or disputes emerge over the distribution of gains even when these gains have benefited all the parties. The latter problem is at the heart of most controversies over FDI. China encouraged foreign investment that transferred technology and management skills to its economy to try to manage this problem.

2.1.3 Cause-Effect Relationships

Just because two factors move in relation to each other does not necessarily mean they are interdependent. Still, opponents of FDI try to link the actions of MNEs to matters like inequitable income distribution, political corruption, environmental debasement, and societal deprivation (Mohsin Habib and Leon Zurawicki, 2002). On the other hand, proponents link their actions to higher tax revenues, employment, innovation, and exports. These sorts of linkages often arise when governments consider either restricting or encouraging FDI. Although the data presented by opponents or proponents of MNEs often are accurate and convincing, there is always the problem of speculating about what would have happened had MNEs gone elsewhere or followed different practices. Technological

developments, competitors' actions, and government policies are just three of the variables that distort the analysis of cause a

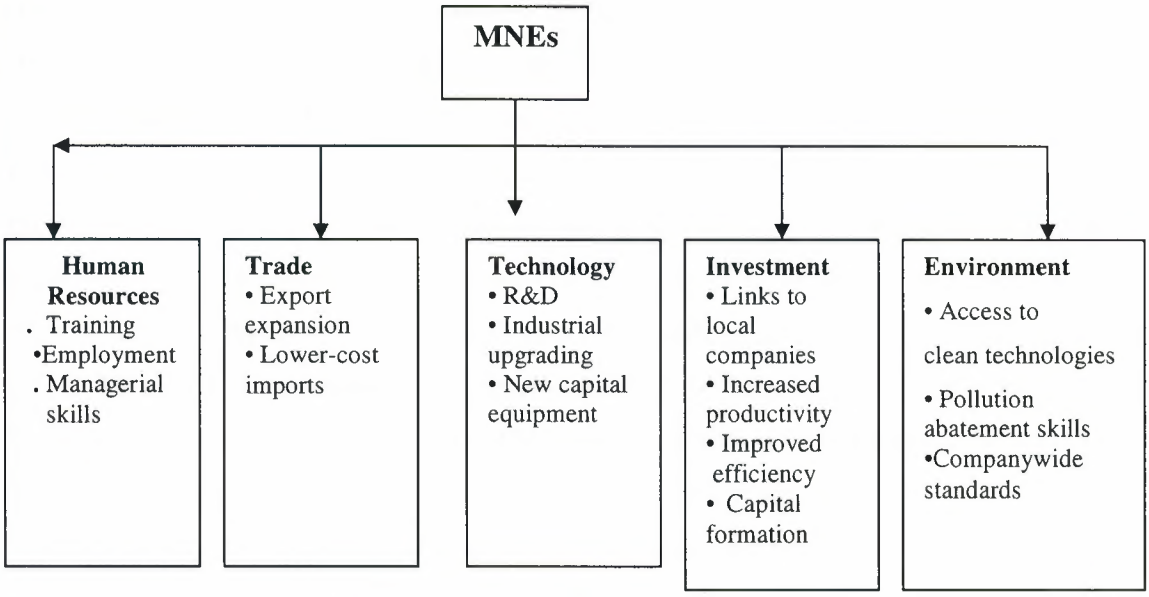
2.1.4 Individua1 and Aggregate Effects

One astute observer noted, "Like animals in a zoo, multinationals (and their affiliates) come in various shapes and sizes, perform distinctive functions, behave differently, and make their individual impacts on the environment (John H. Dunning1974). Some countries have tried to evaluate MNEs and their activities individually. Although this process might lead to greater fairness and better control, it is time-consuming and costly. Therefore, many countries apply the same policies and control mechanisms to all MNEs. This approach eliminates some of the bureaucracy, but it risks throwing out some "good apples' along with the bad. Further, when examining foreign investments on an individual or an aggregate basis, governments have been far from perfect in predicting future impacts.

2.1.5 Potential Contributions of MNEs

MNEs have assets that can contribute to a range of national objectives. MNEs control a large portion of the world's capital, a factor that increases production. They account for most of the world's exports of goods and services, thereby creating access to foreign exchange for a country's purchase of imports. They are the major producers and organizers of technology, which is crucial to improving national competitiveness and solving environmental problems (Geneva: UNCTAD, 1999). Figure 2.1 shows the major assets of MNEs that can satisfy stakeholders' objectives. Nevertheless, critics argue that MNEs use their assets inadequately when trying to satisfy these objectives.

FIGURE 2.1 RESOURCES AND POSSIBLE CONTRIBUTIONS



MNEs can contribute directly to investment, human resources, technology, trade, and the environment, thus contributing to host-country objectives.

Source: Adapted from Transnational Corporations and Management Division, World Investment Report 1992.

2.2 ECONOMIC IMPACT OF THE MNE

MNEs may affect countries' balance-of-payments, growth, and employment objectives. Under different conditions, these effects may be positive or negative for the host or home country.

2.2.1 Balance-of-Payments Effects

Countries want capital inflows because such inflows allow them to increase their imports.

However, because FDI brings both capital inflows and outflows, countries fear that the net balance-of- payments effect may be negative.

Place in the Economic System If a country runs a trade deficit, it must compensate for that deficit either by reducing its capital reserves or by attracting an influx of capital. The influx of capital may be from unilateral transfers (such as foreign aid), from the receipt of credit, or from the receipt of foreign investment (Paul Krugman, 1996). Put another way, the more capital inflows country receives, the more it can import and the more it can run a trade deficit. The capacity to run a trade deficit is especially important for developing countries because they typically have more goods and services available for their use than they produce themselves. The ability to use these additional resources helps them achieve their growth objectives. FDI has recently become a more crucial factor in the effort to contribute capital to developing countries (William Easterly, 2002). For example, China has been a large net receiver of FDI; it has also been running a trade surplus (John Schauble, 2002). This capital accumulation has gone toward the buildup of Chinese reserves, which it holds largely in U.S. Treasury bills. These reserves will enable China to finance future trade deficits that will be necessary to fund infrastructure projects.

Like China, other countries attempt to regulate trade and investment movements and the capital flows that parallel those movements. They do this through incentives, prohibitions, and other types of government intervention (Evan Osbome, 2001). An important aspect of the balance of payments is that gains are a zero sum game—one country's trade or capital surplus is another country's deficit. If both countries looked only at a fixed period, then one country might justifiably be described as a winner at the expense of the other. In fact, a country may be willing to forgo short-term surpluses in favor of long-term ones, or vice versa. As countries regulate capital flows, they influence companies' decisions on whether to invest in their local markets. These countries also constrain companies' ability to transfer income from FDI to other countries.

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Aggregate Assumptions and Responses Generally, MNEs' investments are initially

favorable to the host country and unfavorable to the home country. However, the situation reverses after some time (Ravi Ramamurti, 2001). This occurs because nearly all investors plan eventually to remit to the parent company more than they sent abroad. If the net value of the FDI continues grow through retained earnings, dividend payments for a given year ultimately may exceed the total capital transfers that comprised the initial investment.

From the standpoint of home countries, restrictions on capital outflow improve the availability of short-term capital. These restrictions, however, reduce future earnings inflows from foreign investments. In addition, host country restrictions may erode confidence in the economy because companies fear they cannot move their funds where they want them. This fear reduces capital inflows and spurs capital flight. Consequently, capital outflow restrictions are useful only in buying the time needed to institute other means for solving balance-of- payments difficulties (George J. Kaufman, 2000).

Governments also have sought to attract inflows of long-term capital as a means to develop production that will displace imports or generate exports. Countries, then, must determine how to benefit from FDI while minimizing the long-term adverse effects on their balance of payments. Many countries have approached this problem by strictly valuing new FDI based on contributions of freely convertible currencies, industrial equipment, and other physical assets—not on contributions of goodwill, technology, patents, trademarks, and other intangible assets. The basis of valuation helps determine the regulations on the maximum repatriation of earnings by the MNE, such as a percentage of the FDI valuation. Normally, the maximum is expressed as a percentage of the investment's value. Negotiating a lower stated value for the FDI lets the host government minimize the eventual repatriation earnings. Doing so requires that governments strictly inspect the declared value of the equipment brought into their countries, especially when the investor is also the equipments supplier, to prevent inflated valuations. In addition, host governments often require part of capital contribution to be in the form of loans. Whereas dividends from earnings on equity are capital outflows that can continue indefinitely, interest payments on loans are capital outflows that continue until the loans are repaid.

2.2.2 Growth and Employment Effects

Classical economists assumed that movement of production factors abroad would result in

an increase in output abroad and a decrease at home. Even if this assumption were realistic, the gains in the host country might be greater or less than the losses in the home country.

The argument that both the home and the host countries may gain from FDI rests on two assumptions: (1) Resources are not necessarily fully employed, and (2) capital and technology cannot be easily transferred from one industry to another. For example, a soft-drink maker may be producing at maximum capacity for its domestic market but is limited in developing export sales due to high transportation costs. Further, the company may not simply move into other product lines or easily use its financial resources to increase domestic productivity. Establishing a foreign production facility, however, positions the company to develop foreign sales without reducing resource employment in its home market. In fact, it may hire additional domestic managers to oversee the international operations and receive dividends and royalties from the foreign use of its capital, brand, and technology.

Although stakeholders in both home and host countries may gain from FDI, some stakeholders argue that they are economic losers. Let's examine their arguments.

Home Country Losses The United States is the home country for the largest amounts of foreign licensing and direct investment. Hence, its policies invite close examination. A leading detractor is organized labor, which argues that foreign production often displaces what would otherwise be jobs in the United States (Peter Wilamoski, 1999). Detractors cite examples of advanced technology that has been at least partially developed through government contracts and then transferred abroad. In fact, some U.S. MNEs move their newest technologies abroad and, in some cases, manufacture abroad before they do so in the United States. An example is Boeing's transfer of aerospace technology to China to produce aircraft parts. According to critics, if Boeing did not transfer the technology, China would have had to purchase the products in the United States, thereby increasing employment and output there. These critics further argue that such technology transfer will speed the process of China's gaining control of future global aircraft sales. Alternatively, others counter that had Boeing not found a way to make the sale, then China might have bought from Airbus Industrie or independently developed the technology itself (Jeff Cole,

2001).

Another question is whether outsourcing production causes wages to decline in the home country. Anecdotal evidence suggests it does. For example, call handlers' salaries are 85 to 90 percent lower in India than in the United Kingdom. Even though the costs of information technology infrastructure are higher in India, total operating costs in India are 35 lower than in the United Kingdom. Consequently, British unions' attacks on declining wage levels in the U.K.'s 3,500 call centers met the warning that British operators must improve their service quality or else lose their jobs (Jonathon Guthrie, 2001). In contrast, evidence suggests that moving jobs to lower-wage countries increases the overall home-country demand and wages for skilled labor. MNEs can use the cost savings that result from producing abroad to lower prices that, in turn, generate more demand. For example, Nike uses inexpensive overseas labor to make its shoes and this lowers the price of its shoes and increases demand. Nike then needs more higher-skilled and higher-paid managerial personnel in the United States (Robert Feenstra and Gordon Hanson, 1995).

Host-Country Gains Most observers agree that an inflow of investment from MNEs can stimulate local development through the employment of idle resources. Companies will want to move resources, such as capital and technology, abroad when the potential return is high—especially to those markets where they are scarce. Certainly, the mere existence of resources in a country does not guarantee that they will contribute to output. MNEs, how ever, may enable idle resources to be used. Oil production, for instance, requires not only the presence of underground oil deposits but also the knowledge of how to find them, the capital equipment to extract it, and the facilities to refine it. Simply pumping oil is wasteful without markets and transportation facilities, which an international investor may be able to supply.

FDI by MNEs can initiate the upgrading of resources by educating local personnel to use equipment, technology and new production methods (Vinish Kathuria, 2001). Seemingly minor programs, such as promoting on-the-job safety, can reduce lost worker time and machine downtime. This occurred after the U.S. company Renbco acquired Doe Run Peru, a metallurgical complex (Sally Bowen, 1999). The transfer of innovative work methods increases productivity, thereby freeing time for other activities. Further, additional

competition may push existing companies to improve their efficiency. This happened with European retailers after Wal-Mart entered the European market and with Japanese retailers after Tower Records and Gap entered the Japanese market (Bayan Rahman and Marico Sanchana, 2002).

Host-Country Losses Critics argue that MNEs make investments that domestic companies otherwise would have made, thereby displacing potential local entrepreneurs. Similarly, foreign investors may bid up prices by competing with local companies for labor and other resources—such as when local companies in northern Indiana in the United States complained about Toyota's hiring its best workers by paying them higher wages (of course, the workers did not object (Timothy Aeppel, 1999). Such critics argue, for example, that MNEs can raise lower cost funds in different countries because they have operations in those countries and are known in those financial markets. Local companies, especially those operating only domestically in a developing country, do not have these options. Thus, MNEs can tap cheaper capital and reduce their capital cost relative to that of local companies. The MNEs can then pay more to attract the best personnel or use more promotions to lure customers from competitors and still earn profits. Evidence for these arguments is inconclusive. MNEs frequently pay higher salaries and spend more on promotion than local companies do. It is uncertain, how ever, whether these differences result from external advantages or represent the added costs of attracting workers and customers upon entering new markets. Higher compensation and promotion expenses may offset any external cost advantages obtained from access to cheaper foreign capital. Additionally, in many instances, the local competition can also raise funds in other countries.

Critics contend that FDI destroys local entrepreneurship, an outcome that affects national development. Because the reasonable expectation of success is necessary to inspire entrepreneurship, the collapse of small cottage industries in the face of MNEs' consolidation efforts may make the local population feel incapable of competing. A good deal of evidence questions this contention (William Keng and Mun Lee, 1997). The presence of MNEs may increase the number of local companies in host-country markets because the MNEs serve as role models that local talent can then emulate. Moreover, an

MNE buys many services, goods, and supplies locally that may stimulate local entrepreneurship. For example, automobile producers typically add less than half the value of an automobile at the factory, buying the remaining parts, subassemblies, and modules from suppliers, some of whom are local companies. In China, positive spillovers from FDI have contributed to Chinese companies' acquisition of financial resources, which has helped them become viable suppliers (Haishun Sun, 1998). Finally, some maintain that true entrepreneurs will see large MNEs not as obstacles but as challenges.

There is evidence that local R&D can enhance a country's competitive capability (Wilbur Chung, 1998). However, a country needs a strong technological base if its R&D will create the foundation for product leadership. Therefore, governments seek technology from MNEs to establish their bases and then seek local R&D to build on those bases. At this point, some evidence suggests that dependence on FDI constrains host countries from developing workable R&D (Susan E. Fienberg, 2001). For example, Japan, Korea, Taiwan, and China have been much more restrictive on FDI inflows than have Malaysia, Singapore, and Thailand. The former countries spend much more on R&D as a percentage of gross domestic products than do the latter ones. China's original preference for FDI in the form of joint ventures with Chinese companies, for instance, reflected its desire to use foreign technology to develop local R&D capabilities. MNEs entered joint ventures with Chinese companies that had a base of product experience that positioned them to absorb the incoming technology. Ultimately, China reasoned that its home companies would build on the technology they absorbed through independent and indigenous R&D. This approach, though, is risky; a country that limits foreign ownership may discourage other companies from transferring their technologies (Theodore H. Moran, 1998).

Another argument is that investors learn better ways of doing things abroad. By observing foreign competitive conditions, they may gain access to new technology that they can transfer to their home countries. Such early access, however, may prevent the original developers from fully exploiting their technologies. It may also prevent the originating country from fully capturing the economic benefits of the innovations developed by its residents. For example, foreign investment, especially from Japan, has grown rapidly in high-tech industries in California's Silicon Valley. This FDI may allow non-U.S. companies to develop competitive in their home countries that are based on U.S. scientific

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ABSTRACT

Foreign investment means ownership of foreign property in exchange for a financial return, such as interest and dividends. Foreign investments take two forms: direct and portfolio. Portfolio investments represent passive holdings of securities such as foreign stocks, bonds, or other financial assets whereas foreign direct investment **(FDI)** is acquisition of foreign assets for the purpose of controlling them.

Nowadays, making foreign direct investment has become the dream of all successful firms in the world.

CONTENTS

INTRODUCTION

This project is about foreign direct investments. It presents a comprehensive explanation about foreign direct investments in the world generally and in Jordan particularly.

In the first chapter we will present the definitions, methods and patterns of FDI. Further, we will clarify the relationship between trade and factor mobility theory. Also we will present the reasons why large companies wish to operate internationally—to expand their markets and acquire foreign resources—and the obstacles they face; through nationalism and trade restrictions.

For chapter two, we are going to explain how to evaluate the impact of FDI through discussing how FDI benefits countries. Moreover, we will present the opinions of opponents and proponents of FDI, and also how MNEs may affect countries' balance-of-payments, growth, and employment objectives.

For chapter three, we will see how successful MNEs choose the best locations for their operations to expand their sales or to compete in new markets through weeding out or scanning countries.

Chapter four explains the Jordanian economy in details. We will notice the developments in the Commodity-Producing Sectors and Service-producing Sectors during 2003.

As for chapter five, we are going to notice how the volume of foreign direct investment (FDI) reached to its peak in 2000 and then declined to become only JD83 million in 2003. Further, we will explain the policies and strategies that Jordan' government and Jordan investment board (JIB) follow to attract foreign investors. In addition, tables and charts are shown in this chapter for the statistics of total foreign direct investments in Jordan since 1996 up to 2003.

We will also explain the attractive sectors in Jordan that could attract foreign firms to invest in Jordan such as; information technology, QIZ and tourism.

There are some recommendations—in the end of chapter five— to make reforms in Jordan to increase the volume of foreign direct investments.

CHAPTER ONE

TRADE & INVESTMENT

1.1 Overview

Foreign investment means ownership of foreign property in exchange for a financial return, such as interest and dividends. Foreign investments take two forms: direct and portfolio. The distinction between the two rests on the question of control: does the investor seek an active management role in the firm or merely a return from a passive investment?

Portfolio investments represent passive holdings of securities such as foreign stocks, bonds, or other financial assets, none of which entails active management or control of the securities' issuer by the investor. Modern finance theory suggests that foreign portfolio investments will be motivate by attempts to seek an attractive rate of return as well as the risk reduction that can come from geographically diversifying one's investment portfolio.

Foreign direct investment (FDI) is acquisition of foreign assets for the purpose of controlling them. Control need not be a 100-percent or even a 50-percent interest if a company holds a minority stake and the remaining ownership is widely dispersed, no other owner may be able to counter the company effectively. When two or more companies share ownership of an FDI, the operation is a joint venture. When a government joins a company in an FDI, the operation is called a mixed venture, which is a type of joint venture. Companies may choose FDI as a way to access certain resources or reach a market. Today, about 63,000 companies worldwide have FDIs that encompass every type of business function ---extracting raw materials from the earth, growing crops, manufacturing products or components, selling output, providing various service and so on (Philip L. Martin and Michael S. Teitelbaum, 2001). FDI is not the domain of large companies only. For example, many small firms maintain sales office abroad to

complement their export efforts, which are FDI along with real estate they own abroad. However, because large companies tend to have larger foreign facilities and operate in more countries, the value of their FDI is higher.

U.S. government statisticians define **FDI** as "ownership or control of 10 percent or more of an enterprise's voting securities or the equivalent interest in an unincorporated business.

According to **OECD** countries **foreign direct investment** is capital invested for the purpose of acquiring a lasting interest in an enterprise, and exerting a degree of influence on that enterprise's operations this is to be distinguished from portfolio investment, which involves purchasing assets to earn a rate of return, without acquiring any control of the institution or establishing a lasting presence therein. The control by an investor of 10 per cent or more of the ordinary share of a corporate enterprise is the normal criteria used by the OECD, but other factors may also be taken into account when measuring FDI (OECD, OCDE, Paris 1992).

1.2 METHODS OF FDI

There are two methods of foreign direct investment: (1) building new facilities (called the greenfield strategy), (2) buying existing assets in a foreign country (called the acquisition strategy).

1.2.1 The Greenfield Strategy

The Greenfield strategy means starting a new operation from the beginning. First, the firm buys or leases a land, and then constructs new facilities, hires or transfers in managers and employees, and then launches the new operation.

Reasons for building; companies frequently make foreign investments in sectors where there are few, if any, companies operating, so finding a company to buy may be difficult. Further, local investments may prevent acquisitions because they want more competitors in

the market and fear market dominance by foreign firms. The acquired companies might have substantial problems. Personnel and labor relations may be both poor and difficult to change, ill will may have to existing brands, or facilities may be inefficient and poorly located. Moreover, the managers in the acquiring and acquired companies may not work well together, particularly if the two companies are accustomed to different management styles and practices or if the acquiring company tries to institute many changes. In addition, a foreign company may find local financing easier to obtain if it builds facilities, particularly if it plans to tap development banks for part of its financial requirements (John Child, David Faulkner, and Robert Pitethly, 2002).

The Greenfield strategy has several **advantages**. For one thing, the firm can select the site that best meets its needs and construct modern, up-to-date facilities. Local communities frequently offer economic development incentives to attract such facilities because they create new jobs; these incentives lower the firm's costs. The firm also starts with a clean slate. Managers do not have to deal with existing debts, or struggle to modify ancient work rules protected by intransigent labor unions. In addition, the firm can acclimate itself to the new national business culture at its own pace, rather than having the instant responsibility of managing a newly acquired, ongoing business. Research indicate that the greater the cultural difference between the home and the host countries, the more likely a firm is to choose to build a new factory rather than purchase an existing firm (Ricky W. Griffin and Michael W. Pustay, 2005).

However, the Greenfield strategy also has **disadvantages**. For one thing, successful implementation takes time and patience. For another, land in the desired location may be unavailable or very expensive. In building the new factory, the firm must also comply with various local and national regulations and oversee the factory's construction. It must also recruit a local workforce and train it to meet the firm's performance standards.

Disney managers faced several of these difficulties in building Disneyland Paris. Although the French government sold the necessary land to Disney at bargain prices, Disney was not fully prepared to deal with French construction contractors. For example, Disney executives had numerous communications difficulties with a painter that applied 20 different shades of pink to a hotel before the firm approved the color. The park's grand opening was threatened when local contractors demanded an additional $150 million for

extra work allegedly requested by Disney. And Disney clashed with its French employees, who resisted the firm's attempt to impose its U.S. work values and grooming standards on them (Ricky W. Griffin and Michael W. Pustay, 2005).

1.2.2 The Acquisition Strategy

A second FDI strategy is acquisition of an existing firm conducting business in the host country.

Reasons for acquisition; by acquiring a going concern, the purchaser quickly obtains control over the acquired firm's factories, employees, technologies, brand names, and distribution networks. The acquired firm can continue to generate revenues as the purchaser integrates it into its overall international strategy. And, unlike the Greenfield strategy, the acquisition strategy adds no new capacity to the industry.

There are many other reasons for seeking acquisitions. One is the difficulty of transferring some resource to a foreign operation or acquiring that resource locally for a new facility, especially if the company feels it needs to adapt substantially to the local environment or operate through a multidomestic strategy (Anne-Wil Harzing, 2002). Personnel are a resource that foreign companies may find difficult to hire, especially if local unemployment is low. Instead of paying higher compensation than competitors do to entice employees away from their old jobs; a company can buy an existing company, which gives the buyer not only labor and management but also an existing organizational structure (Jaideep Anand and Andrew Delios, 2002).

Through acquisitions, a company may also gain the goodwill and brand identification important to the marketing of mass consumer products. Moreover, a company that depends substantially on local financing rather than on the transfer of capital may find it easier to gain access to local capital through an acquisition. Local capital suppliers may be more familiar with an ongoing operation than with the foreign enterprise.

Sometimes international business acquires local firms simply as a means of entering a new market. For example, Proter & Gample chose to enter the Mexican tissue products market by purchasing Loreto Y Pena Pobre from its owner, Group Carso SA. By so doing,

it acquired Loreto's manufacturing facilities, its well-known tissue and toilet paper brand names, and its existing distribution system (Ricky W. Griffin and Michael W. Pustay, 2005).

At other times, acquisitions may be undertaken by a firm as a means of implementing a major strategic change. For example, the state-owned Saudi Arabian Oil Co., has tried to reduce its dependence on crude oil production by purchasing "downstream" firms, such as Petron Corporation, the largest petroleum refiner in the Philippines, and South Korea's Ssangyong Oil Refining Company. Similarly, after its privatization in 1994, Konikklijke PTT Netherlands, the Netherlands 'formerly state-owned postal and telephone company, determined that it would need to expand internationally if it were to survive in the European Union's market. To improve its competitiveness, it purchased Australia's TNT Ltd., allowing it to combine its postal operations with TNT's express package delivery services (Ricky W. Griffin and Michael W. Pustay, 2005)

The acquisition does have some **disadvantages**, however. The acquiring firm assumes all the liabilities---financial, managerial, and otherwise---of the acquired firm. For example, if the acquired firm has poor labor relations, unfunded pension obligations, or hidden environmental cleanup liabilities, the acquiring firm becomes financially responsible for solving the problems.

The acquiring firm usually must also spend substantial sums up front. For example, when Matsushita purchased U.S. entertainment conglomerate MCA for $6.6 billion, it had to pay out this vast sum shortly after the deal was closed. The Greenfield strategy, in contrast, may allow a firm to grow slowly and spread its investment over an extended period.

Finally, by buying a company, an investor avoids inefficiencies during the start-up period and gets an immediate cash flow rather than the problem of tying up funds during construction.

1.3 THE PLACE OF FDI IN INTERNATIONAL BUSINESS

A phenomenon of great importance to international business developed during the colonial period and the subsequent Age of Imperialism: the growth of foreign direct investments (FDI) which involve foreigners supplying and controlling investment in a host country. European capitalists from such imperialist powers as the United Kingdom, France, the Netherlands, Spain, Belgium, and Portugal nurtured new business in their colonial empires in the Americas, Asia, and Africa, establishing networks of banking, transportation, and trade that persist to this day. The earliest of these firms included the Dutch East India Company (established in 1600), the British East India Company (1602), and the Hudson's Bay Company (1670). These and latter-day trading companies, such as Jardine Matheon Holdings, LTD., owned copper mines, tea and coffee estates, jute and cotton mills, rubber plantations, and the like as part of their global trading empires.

During the nineteenth century the invention and perfection of the steam engine, coupled with the spread of railroads, dramatically lowered the cost of transporting goods over land and thereby made larger factories more economical. This development in turn broadened the extent of FDI. The forerunners of such large contemporary MNCs as Unilever, Ericsson, and Royal Dutch/Shell took their first steps on the path to becoming international giants by investing in facilities throughout Asia, Europe, and the Americas during this period (Dunning John H., 1993).

At the present, the place of FDI in the international business is very important, where most of the global giant corporations have been investing internationally.

1.4 THE RELATIONSHIP OF TRADE AND FACTOR MOBILITY

Whether capital or some other asset is transferred abroad initially to acquire a direct investment, the asset is a type of production factor. Eventually, the direct investment usually involves the movement of various types of production factors as investors infuse capital, technology, personnel, raw materials, or components into their operating facilities abroad. Therefore, it is useful to examine the relationship of trade theory to the movement

of production factors.

- **The Trade and Factor Mobility Theory**

Trade often occurs because of differences in factor endowments among countries. A country such as Canada, with abundant arable land relative to its small but educated labor force, may cultivate wheat in a highly mechanized manner. This wheat may be exchanged for handmade sweaters from Hong Kong, which require abundant semiskilled labor and little land.

Historical treatises on trade assumed that the factors of production were nearly immobile internationally and that trade could move freely. In actuality, there are many natural and imposed barriers that make both finished goods and production factors partially mobile internationally. Factor movement is an alternative to trade that may or may not be a more efficient allocation of resources. If the factors of production were not free to move internationally as assumed by early economic theorists, then trade would ordinarily be the most efficient way of compensating for differences in factor endowments. If neither trade nor the production factors could move internationally, a country would often have to forgo consuming certain goods. Alternatively, countries could produce them differently, which would usually result in decreased worldwide output and higher prices. We can only speculate on the astronomical cost of coffee if it were produced, say, in hothouses in Arctic regions. In some cases, however, the inability to utilize foreign production factors may stimulate efficient methods of substitution, such as the development of new materials as alternatives for traditional ones or of machines to do hand work. The development of synthetic rubber and rayon was undoubtedly accelerated because wartime conditions made it impractical to move silk and natural rubber, not to mention silkworms and rubber plants.

- **Substitution**

Whenever the factor proportions vary widely among countries, there are pressures for the most abundant factors to move to countries of greater scarcity so that they can command a better return. Thus in countries with an abundance of labor relative to land and capital, there is a tendency for laborers in that country to be unemployed or poorly paid; if

permitted, these workers will gravitate to countries with relatively full employment and higher wages. Likewise, capital will tend to move away from countries where it is abundant to those where it is scarce. Mexico is thus a net recipient of capital from the United States, and the United States is a net recipient of labor from Mexico.

If finished goods and production factors were both completely free to move internationally, then the comparative costs of transferring goods and factors would determine the location of production. Let us take the following example that clarifies the substitutability of trade and labor movements under different scenarios.

Assume: (1) that the United States and Mexico have equally productive land available at the same cost for growing tomatoes; (2) that the cost of transporting tomatoes between the United States and Mexico is $0.75 per bushel; and (3) that workers from either country pick an average of two bushels per hour during a 30-day picking season. The only differences in price between the two countries are due to variations in labor and capital cost. The labor rate in the United States is assumed to be $20.00 per day, or $1.25 per bushel; in Mexico it is assumed to be $4.00 per day, or $0.25 per bushel. The cost of capital needed to buy seeds, fertilizers, and equipment costs the equivalent of $0.50 per bushel in Mexico and $0.30 per bushel in the United States.

If neither tomatoes nor production factors can move between the two countries, then the cost of tomatoes produced in Mexico for the Mexican market would be $0.75 per bushel ($0.25 of labor plus $0.50 of capital), whereas those produced in the United States for the U.S. market would be $1.55 per bushel ($1.25 of labor plus $0.30 of capital). If trade restrictions on tomatoes were eliminated between the two countries, the United States would import from Mexico because the Mexican cost of $0.75 per bushel plus $0.75 of transportation cost to move them to the United States would be less than the $1.55 cost of growing them in the United States.

Consider another scenario in which neither country allows the importation of tomatoes but in which both countries allow certain movements of labor and capital. An investigation shows that Mexican workers can enter the United States on temporary work permits for an incremental travel and living expense of $14.40 per day per worker, or $0.90 per bushel. At the same time, U.S. capital can be enticed to invest in Mexican tomato production provided that it receives a payment equivalent to $0.40 per bushel, less than the

Mexican going rate but more than it would earn in the United States. In this situation, Mexican production costs per bushel would be $0.65 ($0.25 of Mexican labor plus $0.40 of American capital). U.S. production costs would be $1.45 ($0.25 of Mexican labor plus $0.90 of travel and incremental costs plus $0.30 of American capital). Note that each country would be able to reduce its production costs (Mexico from $0.75 to $0.65 and the United States from $1.55 to $1.45) by bringing in abundant production factors from abroad.

With free trade and the free movement of production factors, Mexico would produce for both markets by importing capital from the United States. According to the above assumptions, that would he a cheaper alternative than sending labor to the United States. In reality, neither production factors nor the finished goods that they produce are completely free to move internationally. Some slight changes in imposing or freeing restrictions can greatly alter how and where goods may be produced most cheaply.

In the case of the United States, in recent years there has been more legal freedom for capital to flow out than for labor to flow in. As a result, there has been an increase in U.S.-controlled direct investment to produce goods that are then imported back into the United States. In fact, capital moves globally more easily than does labor. Furthermore, technology, particularly in the form of more efficient machinery, is generally more mobile internationally than labor. The result is that differences in labor productivity and cost explain much of trade and direct investment movements.

- **Complementarity of Trade and Direct Investment**

In spite of the increase in direct investments to produce goods for re-import, firms usually export substantially to their foreign facilities; thus FDI is not usually a substitute for exports (Masaaki kotape, 1989). Many of these exports would not occur if overseas investments did not exist. In these cases, factor movements stimulate rather than substitute for trade. One reason for this phenomenon is that domestic operating units may ship materials and components to their foreign facilities for use in a finished product. For example, the Mexican government requires that automobiles sold in Mexico be assembled there. Chrysler therefore has an investment in Mexico to which parts are shipped from the

United States. Yet the quantity of parts from the United States has varied as Mexico has changed requirements for local parts (Stephen Baker, 1989). The foreign subsidiaries or affiliates also may buy capital equipment or supplies from home-country firms because of their confidence in performance and delivery or to achieve maximum worldwide uniformity. A foreign facility may produce part of the product line while serving as sales agent for exports of its parent's other products. Bridgestone, for instance, continued to export its automobile tires from Japan for several years while using the sales force from its U.S. truck-tire manufacturing operations to handle the imports.

1.5 MOTIVATION

The reasons that firms engage in direct investment ownership are no different from the reasons for their pursuit of international trade. They are:

1. To expand markets by selling abroad, and
2. To acquire foreign resources (e.g., raw materials, production efficiency, knowledge).

When governments are involved in direct investment, an additional motive may be to attain some political advantage. These three objectives in turn may be pursued by any one of three forms of foreign involvement. One of these, the sale of services (e.g., licensing or management contracts), often is avoided either for fear of loss of control of key competitive assets or because of greater economies from self-ownership of production. The following discussion will concentrate on the remaining two forms: trade and direct investment. We will emphasize why direct investment is chosen in spite of the fact that most firms consider it riskier to operate a facility abroad than at home.

1.5.1 MARKET-EXPANSION INVESTMENTS

- **Transportation**

Early trade theorists usually ignored the cost of transporting goods from one place to another. More recently, location theorists have considered total landed cost (cost of production plus shipping) to be a more meaningful way of comparing where production

should be situated. When transportation is added to production costs, some products become impractical to ship over a great distance. One of the factors influencing Bridgestone's decision to invest in the United States was the high cost of transporting tires relative to the production price of tires. Numerous other products that are impractical to ship great distances without a very large escalation in the price quickly come to mind: A few of these products and their investing companies include newspapers (Thompson Newspapers, Canadian), margarine (Unilever, British-Dutch), dynamite (Nobel, Swedish), and soft drinks (PepsiCo, U.S.). For these firms, it is necessary to produce abroad if they are to sell abroad. When firms move abroad to produce basically the same products that they produce at home, their direct investments are known as **horizontal expansions.**

Lack of Domestic Capacity As long as a company has excess capacity at its home-country plant, it may be able to compete effectively in limited export markets in spite of the high transport costs. This could be because the fixed operating expenses are covered through domestic sales, thus enabling foreign prices to be set on the basis of variable rather than full cost. Such a pricing strategy may erode as foreign sales become more important or as output nears full plant capacity utilization. This helps to explain why firms, even those with products for which transport charges are a high portion of total landed costs, typically export before producing abroad. Another major factor is that companies want to get a better indication that they can sell a sufficient amount in the foreign country before committing resources for foreign production. Finally, they may want to learn more about the foreign operating environment by exporting to it before investing in production facilities within it. Once they have experience in foreign production, they are more apt to shorten the export-experience time before they produce abroad.

This reluctance to expand total capacity while there is still substantial excess capacity is not unlike a domestic expansion decision. Internationally as well as domestically, growth is incremental. To understand this process, it is useful to draw a parallel of how growth may take place domestically. The simplest example is the firm that makes only one product. Most likely, this firm will begin operations near the city where its founders are already residing and will begin selling in only the local or regional area. Eventually, sales may be expanded to a larger geographic market. As capacity is reached, the firm may build

a second plant in another part of the country to serve that region and save on transportation costs. Warehouses and sales offices may be located in various cities in order to assure closer contact with customers. Purchasing offices may be located close to suppliers in order to improve the probability of delivery at low prices. In fact, the company may even acquire some of its customers or suppliers in order to reduce inventories and gain economies in distribution. Certain functions may be further decentralized geographically, such as by locating financial offices near a financial center. As the product line evolves and expands, operations continue to disperse. In the pursuit of foreign business it is not surprising that growing firms eventually find it necessary to acquire assets abroad.

Scale Economies Transportation costs must be examined in relation to the type of technology used to produce a good. The manufacture of some products necessitates plant and equipment that use a high fixed-capital input. In such a situation, especially if the product is highly standardized or undifferentiated from competitors, the cost per unit is apt to drop significantly as output increases. Products such as ball bearings, alumina, and semiconductor wafers fall into this category. Such products are exported substantially because the cost savings from scale economies overcome the added transport expenses to get goods to foreign markets.

The needed scale of production must be considered in relation to the size of the foreign market being served. For example, many European firms have production facilities in both the United States and Canada. They are more apt to sell the U.S. output only in the United States because of the large market, whereas much of the Canadian output is sold in their home countries to gain large- scale production (Masaaki Kotape and Glenn Omura, 1989).

Products that are more differentiated and labor intensive, such as pharmaceuticals and certain prepared foods, are not as sensitive to scale economies. For these types of products, transportation costs may dictate smaller plants to serve national rather than international markets (Yves Doz, 1978). David's Cookies, for example, first entered the Japanese market with ingredients mixed in the United States. However, because there was little cost reduction obtained by mixing bigger batches of batter, David's switched to Japanese ingredient preparation to overcome the transport cost incurred when exporting (Clyde Haberman, 1978).

- **Trade Restrictions**

We have shown that for various reasons there are numerous ways in which a government can make it impractical for a firm to reach its market potential through exportation alone. The firm may find that it must produce in a foreign country if it is to sell there. For example, Mexico announced that within five years locally produced microcomputers would have to comprise 70 percent of the market. Although many producers questioned whether the same prices and quality could be maintained as when they exported, they nevertheless were reluctant to abandon a growing market (Laurence Rout, 1982). Such governmental pronouncements are not unusual. They undoubtedly favor large companies that can afford to commit large amounts of resources abroad and make foreign competitiveness more difficult for the smaller firms, which can afford only exportation as a means of serving foreign markets.

How prevalent are trade restrictions as an enticement for making direct investments? There is substantial anecdotal evidence of firms' decisions to locate within protected markets, yet studies of aggregate direct investment movements are inconclusive regarding the importance of trade barriers (Sanjaya Lall and N. S. Siddharthan, 1982). A possible explanation for the fact that some studies have not found import barriers to be an important enticement is that the studies have had to rely on actual tariff barriers as the measure of restrictions. This reliance overlooks the importance of nontariff constraints, indirect entry barriers, and potential trade restrictions. Almost certainly import barriers are a major enticement to direct investment, but they must be viewed alongside other factors, such as the market size of the country imposing barriers.

For example, import trade restrictions have been highly influential in enticing automobile producers to locate in Mexico. Similar restrictions by Central American countries have been ineffective because of their small markets. However, Central American import barriers on products requiring lower amounts of capital investment and therefore smaller markets (e.g., pharmaceuticals) have been highly effective at enticing direct investment.

- **Consumer-Imposed Restrictions**

Government-imposed legal measures are not the only trade barriers to otherwise competitive goods: Consumer desires also may dictate limitations. For example, consumers may prefer buying domestically made goods, even though they are more expensive. They also may demand that merchandise be altered so substantially that scale economies from exporting are infeasible. The reasons for preferring domestically made products may include nationalism, a belief that foreign-made goods are inferior, or a fear that service and spare parts will not be easily obtainable for imported wares.

Nationalism The impact of nationalistic sentiments on investment movements is not assessed easily; however, some evidence does exist. There have been active campaigns at times in many countries to persuade people to buy locally produced goods. In the United States, for instance, attempts have been made to boycott Polish hams, Japanese Christmas ornaments, and French wines. Some U.S. manufacturers have promoted "made in the USA' to appeal to consumers in areas that have been hit with import competition (Kenneth Dreyfack, 1986). Fearful that adverse public opinion might lead to curbs on television imports, some Japanese firms announced the establishment of production plants in the United States (Wall Street Journal, April 5, 1977).

Product Image The link between product image and direct investment is clearer than the one just discussed between nationalism and direct investment. The image may stem from the merchandise itself or from beliefs concerning after-sales servicing. In tests using commodities that were identical except for the label of country origin, consumers were found to view products differently on the basis of product source (Philippe Cattin, Alain Jolibert and Coleen Lohnes, 1982). Although there are examples of eventual image changes, such as the general improvement in the image of Japanese products that occurred concomitantly with the decline in image for U.S. products, it may take a long time and be very costly for a company to try to overcome image problems caused by manufacturing in a country that has a lower-image status for a particular product. Consequently, there may be advantages to producing in a country with an already-existing high image.

Delivery Risk Many consumers fear that parts for foreign-made goods may be difficult to obtain from abroad. Industrial customers often prefer to pay a higher price to a producer located nearby in order to minimize the risk of nondelivery due to distance and strikes. For instance, Hoechst Chemical of Germany located one of its dye factories in North Carolina because the textile industry in that region feared that delivery problems would plague the cheaper German imports.

Product Change Often a company must alter a product to suit local tastes or requirements, and this may compel the use of local raw materials and market testing. Test marketing and altering a product at a great distance from the production is most difficult and expensive. Coca-cola, for example, sells some drinks (made from local fruits) abroad that are not available in the United States. It is definitely much cheaper to make these drinks overseas.

The need for a product alteration has two other effects on company production. Initially, it means an additional investment; as long as an investment is needed to serve the foreign market anyway, management might consider locating facilities abroad. Next, it may mean that certain economies from large-scale production will be lost, which may cause the least-cost location to shift from one country to another. The more the product has to be altered for the foreign market, the more likely that the production will be shifted abroad. Two of the factors influencing the decision of Volkswagen to set up U.S. production facilities, for example, were the ever-increasing safety requirements set by the U.S. government and the desire for new options by U.S. consumers, which were different from those needed to sell in other parts of the world. But these changes were not sufficient to garner a large share of the U.S. market, and Volkswagen announced the closing of its U.S. assembly operations in 1987 (business week, Oct.7, 1987).

- **Following Customers**

There are many examples of companies that sell abroad indirectly: that is, they sell products, components or services that their domestic customer then exports. Bridgestone for example, sold tires to Toyota and Honda, which in turn exported fully assembled cars (including the tires) to foreign markets. In these situations the indirect exporters commonly follow their customers when those customers make direct investments. Bridgestone's

decision to make automobile tires in the United States was based partially on a desire to continue selling to Honda and Toyota once those companies initiated U.S. production. Bridgestone's truck-tire investment was in turn instrumental in Yasuda Fire & Marine Insurance Co.'s decision to establish a U.S. investment in order to provide workman's compensation insurance to Bridgestone's operations in the United States (Wall Street Journal, April 12, 1984).

- **Following Competitors**

Within oligopoly industries (those with few sellers), several investors often establish facilities in a given country within a fairly short time period (Edward B. Flowers, 1976). Much of this concentration may be explained by internal or external changes, which would affect most oligopolists within an industry at approximately the same time. For example, in many industries, capacity-expansion cycles are similar for most firms. Thus the firms would logically consider a foreign investment at approximately the same time because their domestic capacity would be approached at approximately the same time. Externally, they might all be faced with changes in import restrictions or market conditions that indicate a move to direct investment in order to serve consumers in a given country. In spite of the prevalence of these motivators, much of the movement by oilgopolists seems better explained by defensive motives.

Much of the research done in game theory shows that people often make decisions based on the "least-damaging alternative." The question for many firms is, "Do I lose less by moving abroad or by staying at home?" Let's say that some foreign market may be served effectively only by an investment in the market, but the market is large enough to support only one producer. One way of facing this problem would be for competitors to set up one joint operation and divide profit among them; however, antitrust laws might discourage or prevent this. If only one firm decides to establish facilities, it will have an advantage over its competitors by garnering a larger market, spreading its R&D costs, and making a profit that can be reinvested in other areas of the world. Once one firm decides to produce in the market, competitors are prone to follow quickly rather than let the firm gain advantages. Thus the decision is based not so much on the benefits to be gained, but rather

on the greater losses sustained by not entering the field. In most oligopoly industries (e.g., automobiles, tires, petroleum), this pattern emerges and helps to explain the large number of producers relative to the size of the market in some countries.

Closely related to this is the decision to invest in a foreign competitor's home market to prevent that competitor from using high profits obtained therein to invest and compete in other parts of the world.

- **Changes in Comparative Costs**

A company may export successfully because its home country has a cost advantage. The home-country cost advantage depends on the price of the individual factors of production, the size of operations, transportation of finished goods, and the productivity of the combined production factors. None of these conditions affecting cost is static; consequently, the least-cost location may change over time. The factor affecting Bridgestone's decision to locate in the United States was the fact that Japanese costs (measured in dollars) grew much faster than those in the United States, owing largely to a rise in the value of the yen relative to the dollar.

The concept of shifts in comparative costs of production is closely related to that of resource-seeking investments. A firm may establish a direct investment to serve a foreign market but eventually import into the home country from the country to which it was once exporting.

1.5.2 RESOURCE-SEEKING INVESTMENTS

There is a cartoon showing Santa Claus speaking to his elves. The caption reads, "I'm sorry to report that after the first, I'll be moving operations to Taiwan (Wall Street Journal, Dec 15, 1983). This cartoon is consistent with the popular image of direct investments motivated by cheap foreign labor used to make imported products. While this does take place, the explanation overlooks some of the costs of producing abroad. For example, Lionel Trains moved from the United States to Mexico but had so many problems with

training and communications that it moved back home after a few years. Furthermore, there are cost advantages from direct investment that are not fully encompassed in the popular labor-oriented image.

- **Vertical Integration**

Vertical integration involves the control of different stages as a product moves from raw materials through production to its final distribution. As products and their marketing become more complicated, there is a greater need to combine resources located in more than one country. If one country has the iron, a second has the coal, a third has the technology and capital for making steel and steel products, and a fourth has the demand for the steel products, there is a great interdependence among the four and a strong need to establish tight relationships in order to ensure the continuance of the production and marketing flow. One way of adding assurance to this flow is by gaining a voice in the management of one of the foreign operations by investing in it. Most of the world's direct investment in petroleum may be explained by this concept of interdependence. Since much of the petroleum supply is located in countries other than those with a heavy petroleum demand, the oil industry has become integrated vertically on an international basis.

Certain economies also may be gained through vertical integration too. The greater assurance of supply and/or markets may allow a firm to carry smaller inventories and spend less on promotion. . It may also permit considerably greater flexibility in shifting funds, taxes, and profits from one country to another.

Advantages of vertical integration may accrue to a firm by either market-oriented or supply-oriented investments in other countries. There are examples of both: Of the two, however, there have been more examples in recent years of supply-oriented investments designed to obtain raw materials in other countries than vice versa. This is because of the growing dependence on LDCs for raw materials and the lack of resources by LDC firms to invest substantially abroad. This movement of capital and technology to LDCs is consistent with a theory that holds that factor mobility is most efficient when the more mobile factors, such as capital, move so as to be combined with the less mobile ones, such as natural resources. Without the capital movement the natural resources otherwise might not be exploited efficiently (London: Croom Helm, 1978).

- **Rationalized Production**

Companies increasingly produce different components or different portions of their product line in different parts of the world—**rationalized production**—to take advantage of the varying costs of labor, capital, and raw materials. An example of rationalized production is the more than 1800 plants in Mexico, known as *magui/adores,* which are integrated with operations in the United States. Semifinished goods can be exported to Mexico duty free, as long as they will be reexported from Mexico. Once the labor-intensive portion of the production is accomplished in Mexico—such as sewing car seats for General Motors or building television cabinets for Panasonic—duties in the United States are charged only on the amount of value added in Mexico (Business Week, June 18, 1990).

Many companies shrug off the possibility of rationalized production of parts because of the risks of work stoppages in many countries because of strikes or a change in import regulations in just one country. An alternative to parts rationalization is the production of a complete product in a given country, but only part of the product range within that country (Doz, *loc. Cit*). A U.S. subsidiary in France, for example, may produce only product A, another subsidiary in Brazil only product B and the home plant in the United States only product C. Each plant sells worldwide so that each can gain scale economies and take advantage of differences in input costs that may affect total production cost differences. Each may get concessions to import because of demonstrating that jobs and incomes are developed locally. A possible different advantage of this type of rationalization is smoother earnings when exchange rates fluctuate. Take the value of the Japanese yell relative to the U.S. dollar. Honda produces some of its line in Japan, which is then exported to the United States. Honda also produces some of its line in the United States, which is then exported to Japan. If the yen strengthens Honda may have to cut its profit margin to stay competitive with exports to the United States. But this cut may be offset with a higher profit margin on the exports to Japan (Sarkis Khoury, David Nickerson, 1991).

- **Access to Production Factors**

The concept of seeking abroad some input not easily or inexpensively available in the

home country closely resembles vertical integration. Many foreign firms have offices in New York in order to gain better access to what is happening within the U.S. capital market or at least to what is happening within that market that can affect other worldwide capital occurrences. The search for knowledge may take other forms as well. It may be a U.S. pharmaceutical firm in Peru conducting research not allowed in the United States. It may be C.F.P. (French), which bought a share in Leonard Petroleum to learn U.S. marketing in order to compete better with other U.S. oil firms outside the United States. It may be McGraw-Hill, which has an office in Europe to uncover European technical developments.

- **The Product Life Cycle Theory**

This theory shows how, for market and cost reasons, production of many products moves from one country to another as a product moves through its life cycle. During the introductory stage production occurs in only one (usually industrial) country. During the growth stage production moves next to other industrial countries, and the original producer may decide to invest in the foreign facilities to earn profits there. In the mature stage, when production shifts largely to developing countries, the same firm may decide to control those operations as well (Raymond Vernon, 1966).

- **Governmental Investment Incentives**

In addition to placing restrictions on imports, countries frequently encourage direct investment inflows by offering tax concessions or a wide variety of other subsidies. Such incentives are offered by many central governments. Direct-assistance incentives include tax holidays, accelerated depreciation, low-interest loans, loan guarantees, subsidized energy or transport, and the construction of rail spurs and roads to serve the plant facility (Robert Weigand, 1983). These incentives affect the comparative cost of production among countries, enticing companies to invest there to serve national or international markets.

- **Political Motives**

Sometimes trade is undertaken to serve political motives. During the mercantilist period, for example, European powers sought colonies in order to control the colonies' foreign trade and extend their own sphere of influence. With the passing of colonialism, some have sought to accomplish many of the old colonial aims by establishing company control of vital sectors in the economies of LDCs (New York: JAI Press, 1977). For instance, if a U.S. firm controls the production of a vital raw material in an LDC, it can effectively prevent unfriendly countries from gaining access to the production. It may also be able to hold down prices to the home country, prevent local processing, and dictate its own operating terms. Observers have pointed out, for example, that Great Britain, Franc& Italy, and Japan established national oil companies with governmental participation (B.P., C.F.P., E.N.I., and J.P.D.C., respectively) in order to lessen their reliance on U.S. multinational petroleum firms, which might give preference to the United States in the allocation of supplies (Harvard University Press, 1976). In the process of gaining control of resources, much political control is transferred to the industrial nations.

Governmental encouragement of MNE expansion to other developed countries may be aimed toward gaining greater control over vital resources. Japan, for example, is highly dependent on foreign sources for certain food-stuffs, lumber, and raw materials; therefore, Japanese governmental agencies have assisted national companies that undertake foreign investments in these sectors in order to protect supplies in Japan (Terutomio Ozawa, 1977).

The control of resources is not necessarily the political aim for encouraging direct investors. During the early 1980s, for example, the U.S. government instituted various incentives designed to increase the profitability of U.S. investment in Caribbean countries unfriendly to Cuba's Castro regime. The reasoning was that the incentives would lure more investment to the area, causing the economies of the friendly nations to strengthen. This would in turn make it difficult for unfriendly leftist governments to gain control.

Where there is governmental ownership and control of companies, not all of these governmental enterprises have become multinational. There are simply too many objectives for government ownership other than control over foreign economies. Even if the governmental enterprise has foreign facilities, it does not necessarily mean that political motives just described prompted the investment (New York: Willey, 1979).

1.6 RISK MINIMIZATION OBJECTIVES

Companies may reduce risks by operating internationally, such as through sales diversification. Their choice of foreign direct investment as the means of reducing risk is due primarily to the same factors we have discussed for market expansion and resource acquisition motives. For example, Johnson Controls, a U.S. manufacturer of automobile parts and control systems for buildings, expanded into Europe largely to minimize its exposure to cyclical downturns in the United States (Peter Marsh, 1998). One of LUKoil's FDI motives has been to move assets out Russia. Further, much of the FDI by Latin American companies in the United States has been motivated by a desire to move funds from their risky home environments (Jeffrey A. Krug and John D. Daniels, 1994). Transportation costs, foreign import restrictions, and foreign consumer desires for product alterations may make FDI the preferred operating mode for sales diversification. Let's now examine some specific reasons for using FDI to minimize risk.

Following Customers Many companies' customers are other companies. They sell products, components, or services to those customers domestically, which then become embodied in a product or service that their customers sell. If an important customer makes a foreign direct investment, the supplier may have compelling reasons to make a foreign direct investment as well. First, it would like to get that customer's business. Second, if a competitor becomes the supplier in the foreign location, that competitor may improve its chances of serving the customer in the domestic market as well. Third, there may be prohibitions to serving the foreign market through exports. For example, Tredegar Industries sells plastic materials, primarily to Procter & Gamble (P&G), for use in paper diapers. When P&G decided to produce in China using JIT, Tredegar had little choice but to make an investment in China as well (G. George, D. Wood, 2000).

Preventing Competitors' Advantage Within oligopolistic industries (those with few sellers), several investors often establish facilities in a given country within a fairly short time of each other, and they thus often overcrowd the market (Edward B. Flowers, 1976).

For example, 10 different automobile companies have made investments in China, leading one analyst to say, 'The number of entrants is so great, it's difficult to see where the profits could accrue (David Murphy and David Lague, 2002). In many industries, most companies experience capacity-expansion cycles concurrently. Thus, they would logically consider a foreign investment at approximately the same time. Externally, they might all be faced with changes in import restrictions or market conditions that indicate the wisdom of making a move to direct investment to serve consumers in a given country. In spite of the prevalence of these motivators, many movements by oligopolists seem better explained by defensive motives.

Much of the research in game theory shows that people often make decisions based on the "least-damaging alternative." Similarly, many companies ask, 'Do I lose less by moving abroad or by staying at home?" Assume that some foreign market may be served effectively only by an investment in the market, but the market is large enough to support only one producer. To solve this problem, competitors could set up a joint operation and divide the profits among themselves if antitrust laws permit this kind of partnership. If only one company establishes a direct investment, it will have an advantage over its competitors by garnering a larger market, spreading its R&D costs, and making a profit it can reinvest elsewhere. Once one company decides to produce in the market, competitors are prone to follow quickly rather than let that company gain advantages. The company decision to invest depends not so much on the benefits it gains but rather on what it could lose by not entering the field. In most oligopolistic industries (such as automobiles, tires, and petroleum), this pattern helps explain the large number of producers compared to the size of the market in some countries. Along these same lines, company will sometimes invest in a foreign competitor's home market to prevent that competitor from wing the high profits it makes in that market to invest and compete elsewhere (*E. M. Graham*, 1990).

1.7 INVESTORS' ADVANTAGES

Companies invest directly only if they think they hold some supremacy over similar companies in countries of interest. The advantage results from a foreign company's ownership of some resource—patents, product differentiation, management skills, access to markets—unavailable at the same price or terms to the local company. This edge is often called a monopoly advantage. Because of the increased cost of transferring resources abroad and the perceived greater risk operating in a different environment, the company will not move unless it expects a higher return than it can get at home and unless it can outperform local firms.

Companies from certain countries may enjoy a monopoly advantage if they can borrow capital at a lower interest rate than companies from other countries.

Another advantage is when the foreign company's currency has high buying power. During the two and a half decades following World War II, the U.S. dollar was very strong by converting dollars to other currencies; U.S. companies could purchase more in foreign countries than they could in the United States. This advantage was an incentive for U.S companies to make foreign investments. They could add production capacity more cheaply abroad than at home. Further, non-U.S. companies could not as easily make FDIs in the United States. Currency values do not, however, provide a strong explanation for direct investment patterns because investors see a strong currency as an indicator of a strong economy that will enhance their sales.

To support the high costs necessary to maintain domestic competitiveness, companies frequently must sell on a global basis. To sell most efficiently, many companies establish direct investments abroad. In contrast to less internationally oriented companies, the advantage accruing to more internationally oriented companies from spreading out some of the costs of product differentiation, R&D, and advertising is apparent.

1.8 DIRECT INVESTMENT PATTERNS

Although foreign direct investment began centuries ago its biggest growth has occurred since the middle of the twentieth century. Recent growth has resulted from several factors, particularly the more receptive attitude of governments to investment inflows, the process of privatization, and the growing interdependence of the world economy. By 2000, about 63,000 companies owned about 800,000 FDIs. These FDIs produced about 10 percent of global output (*New York and Geneva: United Nations,* 2001). Let's now look at where FDI is owned and located and the industries in which it exists.

- **Location of Ownership**

The industrial countries account for a little over 90 percent of all direct investment outflows (*United Nations Conference on Trade and Development*, 2000). This is understandable, because more companies from those countries are likely to have the capital, technology, and managerial skills needed to invest abroad. Nevertheless, hundreds of firms from emerging economies have FDIs, although the holdings from individual developing countries remain small compared to investments from industrial nations. For example, of the 100 companies that own the most FDI, only five are from developing or newly industrialized countries, Hutchinson Whampoa (Hong Kong), Cemex (Mexico), LG Electronics (Korea), Petroven (Venezuela), and Petronas (Malaysia). Table 1.1 shows the top 25 direct investors in terms of their foreign assets.

During much of the post—World War II period, the United States was the dominant investor. However, its share has been falling as the share from other industrial countries, especially the United Kingdom and Japan, has increased. Recently, FDI has been flowing more rapidly into the United States than out of it. Much of this development has resulted from the large foreign purchases of U.S. companies, such as British Petroleum's $61 billion acquisition of Amoco in 1998 and Vodaphone Group's (also from the United Kingdom) $58 billion acquisition of AirTouch in 1999 (*Wall Street Journal*, 1999).

- **Location of Investment**

largest investors in the United States are the United Kingdom, Japan, and the Netherlands, accounting in 2001 for about 16, 12, and 12 percent, respectively, of FDI there (*BEA Current and Historical Data*, 2003). The largest locations of U.S-owned FDI in 2001 were in the United Kingdom, Canada and the Netherlands, which held 18, 10, and 10 percent of the value of U.S-owned FDI. The major recipients of FDI are developed countries, which received about 79 percent of the world's total in 2001. However, for 2001 a larger share went to developing countries, primarily because of a drop in inflows to developed countries from 2000 to 2001 of more than half because of an economic slowdown (*www.oecd.org*, 2002). Nevertheless, inflow to developing countries also fell, but not by as much. The small share going to emerging economies has caused concern about how those economies will meet their capital needs.

The interest in developed countries has come about for three main reasons:

1. More investments have been market seeking, and the markets are larger in developed countries.

1. Political turmoil in many emerging economies has discouraged investors.
2. The industrial nations, through the Organization for Economic Cooperation and Development (OECD), are committed to liberalizing direct investment among their members.

The OECD operates (with exceptions) under a principle that member countries should treat foreign-controlled companies no less favorably than domestic ones in such areas as taxes, access to local capital, and government procurement. The OECD member countries also have agreed on procedures through which direct investors can resolve situations that may result from conflicting laws between their home and host countries.

TABLE 1.1

THE WORLD'S 25 LARGEST TNCS, RANKED BY FOREIGN ASSETS, 2000

(Billions of dollars and number of employees)

Note that all the companies are from developed or newly industrialized countries.

RANKING 2000 BY FOREIGN ASSETS	CORPORATION	COUNTRY	INDUSTRY	ASSETS. FOREIGN	SALES FOREIGN	EMPLOYMENT FOREIGN
1	Vodaphone	United Kingdom	Telecommunications	221.2	7.4	24,000
2	General Electric	United States	Electronics	159.2	49.5	145,000
3	ExxonMobil	United States	Petroleum expl./ref./distr.	101.7	143.0	64,000
4	Vivendi Universal	France	Diversified	93.3	39.4	210,084
5	General Motors	United States	Motor vehicles	75.2	48.21	65,300
6	Royal Dutch/Shell Group	The Netherlands/ United Kingdom	Petroleum expl./ref./distr.	74.8	81.1	54,337
7	BP	United Kingdom	Petroleum expl./ref./distr.	57.5	105.6	88,300
8	Toyota Motor	Japan	Motor vehicles	56.0	622	
9	TelefOnica	Spain	Telecommunications	56.0	12.9	71,292
10	Fiat	Italy —	Motor vehicles	52.8	35.9	112,224
11	IBM	United States	Computers	43.1	51.2	170,000
12	Volkswagen Group	Germany	Motor vehicles	42.7	57.8	160,274
13	Chevron Texaco	United States	Petroleum expl./ref/dist.	42.6	65.0	21,693
14	HutchinsonWhampoa	Hong Kong	Diversified	41.9	2.8	27,165
15	Suez	France	Diversified/utility	38.5	24.1	117,280
16	DaimlerChrysler AG	Germany/United States	Motor vehicles	...	48.7	83,464
17	News Corporation	Australia	Media	36.1	12.8	24,500
18	Nestlé 5.A.	Switzerland	Food/beverages	35.3	48.9	218,112
19	Total Fina SA	France	Petroleum expl./ref/dist.	33.1	82.5	30,020
20	Repsol YPF	Spain	Petroleum expl./ref/dist.	29.8	9.1	
21	BMW	Germany	Motorvehicles	31.2	26.1	23,759
22	Sony Corporation	Japan	Electronics	30.2	42.8	109,080
23	E.On	Germany	Electricity, gas and water		41.8	83,338
24	ABB	Switzerland	Electrical equipment	28.6	22.5	151,340
25	Phillips Electronics	Netherlands	Electrical & Electronic equipment	27.9	33.3	1 84,200

Note: United Nations Conference on Trade and Development, *The World Investment* Report (Geneva and New York: United Nations, 2002), p. 86. Measurements are based on 10 percent ownership or more. Only nonfinancial companies are included. In some companies, foreign investors may hold a minority share of more than 10 percent.

expl./ref/dist.= exploration, refining, and distribution

CHAPTER TWO

GOVERNMENT ATTITUDES TOWARD FOREIGN DIRECT INVESTMENT

2.1 EVALUATING THE IMPACT OF FDI

Developing and industrial countries have deregulated their markets, privatized national enterprises, liberalized private ownership, and encouraged regional integration in an effort to create more favorable settings for foreign investments. Total worldwide FDI flows surged in this environment, rising from $202 billion in 1990 to a record $1.3 trillion in 2000 (*Geneva: UNCTAD*, 2001).

Now we are going to discuss how FDI benefits countries. FDI has come to be seen as a major contributor to growth and development, bringing capital, technology, management expertise, jobs, and wealth. However, FDI is not without controversy (*Northampton, MA: Edward Eglar*, 1999). Many countries that opened their markets to FDI experienced economic and social disruptions; they also watched investments by MNEs constrain existing or potential domestic companies. MNEs have also run into problems; many made big foreign investments that have performed poorly. As a result, the first years of the twenty-first century saw declining volume of FDI worldwide (*Louis Uchetelle,* 2002).

As MNE managers and as national citizens, we need to understand the costs and benefits of FDI. Companies, in the quest to optimize their performance, allocate resources among different countries. However, this allocation is influenced by governments' interpretation of the relative costs and benefits of FDI. As managers, we must be aware of these interpretations and, at times, try to clarify them. As citizens, we need to argue for government policies that will enhance national interests. Both responsibilities require understanding why countries would react to FDI, like China, with opposition, suspicion, or cooperation.

2.1.1 Trade-offs Among Constituencies

To prosper and survive, a company must satisfy different groups, which we call stakeholders. Stakeholders include stockholders, employees, customers, and society. In the short term the aims of these groups conflict. Stockholders want additional sales and increased productivity, which result in higher profits and higher returns for them. Employees want safer workplaces and higher compensation. Customers want higher quality products at lower prices. Society would like to see increased corporate taxes, more corporate support for social services, and trustworthy behavior. In the long term, all of these aims must be achieved adequately because each stakeholder group is powerful enough to cause a company's demise.

Pressure groups lobby governments to restrict MNEs' activities at home and abroad. Although management must be aware of these competing interests, it has to serve them unevenly at any given period. At one time, gains may go to consumers; at another, to stockholders. Making necessary tradeoffs is difficult in the home environment. Abroad, managers' poorer familiarity with customs and stakeholders complicates the challenge of choosing the best alternative—particularly if dominant interests differ among countries.

The principal difficulty for MNEs in overseas relationships is not so much trying to serve conflicting interests within various countries. Rather, it is the challenges that arise from MNEs' attempts to handle cross-national controversies in ways that let them still achieve global objectives. That is, MNEs' choice of where to locate their plants influences which countries will prosper. Consequently, stakeholders in any given country seek to achieve their own, rather than global, objectives. For example, laborers in the United States have shown little concern for the number of jobs that their employers create in foreign markets. They have pushed for legislation to increase the number of jobs in the United States. Managers' tasks, then, are complicated because the decisions they make in one country most likely have repercussions in another. The fact that these decisions determine the destination of jobs, profits, taxes, and capital flows attracts the interests of stakeholders and governments.

2.1.2 Trade-offs Among Objectives

An MNE's actions may affect a country's economic, social, and political objectives. However, a positive effect on one objective, such as technology transfer, may accompany a negative effect on another objective, such as unemployment. Therefore, although a country hopes that an MNE can solve a given problem, it has to prepare for the costs created by the benefit. Naturally, governments want benefits with little or no costs; this, though, is seldom possible (Ashish Arora, 2002). Therefore, countries must rank their objectives, somehow resolving the unavoidable tradeoffs among objectives.

Similar ideas influence how people see FDI. People sometimes mistakenly assume one stakeholder gains from FDI, and then another must lose (Jean J. Boddewyn and Thomas L. Brewer.). They might also assume that if there are gains in one country from FDI, then there must be losses in another country. Either may happen, but it is also possible that multiple stakeholders in more than one country will either gain or lose. In theory, no party would participate willingly in FDI pacts with the belief that the investment would harm its priorities. Controversies develop because agreements fail to work as planned, the weight given to the objectives changes, or disputes emerge over the distribution of gains even when these gains have benefited all the parties. The latter problem is at the heart of most controversies over FDI. China encouraged foreign investment that transferred technology and management skills to its economy to try to manage this problem.

2.1.3 Cause-Effect Relationships

Just because two factors move in relation to each other does not necessarily mean they are interdependent. Still, opponents of FDI try to link the actions of MNEs to matters like inequitable income distribution, political corruption, environmental debasement, and societal deprivation (Mohsin Habib and Leon Zurawicki, 2002). On the other hand, proponents link their actions to higher tax revenues, employment, innovation, and exports. These sorts of linkages often arise when governments consider either restricting or encouraging FDI. Although the data presented by opponents or proponents of MNEs often are accurate and convincing, there is always the problem of speculating about what would have happened had MNEs gone elsewhere or followed different practices. Technological

developments, competitors' actions, and government policies are just three of the variables that distort the analysis of cause a

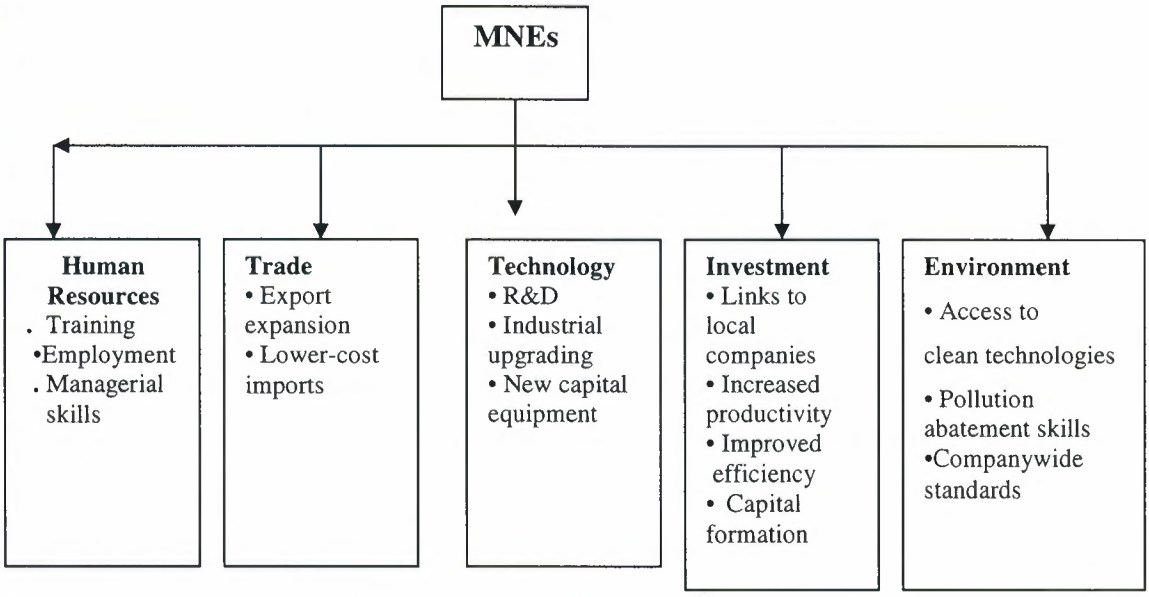
2.1.4 Individua1 and Aggregate Effects

One astute observer noted, "Like animals in a zoo, multinationals (and their affiliates) come in various shapes and sizes, perform distinctive functions, behave differently, and make their individual impacts on the environment (John H. Dunning1974). Some countries have tried to evaluate MNEs and their activities individually. Although this process might lead to greater fairness and better control, it is time-consuming and costly. Therefore, many countries apply the same policies and control mechanisms to all MNEs. This approach eliminates some of the bureaucracy, but it risks throwing out some "good apples' along with the bad. Further, when examining foreign investments on an individual or an aggregate basis, governments have been far from perfect in predicting future impacts.

2.1.5 Potential Contributions of MNEs

MNEs have assets that can contribute to a range of national objectives. MNEs control a large portion of the world's capital, a factor that increases production. They account for most of the world's exports of goods and services, thereby creating access to foreign exchange for a country's purchase of imports. They are the major producers and organizers of technology, which is crucial to improving national competitiveness and solving environmental problems (Geneva: UNCTAD, 1999). Figure 2.1 shows the major assets of MNEs that can satisfy stakeholders' objectives. Nevertheless, critics argue that MNEs use their assets inadequately when trying to satisfy these objectives.

FIGURE 2.1 RESOURCES AND POSSIBLE CONTRIBUTIONS



MNEs can contribute directly to investment, human resources, technology, trade, and the environment, thus contributing to host-country objectives.

Source: Adapted from Transnational Corporations and Management Division, World Investment Report 1992.

2.2 ECONOMIC IMPACT OF THE MNE

MNEs may affect countries' balance-of-payments, growth, and employment objectives. Under different conditions, these effects may be positive or negative for the host or home country.

2.2.1 Balance-of-Payments Effects

Countries want capital inflows because such inflows allow them to increase their imports.

However, because FDI brings both capital inflows and outflows, countries fear that the net balance-of- payments effect may be negative.

Place in the Economic System If a country runs a trade deficit, it must compensate for that deficit either by reducing its capital reserves or by attracting an influx of capital. The influx of capital may be from unilateral transfers (such as foreign aid), from the receipt of credit, or from the receipt of foreign investment (Paul Krugman, 1996). Put another way, the more capital inflows country receives, the more it can import and the more it can run a trade deficit. The capacity to run a trade deficit is especially important for developing countries because they typically have more goods and services available for their use than they produce themselves. The ability to use these additional resources helps them achieve their growth objectives. FDI has recently become a more crucial factor in the effort to contribute capital to developing countries (William Easterly, 2002). For example, China has been a large net receiver of FDI; it has also been running a trade surplus (John Schauble, 2002). This capital accumulation has gone toward the buildup of Chinese reserves, which it holds largely in U.S. Treasury bills. These reserves will enable China to finance future trade deficits that will be necessary to fund infrastructure projects.

Like China, other countries attempt to regulate trade and investment movements and the capital flows that parallel those movements. They do this through incentives, prohibitions, and other types of government intervention (Evan Osbome, 2001). An important aspect of the balance of payments is that gains are a zero sum game—one country's trade or capital surplus is another country's deficit. If both countries looked only at a fixed period, then one country might justifiably be described as a winner at the expense of the other. In fact, a country may be willing to forgo short-term surpluses in favor of long-term ones, or vice versa. As countries regulate capital flows, they influence companies' decisions on whether to invest in their local markets. These countries also constrain companies' ability to transfer income from FDI to other countries.

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Aggregate Assumptions and Responses Generally, MNEs' investments are initially

favorable to the host country and unfavorable to the home country. However, the situation reverses after some time (Ravi Ramamurti, 2001). This occurs because nearly all investors plan eventually to remit to the parent company more than they sent abroad. If the net value of the FDI continues grow through retained earnings, dividend payments for a given year ultimately may exceed the total capital transfers that comprised the initial investment.

From the standpoint of home countries, restrictions on capital outflow improve the availability of short-term capital. These restrictions, however, reduce future earnings inflows from foreign investments. In addition, host country restrictions may erode confidence in the economy because companies fear they cannot move their funds where they want them. This fear reduces capital inflows and spurs capital flight. Consequently, capital outflow restrictions are useful only in buying the time needed to institute other means for solving balance-of- payments difficulties (George J. Kaufman, 2000).

Governments also have sought to attract inflows of long-term capital as a means to develop production that will displace imports or generate exports. Countries, then, must determine how to benefit from FDI while minimizing the long-term adverse effects on their balance of payments. Many countries have approached this problem by strictly valuing new FDI based on contributions of freely convertible currencies, industrial equipment, and other physical assets—not on contributions of goodwill, technology, patents, trademarks, and other intangible assets. The basis of valuation helps determine the regulations on the maximum repatriation of earnings by the MNE, such as a percentage of the FDI valuation. Normally, the maximum is expressed as a percentage of the investment's value. Negotiating a lower stated value for the FDI lets the host government minimize the eventual repatriation earnings. Doing so requires that governments strictly inspect the declared value of the equipment brought into their countries, especially when the investor is also the equipments supplier, to prevent inflated valuations. In addition, host governments often require part of capital contribution to be in the form of loans. Whereas dividends from earnings on equity are capital outflows that can continue indefinitely, interest payments on loans are capital outflows that continue until the loans are repaid.

2.2.2 Growth and Employment Effects

Classical economists assumed that movement of production factors abroad would result in

an increase in output abroad and a decrease at home. Even if this assumption were realistic, the gains in the host country might be greater or less than the losses in the home country.

The argument that both the home and the host countries may gain from FDI rests on two assumptions: (1) Resources are not necessarily fully employed, and (2) capital and technology cannot be easily transferred from one industry to another. For example, a soft-drink maker may be producing at maximum capacity for its domestic market but is limited in developing export sales due to high transportation costs. Further, the company may not simply move into other product lines or easily use its financial resources to increase domestic productivity. Establishing a foreign production facility, however, positions the company to develop foreign sales without reducing resource employment in its home market. In fact, it may hire additional domestic managers to oversee the international operations and receive dividends and royalties from the foreign use of its capital, brand, and technology.

Although stakeholders in both home and host countries may gain from FDI, some stakeholders argue that they are economic losers. Let's examine their arguments.

Home Country Losses The United States is the home country for the largest amounts of foreign licensing and direct investment. Hence, its policies invite close examination. A leading detractor is organized labor, which argues that foreign production often displaces what would otherwise be jobs in the United States (Peter Wilamoski, 1999). Detractors cite examples of advanced technology that has been at least partially developed through government contracts and then transferred abroad. In fact, some U.S. MNEs move their newest technologies abroad and, in some cases, manufacture abroad before they do so in the United States. An example is Boeing's transfer of aerospace technology to China to produce aircraft parts. According to critics, if Boeing did not transfer the technology, China would have had to purchase the products in the United States, thereby increasing employment and output there. These critics further argue that such technology transfer will speed the process of China's gaining control of future global aircraft sales. Alternatively, others counter that had Boeing not found a way to make the sale, then China might have bought from Airbus Industrie or independently developed the technology itself (Jeff Cole,

2001).

Another question is whether outsourcing production causes wages to decline in the home country. Anecdotal evidence suggests it does. For example, call handlers' salaries are 85 to 90 percent lower in India than in the United Kingdom. Even though the costs of information technology infrastructure are higher in India, total operating costs in India are 35 lower than in the United Kingdom. Consequently, British unions' attacks on declining wage levels in the U.K.'s 3,500 call centers met the warning that British operators must improve their service quality or else lose their jobs (Jonathon Guthrie, 2001). In contrast, evidence suggests that moving jobs to lower-wage countries increases the overall home-country demand and wages for skilled labor. MNEs can use the cost savings that result from producing abroad to lower prices that, in turn, generate more demand. For example, Nike uses inexpensive overseas labor to make its shoes and this lowers the price of its shoes and increases demand. Nike then needs more higher-skilled and higher-paid managerial personnel in the United States (Robert Feenstra and Gordon Hanson, 1995).

Host-Country Gains Most observers agree that an inflow of investment from MNEs can stimulate local development through the employment of idle resources. Companies will want to move resources, such as capital and technology, abroad when the potential return is high—especially to those markets where they are scarce. Certainly, the mere existence of resources in a country does not guarantee that they will contribute to output. MNEs, how ever, may enable idle resources to be used. Oil production, for instance, requires not only the presence of underground oil deposits but also the knowledge of how to find them, the capital equipment to extract it, and the facilities to refine it. Simply pumping oil is wasteful without markets and transportation facilities, which an international investor may be able to supply.

FDI by MNEs can initiate the upgrading of resources by educating local personnel to use equipment, technology and new production methods (Vinish Kathuria, 2001). Seemingly minor programs, such as promoting on-the-job safety, can reduce lost worker time and machine downtime. This occurred after the U.S. company Renbco acquired Doe Run Peru, a metallurgical complex (Sally Bowen, 1999). The transfer of innovative work methods increases productivity, thereby freeing time for other activities. Further, additional

competition may push existing companies to improve their efficiency. This happened with European retailers after Wal-Mart entered the European market and with Japanese retailers after Tower Records and Gap entered the Japanese market (Bayan Rahman and Marico Sanchana, 2002).

Host-Country Losses Critics argue that MNEs make investments that domestic companies otherwise would have made, thereby displacing potential local entrepreneurs. Similarly, foreign investors may bid up prices by competing with local companies for labor and other resources—such as when local companies in northern Indiana in the United States complained about Toyota's hiring its best workers by paying them higher wages (of course, the workers did not object (Timothy Aeppel, 1999). Such critics argue, for example, that MNEs can raise lower cost funds in different countries because they have operations in those countries and are known in those financial markets. Local companies, especially those operating only domestically in a developing country, do not have these options. Thus, MNEs can tap cheaper capital and reduce their capital cost relative to that of local companies. The MNEs can then pay more to attract the best personnel or use more promotions to lure customers from competitors and still earn profits. Evidence for these arguments is inconclusive. MNEs frequently pay higher salaries and spend more on promotion than local companies do. It is uncertain, how ever, whether these differences result from external advantages or represent the added costs of attracting workers and customers upon entering new markets. Higher compensation and promotion expenses may offset any external cost advantages obtained from access to cheaper foreign capital. Additionally, in many instances, the local competition can also raise funds in other countries.

Critics contend that FDI destroys local entrepreneurship, an outcome that affects national development. Because the reasonable expectation of success is necessary to inspire entrepreneurship, the collapse of small cottage industries in the face of MNEs' consolidation efforts may make the local population feel incapable of competing. A good deal of evidence questions this contention (William Keng and Mun Lee, 1997). The presence of MNEs may increase the number of local companies in host-country markets because the MNEs serve as role models that local talent can then emulate. Moreover, an

MNE buys many services, goods, and supplies locally that may stimulate local entrepreneurship. For example, automobile producers typically add less than half the value of an automobile at the factory, buying the remaining parts, subassemblies, and modules from suppliers, some of whom are local companies. In China, positive spillovers from FDI have contributed to Chinese companies' acquisition of financial resources, which has helped them become viable suppliers (Haishun Sun, 1998). Finally, some maintain that true entrepreneurs will see large MNEs not as obstacles but as challenges.

There is evidence that local R&D can enhance a country's competitive capability (Wilbur Chung, 1998). However, a country needs a strong technological base if its R&D will create the foundation for product leadership. Therefore, governments seek technology from MNEs to establish their bases and then seek local R&D to build on those bases. At this point, some evidence suggests that dependence on FDI constrains host countries from developing workable R&D (Susan E. Fienberg, 2001). For example, Japan, Korea, Taiwan, and China have been much more restrictive on FDI inflows than have Malaysia, Singapore, and Thailand. The former countries spend much more on R&D as a percentage of gross domestic products than do the latter ones. China's original preference for FDI in the form of joint ventures with Chinese companies, for instance, reflected its desire to use foreign technology to develop local R&D capabilities. MNEs entered joint ventures with Chinese companies that had a base of product experience that positioned them to absorb the incoming technology. Ultimately, China reasoned that its home companies would build on the technology they absorbed through independent and indigenous R&D. This approach, though, is risky; a country that limits foreign ownership may discourage other companies from transferring their technologies (Theodore H. Moran, 1998).

Another argument is that investors learn better ways of doing things abroad. By observing foreign competitive conditions, they may gain access to new technology that they can transfer to their home countries. Such early access, however, may prevent the original developers from fully exploiting their technologies. It may also prevent the originating country from fully capturing the economic benefits of the innovations developed by its residents. For example, foreign investment, especially from Japan, has grown rapidly in high-tech industries in California's Silicon Valley. This FDI may allow non-U.S. companies to develop competitive in their home countries that are based on U.S. scientific

and technical investments (David J. Teece, 1992). However, Japanese companies in Silicon Valley also spend heavily on R&D, and their results spillover to nearby U.S. companies (Manuel G. Seraio, and Donald H. Dalton, 1999).

Critics assert that MNEs' use of local funds, by borrowing either locally or by receiving investment incentives, reduces the funds that are available to local companies (Martin Feldstein, 1994). This question then arises: Does this development necessarily mean that local companies lack access to funding sources? The answer is unclear (European Economic Review, 2000). For MNEs to have a material effect on capital availability in a country requires that the amount of funds diverted to those investors be larger than is typically the case. Further, few MNEs acquire all resources locally; capital transfers that are used to start up and then fund ongoing operations usually benefit the host economy. Still, some countries try to manage this risk, restricting local borrowing by MNEs and providing incentives for them to locate in depressed areas that have idle resources.

Many countries are alarmed when a foreign company buys a local firm. Debate persists over the employment effects of foreign acquisitions because of assumptions about what would have happened had the acquisition not taken place, particularly when the local company that is not doing well is then downsized. It is difficult to determine that there was more or less employment because of the acquisition. No matter what the circumstances are, it is ultimately speculation about what might have happened had the foreign acquisition not taken place (Barry P. Bosworth and Susan M. Collins, 1999).

General Conclusions Nor all MNE activities will have the same effect on growth in the home or the host country. Complicating any analysis is the difficulty of identifying and reliably measuring the effects of MNES' activities. The following observations help identify those situations in which foreign investment is likely to make a positive contribution to a host country:

1. *Developing countries and developed countries.* Developing countries are less likely than developed countries to have domestic firms capable of making investments like those made by foreign investors from developed countries. Therefore, foreign investment in developing countries is less likely to substitute for domestic investment; it tends to yield more growth than if it were located in developed countries.

2. *Degree of product sophistication.* When the foreign investor seeks to make highly differentiated products or to introduce new process technologies, local companies are less likely to undertake similar production on their own. The differentiation may derive from product style, quality, brand name, and technology

3. *Access to resources.* A foreign investor with access to resources that local companies cannot easily acquire is more likely to generate local growth than merely substitute for what local companies would otherwise do. Some of these resources are capital and access to foreign markets.

4. *Degree of development of the country.* Foreign investors are more likely to transfer management processes and production technologies to the more economically advanced of the developing countries because such investors are better prepared to absorb these ideas.

2.3 DEFERENCES IN NATIONAL ATTITUDES TOWARD MNEs

In theory, host countries may take completely restrictive or laissez-faire positions toward MNEs. In actuality, their policies are seldom completely restrictive or completely laissez-faire but rather ebb and flow over time. Currently, countries such as Bhutan and Cuba are close to the restrictive end, and countries such as the United States and the Netherlands are near the laissez-faire end of the continuum. Countries between these extremes adopt policies with varying degrees of restrictions as they attempt to attract investment and receive the most benefit it. Presently, the effort to attract FDI has led more host governments to adopt policies that move their countries toward the laissez-faire end of the continuum.

The concern of home- and host-country stakeholders about MNEs' international operations increases with their international commitments. For example, home-country stakeholders are generally unconcerned when a company begins to export, but they are concerned when the company begins producing abroad because they fear that jobs, technology, and growth are being transferred. Likewise, host-country stakeholders pay

more attention to foreign companies that are wholly owned direct investments than to those that share ownership locally or those that merely export into their market. Closer scrutiny occurs in such cases because the company now employs local personnel and---with full ownership---it may be able to pursue global or home-country objectives at the expense of local ones. Therefore, the need for companies to justify the benefit of their local operations grows in tandem with their international commitments.

Countries tend to be more concerned about large companies than small ones because of the former's greater potential impact on national economic and political objectives. However, not all companies that operate internationally are large. Smaller companies generally have less significant foreign investments and have an easier time justifying their entry and operations. Because officials presume small companies have a smaller impact on host societies, countries often treat their FDIs differently. Further, the governments of many developing countries prefer smaller MNEs because such MNEs may be more willing to support country ambitions, increase local competition because of their numbers, and supply smaller scale technology that is better suited to local needs (Carol Graham, 2001).

The perception of a company's operations in one country may have an effect on the perception of stakeholders in other countries. For example, a company's confrontation with labor, tax authorities, or environmental pressure groups in one country may cause similar stakeholders in another country to be warier of the company. Further, improving communications can widely publicize negative reports about company practices. As an MNE expands to more countries, the odds of negative perceptions about its impact increases.

The relationship between MNEs and societies has generated so many allegations and controversies that it is impossible to investigate all of them in this chapter.

CHAPTER THREE

COUNTRY EVALUATING AND SELECTION

3.1 CHOOSING MARKETING AND PRODUCTION SITES, AND GEOGRAPHIC STRATEGY

Companies must determine where to sell and where to produce. In so doing, managers will need to determine which markets they should serve and where they should place production to serve those markets. Many service industries, such as hotels, construction and retailing, must locate facilities near their foreign customers, so decisions on market and production location are connected. If a company develops a product that consumers find attractive, it must still find means to produce and transport the product cheaply enough so that consumers will buy it. Finding the right production location, which may be abroad, allows the company to sustain a long-term competitive edge.

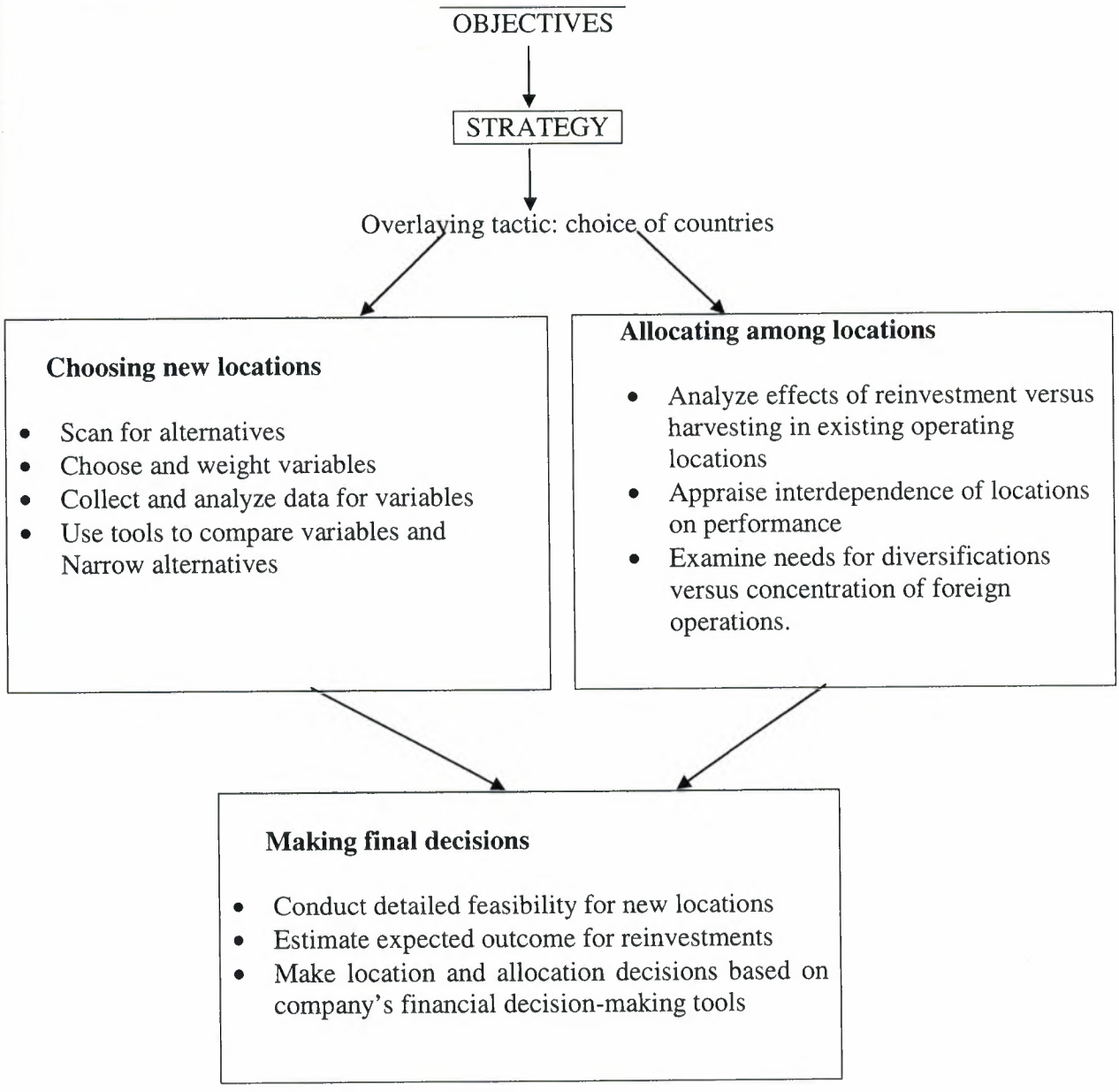
Decisions on market and production locations may be highly interdependent for other reasons. A company may have excess production capacity already in place that will influence its ability to serve markets in different countries.

The process of determining an overall geographic strategy must be flexible because country conditions change. A plan must let a company both respond to new opportunities in different locations and withdraw from less profitable ones. Unfortunately, there is little agreement on a comprehensive theory or technique for choosing the best location. Further, it is hard for companies to formulate strategies when they have to make assumptions about factors in the foreign environment, such as future costs and prices, competitors' reactions, and technology.

Nevertheless, managers can use several geographic strategies. A company may expand its international sales by marketing more of its existing product line. Most companies begin by asking, "Where can we sell more of our products?'' Alternatively, they can ask, 'What new product can we make to maximize sales in a given market?' In this chapter, we assume that companies have pursued the first question. In essence, a company needs to decide

where to operate and what portion of operations to place within each location. Figure 3.1 shows the major steps international business managers must take in making the decisions.

FIGURE 3.1 Flowchart for Choosing Where to Operate



3.2 SCAN FOR ALTERNATIVE LOCATIONS

To compare countries, managers use scanning techniques based on broad variables that indicate opportunities and risks. That way, decision makers can perform a detailed analysis of a manageable number of geographic locations.

A company can easily overlook some promising options. Some locations may be skipped rather than rejected, simply because managers either never think of them or because they eliminate consideration of a whole region. Or a company may decide to go where "every one has gone".

A detailed analysis of every alternative might result in maximized sales or a least-cost production location, but the cost of so many studies would erode profits. A company with 1,000 products that might locate in any of 150 countries would need 150,000 different studies.

3.3 CHOOSE AND WEIGHT VARIABLES

When scanning, managers will take the environmental climate into consideration. The environmental climate is the external conditions in a host country that could significantly affect the success or failure of a foreign business enterprise. It can determine whether a company will make a detailed study as well as the terms under which it will initiate a project. The environmental climate reveals both opportunities and risks.

3.3.1 Opportunities

Managers make investment decisions after weighing opportunities against risks. Opportunities are determined by revenues less costs. From a broad scanning perspective, there are variables that indicate the amount of revenue, cost factors, and risk that might be forthcoming from one country to another.

The factors that have the most influence on the placement of marketing and production emphasis are market size, ease and compatibility of operations, costs, resource availability,

and red tape. Some of these variables are more important for the market-location decision; others are more important for the production-location decision. Some variables affect both.

Market Size Sales potential is probably the most important variable managers use when determining where and whether to make an investment. The assumption, of course, is that sales will occur at a price above cost, so that where there are sales, there are profits.

In some cases, a company can obtain past and current sales figures on a country-by-country basis for the type of product it wants to sell. In many cases, however, such figures are unavailable. Nevertheless, management must make projections about what will happen to future sales (Philip Parker, 1998). Often, data such as GNP, per capita income, growth rates, population, and level of industrialization are also good indicators of market size and future sales. Further, demographic factors other than income influence potential demand, such as age, gender, religion, and ethnic background. For example, Pollo Campero, a Guatemalan-based fast-food chain, successfully entered the United States by going to cities with large Central American populations (David Gonzalez, 2002).

Ease and Compatibility of Operations Managers prefer to go where they perceive it's easier to operate. U.S. companies put earlier and more emphasis on Canada, the United Kingdom, and Mexico than would be indicated by those countries' economic sizes. These companies rank Canada and Mexico high because of geographic proximity, which make it easier and cheaper for the companies to ship merchandise to and to control their foreign subsidiaries. Moreover, since the advent of NAFTA, U.S. companies encounter fewer border restrictions for their operations in Canada and Mexico than they do for most other locales. Also, at the early stages of international expansion, managers feel uncomfortable doing business in a dissimilar language, culture, and legal system, and this helps explain why U.S. companies' prefer to operate in Canada and the United Kingdom as opposed to, say, Russia (Mikhail V. Gratchev, 2001).

After companies pare alternatives to a reasonable number, they must prepare much more detailed feasibility studies. These studies can be expensive. The more time and money companies invest in examining an alternative, the more likely they are to accept it regardless of its merits, a situation known as an *escalation of commitment.* A feasibility

study should have clear-cut decision points, points at which managers can cut the commitment before it escalates.

Proposals for expansion may originate almost anywhere within a company, but top-level managers should have the final say in whether they are approved because a company needs to put its limited resources to the best possible use.

Companies may limit consideration of proposals to countries that will permit them to operate with product types and plane sizes familiar to the managers. From a policy standpoint, management may find it useful to ensure that its proposal group includes personnel with backgrounds in each functional area—marketing, finance, personnel, engineering, and production. Further, companies limit consideration of proposals to only those countries that permit them to own an acceptable percentage of operations and that allow sufficient remittance of profits.

Costs and Resource Availability So far, we have discussed market-seeking operations. However, companies also go abroad to secure resources that are either unavailable or expensive in their home countries. They must examine labor costs, raw material inputs, capital requirements, utilities, real estate costs, taxes, and transportation costs in relation to productivity. Before collecting all this information in a final feasibility study, the company can narrow the alternative locations by examining a few key indicators.

Labor compensation is an important cost of manufacturing for most companies. However, capital intensity is growing in most industries, which reduces labor costs as a percentage of total costs and reduces the differences in production costs from one location to another. At any rate, companies can examine current labor market size, labor costs, trends in those costs, and unemployment rates to approximate labor availability and cost differences among countries. Labor, however, is not homogeneous. If country's labor force lacks the specific skill levels required a company may have to train, redesign production, or add supervision—all of which are expensive. In the case of specialized units, such as an R&D lab, the existing availability of specific skills is almost essential (David Luchnow, 2002).

When companies move into emerging economies because of labor-cost differences, their advantages may be short-lived because:

- Competitors follow leaders into low-wage areas.
- There is little first-in advantage for this type of production migration.
- Foreign costs rise quickly as a result of pressure on wage or exchange rates.

As a result, some companies, especially those with rapidly evolving technologies, seek to locate production close to product-development activities. Doing this allows for a tight link between product and process technologies (for example, making smaller disk drives is as much a manufacturing problem as it is a technical one), a faster market entry with new products, and unique production technologies that cannot be easily copied by competitors (Andrew Bartmess and Keith Cerny, 1993). These factors tend to push more of a company's production into industrial countries, in which most R&D occurs. However, a geographically isolated country, such as New Zealand does not fit as easily into a company's global process-product integration strategy because of transportation time and cost (G. Bruce knecht, 2002).

Increasingly, companies need to be near suppliers and customers in an area where the infrastructure will allow them to move supplies and finished products efficiently. Regional headquarters should reside near specialized private and public institutions such as banks, financing firms, insurance groups, public accountants, customs brokers and consular offices, all of which handle international functions. If a company is looking for a production location that will serve sales in more than one country, the ease of moving goods into and out of the country is very important. The company may compare countries in terms of their port facilities and trade liberalization agreements with other countries (Lisa Bannon, 2002).

The continuous development of new production technologies makes cost comparisons among countries more difficult. As the number of ways in which the same product can be made increases, a company must compare the cost of producing with a large labor input in a low-wage country with that of producing with capital intensity in a high-wage country For example, Volkswagen moved production of its Golf Syncro from Germany to Slovakia and switched from a highly automated, capital-intensive assembly line to a labor-intensive plant because the low Slovakian wages and high productivity cut costs from those in

Germany (Financial Times, December 19, 1995). A company might have to compare large-scale production with reducing fixed costs per unit by serving multicountry markets and the latter has the advantage of multiple smaller-scale production units; the former has the advantage of reducing transport and inventory costs.

Red Tape Companies frequently compare the degrees of red tape needed to operate in given countries because red rape increases their operating costs. Red tape includes the difficulty of getting permission to operate; bringing in expatriate personnel; obtaining licenses to produce and sell certain goods; and satisfying government agencies on such matters as taxes, or conditions, and environmental compliance. For example, Vietnam has thousands of government employees who have the power to cause trouble for foreign businesses. Their actions reflect not only what they think is the national interest, but also their desire to protect friends and state companies from competition and to receive bribes for favors. As a result, such companies as Raytheon and Sheraton Hotels have closed their Vietnamese operations (Sheri Brasso and Paul Magnusson, 1999). The degree of red tape is not directly measurable, so companies commonly rate countries subjectively on this factor.

3.3.2 Risks

Is a projected rate of return of 9 percent in Bolivia the same as a projected rate of 9 percent in France? Should a company calculate return on investment (ROI) on the entire earnings of a foreign subsidiary or just on the earnings that can be remitted to the parent? Does it make sense for a company to accept a low return in one country if doing so will help the company's competitive position elsewhere? Is it ever rational for a company to invest in a country that has an uncertain political and economic future? These are but a few of the unresolved questions that companies must consider when making international capital-investment decisions.

Risk and Uncertainty Companies use a variety of financial techniques to compare potential projects, including discounted cash flow, economic value added, payback period, net present value, return on sales, return on assets employed, internal rate of return,

accounting rate of in, and return on equity.

Given the same expected return, most decision makers prefer a more certain outcome to less certain one. To calculate an estimated ROI, a company averages the various returns it deems possible for investments. Table 3.1 shows that two identical projected ROIs may have very different certainties of achievement as well as different probabilities. In the table, the certainty of a 10 percent projected ROI is higher for investment B than for investment A (40 percent versus 30 percent). Further, the probabilities of earning at least 10 percent is also higher for B (.40 + .30 .70 or 70 percent) than for A (.30 + .20 + .15 = .65 or 65 percent).

TABLE 3.1

COMPARISON OF ROI CERTAINTY

To determine the estimated return on investment, (1) multiply each ROI as a percentage by its probability to derive a weighted value and (2) add the weighted values. (The weighted value is probability X percentage)

	INVESTMENT A		INVESTMENT B	
ROI AS PERCENTAGE	PROBABILITY	WEIGHTED VALUE	PROBABILITY	WEIGHTED VALUE
0	.15	0	0	0
5	.2	1	.30	1.5
10	.3	3.0	.40	4.0
15	.2	3.0	.30	4.5
20	.15	3.0	0	0.0
Estimated ROI		10.0%		10.0%

Experience shows that most, but not all, investors will choose alternative B over alternative A. In fact, as uncertainty increases, investors may require a higher estimated ROI.

Often, companies may reduce risk or uncertainty by insuring. However, insuring against nonconvertibility of funds or expropriation is apt to be costly. In the initial process of scanning to develop a manageable number of alternatives, the company should give some weight to the elements of risk and uncertainty. At the later and more detailed stage of the feasibility study, management should determine whether the degree of risk is acceptable so that it does not incur additional costs. If it is not, management needs to calculate an ROI that includes expenditures—for example, for insurance—to increase the outcome certainty of the operation.

When a company operates abroad, it usually has higher uncertainty than at home because the foreign operations are in environments with which it is less familiar. As a company gains experience in operating in a particular country or in similar countries, it improves its assessments of consumer, competitor, and government actions—thereby reducing its uncertainty. In fact, foreign companies have a lower survival rate than local companies for many years.

Competitive Risk A company's innovative advantage may be short-lived. Even when it has a substantial competitive lead time, the time may vary among markers. One strategy for exploiting temporary innovative advantages is known as the imitation Lag. To pursue this strategy, a company moves first to those countries most likely to adapt and catch up to the innovative advantage, and later to other countries (Philip Paker, 1998). Those countries apt to catch up more rapidly are the ones whose companies invest a great deal in technology and whose governments offer little protection for the innovator's intellectual property rights. If the country also offers import protection, a local producer can, despite inefficiencies, gain a cost advantage over imported goods.

Companies also may develop strategies to find countries in which there is least likely to be significant competition. Further, companies try to gain first-entry advantage in markets likely to grow. By being the first major competitor in a market, it can gain the best partners, best locations, and best suppliers.

However, companies may gain advantages in locating where competitors are. To begin with, the competitors may have performed the costly task of evaluating locations, so a follower may get a "free ride." More recently, hundreds of high-tech computer companies from all over the world have located in Dubai (Huge Pope, 2001). These companies attract multiple suppliers and personnel with specialized skills. They also attract buyers who want to compare potential suppliers but don't want to travel great distances between them.

Monetary Risk If a company's expansion occurs through direct investment abroad, exchange rates on and access to the invested capital and earnings are key considerations. The concept of 'Liquidity preference' is a common theory that helps explain companies' capital budgeting decisions in general and can be applied to their international expansion decisions.

Liquidity preference is the theory that investors usually want some of their holdings to be in highly liquid assets, on which they are willing to take a lower return. Liquidity is needed in part to make near-term payments, such as paying out dividends; in part to cover unexpected contingencies, such as stockpiling materials if a strike threatens supply; and in part to be able to shift funds to even more profitable opportunities, such as purchasing materials at a discount during a temporary price depression (Robert C. Merton, Myron S. Scholes, and Fisher Black, 1998).

Sometimes companies want to sell all or part of their equity in a foreign facility so that the funds may be used for other types of expansion endeavors. However, the ability to find local buyers varies substantially among countries and among industries, depending largely on the existence of a local capital market and on the potential for the operation being sold. For example the Mexican conglomerate, Grupo Carso, spun off its stake in CompUSA, a process facilitated by CompUSA's potential profits and the developed U.S. capital market (Andrea Mendel, 2001). However when Nike canceled a contract with an Indonesian-Korean joint venture in Indonesia the partners simply had to close the operation (Sadanand Dhume and Maureen Tkacik, 2002).

Political Risk It occurs because of changes in political leaders' opinions and policies, civil disorder, and animosity between the host and other countries—particularly with the

company's home country. It may cause property takeovers as well as damage property, disrupt operations, and use a change in the rules governing business. Further, it may create expensive operational adjustments. Recently, for example, Unilever has encountered difficulty in attracting foreign executives to work in Pakistan because of security concerns, Occidental Petroleum has had to dedicate funds to protect its Colombian pipeline from rebel attacks, and Coca-Cola has had interrupted services (police protection of its trucks and telephone Connections) in Angola because of its policy against paying bribes (Farhan Bokhari, 2002). Managers use three approaches to predict political risk: analyzing past patterns, using expert opinion, and examining the social and economic conditions that might lead to such risk.

Companies cannot help but be influenced by past patterns of political risk. However, predicting the risk on that basis holds many dangers. Political situations may change rapidly for better or worse as far as foreign companies are concerned. For example, foreign direct investment into the United States fell sharply after the 2001 terrorist attack in New York because foreign firms saw the United States as less safe than before.

Asset takeover or property damage does not necessarily mean a full loss to investors. Governments have preceded most takeovers with a formal declaration of intent and have followed with legal processes to determine the foreign investor's compensation. Companies may examine past settlement patterns as an indicator of whether and how they may be compensated. In addition to the asset's book value, other factors may determine the adequacy of compensation. First, the compensation may earn a different return elsewhere. Second, other agreements (such as purchase and management contracts) may create additional benefits for the former investor. In analyzing political risk, managers should predict the likely loss if political problems occur.

Companies may also rely on experts' opinions about a country's political situation, with the purpose of ascertaining how influential people may sway future political events affecting business. The first step is reading statements made by political leaders both in and out of office to determine their philosophies on business in general, foreign input to business, the means of effecting economic changes, and their feelings toward given foreign countries. Modern technology has improved access to press reports in foreign countries. Online services include full-text reports from newspapers and television from major parts

of the world, and reports are sometimes available within hours of the original publication or broadcast. However, published statements may appear too late for a company to react. The second step is for managers to visit the country and "listen" to a cross-section of opinions. Embassy officials and foreign and local businesspeople are useful sources of opinions about the probability and direction of change. Journalists, academicians, middle-level local government authorities, and labor leaders usually reveal their own attitudes, which often reflect changing political conditions that may affect the business sector. These attitudes are particularly important in countries without a well-defined and transparent legal system. For example, Many U.S. companies have shied away from making investments in Russia because Russian tax and regulatory laws are so unstable and unpredictable (Thaddeus Herrick and Alexi Barrionuevo, 2002).

Companies may determine opinions more systematically by relying on analysts with experience in a country. These analysts might rate a country on specific political conditions that could lead to problems for foreign businesses, such as the fractionalization of political parties that could cause disruptive changes in government. A company also may rely on commercial risk-assessment services, such as those published by Business International, Economist Intelligence Unit, Euromoney, Political Risk Services (PRS), Bank of America World Information Services, Control Risks Information Services (CR1S), Institutional Investor, Moody's Investors Service, S. J. Rundt & Associates, Standard & Poor's Ratings Group, and Business Environment Risk Information (BERI). In fact, companies have been relying more on these services rather than on their internal generation of risk analyses. In essence, their reports generated internally are often too lengthy or abstract to be useful. Further, they are often not seen as credible by management decision makers (Marvin Zonis and Sam Wilkin, 2000).

Finally, companies may examine countries' social and economic conditions that could lead to political instability. However, there is no general consensus as to what constitutes dangerous instability or how such instability can be predicted. The lack of consensus is illustrated by the diverse reactions of companies to the same political situations. For example, before the coalition forces defeated Iraq's Hussein government in 2003 most MNEs avoided investing in Iraq because of political uncertainty—U.S. companies were not allowed to invest—but some companies made large foreign investments there (Andrew

Buncombe, 2002).

3.4 COLLECT AND ANALYZE DATA

Companies undertake business research to reduce uncertainties in their decision process, to expand or narrow the alternatives they consider, and to assess the merits of their existing programs. Efforts to reduce uncertainties include attempts to answer such questions as these: "Can qualified personnel be hired?" "Will the economic and political climate allow for a reasonable certainty of operations?" Alternatives may be expanded by asking, "Where are possible new sources of funds or sales?" Or they may be narrowed by querying, "Where among the alternatives would operating costs be lowest?" Evaluation and control are improved by assessing present and past performance: "Is the distributor servicing sufficient accounts?" "What is our market share?" Clearly, there are numerous details that, if a company ascertains them, can be useful to it in its efforts to achieve its objectives.

A company can seldom, if ever, gain all the information its managers would like. This is because of time constraints and the cost of collecting information.

3.4.1 Problems with Research Results and Data

The lack, obsolescence, and inaccuracy of data on many countries make much research difficult and expensive to undertake. Data discrepancies sometimes create uncertainties about location decisions. In most industrial countries, such as the United States, governments collect very detailed demographic and purchasing data, which are available cheaply to any company or individual.

Using samples based on available information, a company can draw fairly accurate inferences concerning market-segment sizes and locations, at least within broad categories. In the United States, the fact that so many companies are publicly owned and are required to disclose much operating information enables a company to learn competitors' strengths and weaknesses. Further, companies may rely on a multitude of behavioral studies dealing with U.S. consumer preferences and experience. With this available information, a company can devise questionnaires or do some test marketing using a selected sample so that responses reflect the behavior of the larger target group to whom the company plans to

sell. Contrast this situation to that of a country whose basic census, national income accounts, and foreign-trade figures are suspect and where no data are collected on consumer expenditures. In many countries, business is conducted under a veil of secrecy, consumers' buying behavior is a matter of speculation, market intermediaries are reluctant to answer questions, and expensive primary research may be required before meaningful samples and questions can be developed.

Reasons for Inaccuracies For the most part, incomplete or inaccurate published data result from the inability of many governments to collect the needed information. Poor countries may have such limited resources that other projects necessarily receive priority in the national budget. Why collect precise figures on the literacy rate, the leaders of a poor country might reason, when the same outlay can be used to build schools to improve that rate?

Education affects the competence of government officials to maintain and analyze accurate records. Economic factors also hamper record retrieval and analysis, because hand calculations may be used instead of costly electronic data-processing systems. The result may be information that is years old before it is made public. Finally, cultural factors affect responses. Mistrust of how the data will be used may lead respondents to answer incorrectly, particularly if questions probe financial derails.

Of equal concern to the researcher is the publication of false or purposely misleading information designed to mislead government superiors, the country's rank and file, or companies and institutions abroad. For example, an in-house investigation in China's National Bureau of Statistics found over 60,000 cases of statistical misrepresentations that distorted such important figures as GNP, economic growth, and energy use (James Kynge, 2002). Even if government and private organizations do not purposely publish false statements, many organizations may be so selective in the data they include that they create false impressions. Therefore, it is useful for managers to consider carefully the source of such material in light of possible motives or biases.

Comparability Problems Countries publish censuses, output figures, trade statistics, and base-year calculations for different time periods. So companies need to compare country figures by extrapolating from those different periods.

There also are numerous definitional differences among countries. For example, a category as seemingly basic as "family income" may include only the nuclear family—parents and children—in some countries, but it may include the extended family—the nuclear family plus grandparents, uncles, and cousins—elsewhere. Similarly, some countries define literacy as some minimum level of formal schooling, others as attainment of certain specified standards, and still others as simply the ability to read and write one's name. The definitions of accounting rules such as depreciation also differ, resulting in noncomparable net national product figures.

Countries vary in how they measure investment inflows. They might record the total value of the project (regardless of what portion may be locally owned or financed), the value of foreign capital invested, or the percentage of the project owned by foreign interests (Michael Stephan and Eric Pfaffmann, 2001).

Another comparability problem concerns exchange rates, which must be used to convert countries' financial data to some common currency. A 10-percent appreciation of the Japanese yen in relation to the U.S. dollar will result in a 10-percent increase in the per capita income of Japanese residents when figures are reported in dollars. Does this mean that the Japanese are suddenly 10 percent richer? Obviously not, because their yen income, which they use for about 85 percent of their purchase in the Japanese economy, is unchanged and buys no more. Even if changes in exchange rates are ignored, purchasing power and living standards are difficult to compare, because costs are so affected by climate and habit.

3.4.2 External Sources of Information

Although we have indicated variables that may be useful for making locational decisions. It is impossible to include a comprehensive list of information sources. There are simply too many. A routine search on the Internet often yields thousands of sources with full-text citations from thousands of sources. The following discussion highlights the major types of information sources in terms of their completeness, reliability, and cost.

Individualized Reports Market research and business consulting companies will conduct

studies for a fee in most countries. Naturally, the quality and the cost of these studies vary widely. They generally are the most costly information source because the individualized nature restricts prorating among a number of companies. However, the fact that a company can specify what information it wants often makes the expense worthwhile.

Specialized Studies Some research organizations prepare fairly specific studies that they sell to any interested company at costs much lower than those for individualized studies. These specialized studies sometimes are printed as directories of companies that operate in a given locale, perhaps with financial or other information about the companies. They also may be about business in certain locales, forms of business, or specific products. They may combine any of these elements as well. For example, a study could deal with the market for imported auto parts in Germany.

Service Companies Most companies that provide services to international clients—for example, banks, transportation agencies, and accounting firms—publish reports. These reports usually are geared toward either the conduct of business in a given area or some specific subject of general interest, such as tax or trademark legislation. Because the service firms intend to reach a wide market of companies, their reports usually lack the specificity a company may want for making a final decision. However, much of the data give useful background information. Some service firms also offer informal opinions about such things as the reputations of possible business associates and the names of people to contact in a company.

Government Agencies Governments and their agencies are another source of information. Different countries statistical reports vary in subject matter, quantity, and quality. When a government or government agency wants to stimulate foreign business activity, the amount and type of information it makes available may be substantial. For example, the U.S. Department of Commerce not only compiles such basic data as news about and regulations in individual foreign countries and product-location-specific information in the National Trade Data Bank, but it will also help set up appointments with businesspeople abroad.

International Organizations and Agencies Numerous organizations and agencies are supported by more than one country. These include the UN, the WTO, the IMF, the OECD, and the EU. All of these organizations have large research staffs that compile basic statistics as well as prepare reports and recommendations concerning common trends and problems. Many of the international development banks even help finance investment-feasibility studies.

Trade Associations Trade associations connected to various product lines collect, evaluate, and disseminate a wide variety' of data dealing with technical and competitive factors in their ~industries. Many of these data are available in the trade journals published by such associations; others may or may not be available to nonmembers.

Information Service Companies A number of companies have information-retrieval services that maintain databases from hundreds of different sources, including many of those already described. For a fee, or sometimes for free at public libraries a company can obtain access to such computerized data and arrange for an immediate printout of studies f interest.

The Internet Printed publications are quickly being transformed into archives that are older than information one may find on the Internet. This is because Internet changes appear immediately, whereas changes for periodicals must be printed, disseminated, cataloged, and shelved before they are available. The amount of materials available on the Internet and odd Wide Web is expanding very rapidly; however, finding these materials is still somewhat haphazard because of cataloging methods.

3.4.3 Internal Generation of Data

MNEs may have to conduct many studies abroad themselves. Sometimes the research process may consist of no more than observing keenly and asking many questions. Investigators can see what kind of merchandise is available, can see who is buying and where, and can uncover the hidden distribution points and competition. In some countries, for example, the competition for ready-made clothes may be from seamstresses working in

private homes rather than from retailers. The competition for vacuum cleaners may be from servants who clean with mops rather than from other electrical-appliance manufacturers. Surreptitiously sold contraband may compete with locally produced goods. Traditional analysis methods would not reveal such facts. In many countries, even bankers have to rely more on clients' reputations than on their financial statements. Accurate questioning may yield very interesting results. But such questioning is not always feasible. For example, Bass thinks that women consume most of its Barbicon Malt with Lemon, which sells well in Saudi Arabia. But it cannot be sure because in that country it cannot hold focus groups to discuss products, rely on phone books for random surveys, stop strangers on the street, or knock on the door of someone's house (Tara Parker-Pope, 1995).

3.5 COUNTRY COMPARISON TOOLS

Once companies collect information on possible locations through scanning, they need to analyze the information. Three common tools for analysis are *grids, matrices* and *environmental scanning*. However, once companies commit to locations, they need continuous updates, which they commonly make through environmental scanning. We shall now discuss grids and environmental scanning.

TABLE 3.2

SIMPLIFIED GRID TO COMPARE COUNTRIES FOR MARKET PENETRATION

Managers may choose which variables to include in the grid; this table is merely an example. Note also that managers may weight some variables as more important than others. Here, country I is immediately eliminated because the company will go only where 100-percent ownership is permitted. Countries II and IV are estimated to have the highest return; and countries II and III are estimated to have the lowest risk.

		COUNTRY				
VARIABLE	**WIEIGHT**	**I**	**II**	**III**	**IV**	**V**
1.Acceptable(A),Unacceptable(U) factors						
a. Allows 100-percent ownership	—	U	A	A	A	A
b. Allows licensing to majority-owned subsidiary	—	A	A	A	A	A
2. Return (higher number = preferred rating)						
a. Size of investment needed	0-5	—	4	3	3	3
b. Direct costs	0- 3	—	3	1	2	2
c. Tax rate	0-2	—	2	1	2	2
d. Market size, present	0-4	—	3	2	4	1
e. Market size, 3—10 years	0-3	—	2	1	3	1
f. Market share, immediate potential, 0—2 years	0-2	—	2	1	2	1
g. Market share, 3-10 years	0-2	—	2	1	2	0
Total			**18**	**10**	**18**	**10**
3. Risk (lower number = preferred rating)						
a. Market loss, 3—10 years (if no present penetration)	0-4	—	2	1	3	2
b. Exchange problems	0-3	—	0	0	3	3
c. Political-unrest potential	0-3	—	0	1	2	3
d. Business laws, present.	0-4	—	1	0	4	3
e. Business laws, 3—10 years	0-2	—	0	1	2	2

- **Grids**

A company may use a grid to compare countries on whatever factors it deems important. Table 3.2 is an example of a grid with information placed into three categories. The company may eliminate certain countries immediately from consideration because of characteristics it finds unacceptable. These factors are in the first category of variables, in which country I is eliminated. The company assigns values and weights to other variables so that it ranks each country according to attributes it considers important. For example, the table graphically pinpoints country II as high return—low risk, country III as low return—low risk, country IV as high return—high risk, and country V as low return—high risk.

Both the variables and the weights will differ by product and company depending on the company's internal situation and its objectives. The grid technique is useful even when a company does not compare countries because it can set the minimum score needed for either investing additional resources or committing further funds to a more detailed feasibility study. Grids do tend to get cumbersome as the number of variables increases. Although they are useful in ranking countries, they often obscure interrelationships among countries.

- **Environmental Scanning**

International companies rely on environmental scanning, which is the systematic assessment of external conditions that might affect their operations (Chun Wei Choo, 1999). For example, a company might assess societal attitudes that could foreshadow legal changes. Most MNEs employ at least one executive to conduct environmental scanning continuously. The most sophisticated of these companies tie the scanning to the planning process and integrate information on a worldwide basis. Companies are most likely to seek economic and competitive information in their scanning process, and they depend heavily on managers based abroad to supply them with information.

CHAPTER FOUR

JORDAN

Source: www.mapzones.com

4.1 OVERVIEW

Jordan is a small Country with an area of 89,287 Square Kilometers and approximately 5.3 million inhabitants. It is situated in the very heart of the Arab World with only one outlet to the sea at the port of Aqaba, located at the northernmost tip of the Red Sea. Jordan has common borders with Saudi Arabia, Iraq, Syria, Palestine, and Israel. Due to its geographic position, Jordan has played an important roll as a stabilizing political factor in the Middle East.

The Hashemite Kingdom of Jordan is a democratic constitutional monarchy with His Majesty King Abdullah II at the helm. Executive power is clearly defined and vested in the counsel of ministers. The legislative authority is composed of the two-chamber House of Parliament: The Upper House (senate) with 40 members appointed by the King and the eighty members elected Lower House (Chamber of Deputies). The authority as vested in the King requires that all laws be endorsed by Royal Decree before being published in the Official Gazette. The freedom of speech, press and religious belief are guaranteed by the Constitution.

4.2 COUNTRY'S PROFILE

Jordan : Currency	**Dinar**
Jordan : Population growth rate	**3%**
Jordan : Birth rate	**25.44 births/1,000 population**
Jordan : Death rate	**2.62 deaths/1,000 population**
Jordan : People living with HIV/AIDS	**N/A**
Jordan : Independence	**25 May 1946**
Jordan : National holiday	**Independence Day, 25 May**
Jordan : Constitution	**8 January 1952**
Jordan : GDP	**purchasing power parity - $17.3 billion**
Jordan : GDP - per capita	**purchasing power parity - $3,500**
Jordan : Electricity - consumption	**6.594 billion kWh**
Jordan : Exports	**$2 billion phosphates, fertilizers, potash, agricultural products, manufactures**
Jordan : Imports	**$4 billion crude oil, machinery, transport equipment, food, live animals, manufactured goods**
Jordan : Telephones	**403,000**
Jordan : Mobile cellular	**11,500**
Jordan : Radio broadcast stations	**AM 6, FM 5, shortwave 1**
Jordan : Radios	**1.66 million**
Jordan : Television	**20**

broadcast stations	
Jordan : Televisions	500,000
Jordan : Internet country code	.jo
Jordan : Internet Service Providers (ISPs)	5
Jordan : Internet users	87,500
Jordan : Railways	677 km
Jordan : Highways	8,000 km
Jordan : Waterways	N/A
Jordan : Pipelines	crude oil 209 km
Jordan : Ports and harbors	Al 'Aqabah
Jordan : Merchant marine	6 ships
Jordan : Airports	18
Jordan : Heliports	1
Jordan : Military branches	Royal Jordanian Land Force, Royal Naval Force, and Royal Jordanian Air Force
Jordan : Military expenditures	$608.9 million

4.3 JORDAN'S ECONOMY

Poor in natural resources, and largely too arid for agriculture, Jordan is not economically self-supporting and must depend heavily on foreign aid, primarily from petroleum-valuable Arab countries. Further burdens were placed on the economy after the 1967 Israeli occupation of the West Bank, which contained nearly half of Jordan's agricultural land, and by the consequent influx of unemployed refugees. In the late 1980s Jordan's economy became increasingly dependent on the overland transport of goods from the port of Al'Aqabah to Iraq and on remittances from Jordanian workers employed in the Persian Gulf states. Both these sources of revenue were jeopardized by Iraq's invasion of Kuwait in August 1990; the Persian Gulf War of 1991 dealt a serious blow to the Jordanian economy. In 1998 Jordan's budget revenues were $2 billion and its expenditures were $2.6 billion.

The Jordanian economy was resilient and growing before the 1967 war. The West Bank, prior to its occupation by Israel during the war, contributed about one-third of Jordan's total domestic income. Economic growth continued after 1967 at a slower pace but was revitalized by a series of state economic plans. Trade increased between Jordan and Iraq during the Iran-Iraq War (1980–90), because Iraq gained access to Jordan's port of Al-'Aqabah. Jordan initially supported Iraqi president Saddam Hussein when Iraq occupied Kuwait during the 1990–91 Persian Gulf War, but it eventually agreed to the United Nations' trade sanctions against Iraq, its principal trading partner, and thereby put its whole economy in jeopardy. External emergency aid helped Jordan weather the crisis, and the economy was boosted by the sudden influx of 200,000–300,000 Palestinians expelled by Kuwait in 1991, many of whom brought in capital.

Jordan is a small Arab nation with insufficient supplies of water and other natural resources such as oil. The Persian Gulf crisis, which began in August 1990, aggravated Jordan's already serious economic problems, forcing the government to stop most debt payments and suspend rescheduling negotiations. Aid from Gulf Arab states, worker remittances, and trade revenues contracted. Refugees flooded the nation, producing

serious balance-of-payments problems, stunting GDP growth, and straining government resources. The economy rebounded in 1992, largely due to the influx of capital repatriated by workers returning from the Gulf. After averaging 9% in 1992-95, GDP growth averaged only 1.5% during 1996-99. In an attempt to spur growth, King ABDALLAH has undertaken limited economic reform, including partial privatization of some state-owned enterprises and Jordan's entry in January 2000 into the World Trade Organization (WTO). Debt, poverty, and unemployment are fundamental ongoing economic problems (www.mapzones.com).

The Jordanian economy managed in 2003 to overcome the negative effects of the unfavorable regional developments that affected the region. Despite the slowdown in real GDP growth rate during the year (3.3%), compared to that of previous year (4.8%), the recorded growth rate in 2003 is considered, from whatever perspective, good, especially in light of heightened conditions of uncertainty that prevailed in the region for the greater part of the year. This clearly shows the high degree of flexibility that the Jordanian economy enjoys in withstanding shocks.

The real growth recorded in 2003 was primarily driven by the growth in service-producing sectors, which, combined, contributed to nearly two thirds of the recorded real growth rate. This growth was achieved within an environment marked by relative stability in the general price level, as inflation rate, measured by the percentage change in the Consumer Price Index, did not exceed 2.3%.

Despite the slowdown, the recorded real growth rate in 2003 had surpassed the population growth rate of 2.8%, thus bringing up real per capita GDP by 0.4%.

Available data on the labor market indicate that the unemployment rate decreased during 2003 by 0.8 percentage point below its level in 2002, to settle this year at 14.5%. Though falling, the unemployment rate is still high and, along with poverty, continues to pose one of the major challenges confronting the Jordanian economy, which the government is relentlessly seeking to overcome.

As far as policies are concerned, the government had in 2003 undertaken more measures related to output and prices in various economic sectors and fields. These measures aimed at supporting structural reform efforts, and completing legislative and legal frameworks that are consistent with the ultimate goal of economic development (www.cbj.gov.jo).

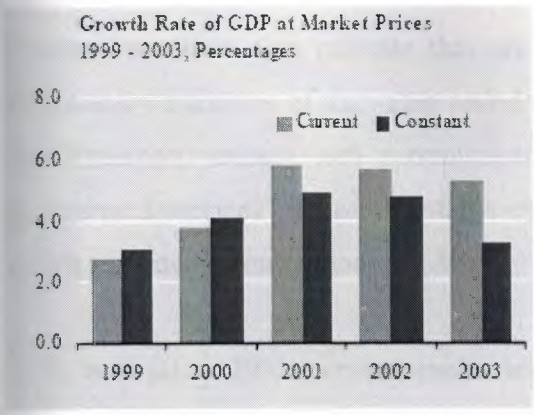
4.3.1 OUTPUT

GDP, at constant basic prices, grew in 2003 by 3.6% compared to 5.4% in the year before. When adding net taxes on products, which grew by 0.8% against 1.1% in 2002, GDP at constant market prices grew in 2003 at a rate of 3.3% against a rate of 4.8% in 2002. Growth was fairly broad-based, with "transport, storage & communications" (7.1%), "trade, restaurants and hotels" (4.5%), manufacturing (4.0%), "finance, insurance, real estate, and business services" (2.6%), and "producers of government services" (2.4%) registering strong advances in 2003. A noticeable exception was the "mining and quarrying" sector, which contracted by 0.8%.

In light of the increase in GDP deflator in 2003 by 2.0% compared to a slight increase of 0.8% in 2002, GDP at current market prices grew in 2003 by 5.3%, to reach JD 7,056.2 million, against a growth rate of 5.7% in the year before.

When adding net factor income from abroad, which attained a surplus of JD 87.1 million in 2003, to GDP at current market prices, Gross National Product (GNP) at current market prices recorded a growth rate of 5.4% against 4.7% in 2002. As a result of the remarkable increase in net other current transfers from abroad in 2003 by JD 620.9 million, Gross National Disposable Income (GNDI) grew by 11.8%, compared to 5.7% a year before, to reach JD 9,369.6 million in 2003.

CHART 4.1



Source: www.cbj.gov.jo

Moreover, as the growth rate of nominal GDP in 2003 surpassed the population growth rate of 2.8%, per capita GDP at current market prices increased by 2.5%, against 2.8% in 2002, to reach JD 1,288.1 (US$ 1,816.8). Per capita GDP at constant prices slightly edged up by 0.4%, compared with a rise of 1.9% a year earlier. Per capita GNDI at current market prices registered a visible increase of 8.7% against 2.8% in 2002, thus reaching JD 1,710.4 (US$2,412.4). At constant prices, the latter indicator rose by 6.6% in 2003 compared to 1.9% a year earlier.

TABLE 4.1

Economic Growth Rates
2000-2003, Percentages

	2000	2001	2002	2003(1)
At Current Prices				
GDP	3.8	5.8	5.7	5.3
GNP*	5.7	6.4	4.7	5.4
GNDI**	7.7	3.9	5.7	11.8
At Constant Prices (1994=100)				
GDP	4.1	4.9	4.8	3.3
GNP	5.9	5.4	3.9	3.3
GNDI	8.0	3.0	4.8	9.6

* : Represents gross domestic product plus net factor income from abroad.
** : Represents gross national product plus net other current transfers from abroad.
(1): Preliminary.

Source: www.cbj.gov.jo

- **Sectoral Developments**

National accounts data indicate that growth in GDP was fairly broad-based in 2003. Preliminary estimates of the value added indicate that real growth ranged from 7.1% for the "transport, storage and communications" sector, to 2.4% for the "producers of government services" sector. A notable exception was the "mining and quarrying" sector, which recorded a contraction of 0.8%.

In contrast to 2002, services-producing sectors, combined, recorded a real growth at an accelerated rate, while commodity- producing sectors collectively grew at a slower pace. The real growth rate amounted to 3.7% for the former and 3.5% for the latter, compared to 2.2% and 12.8% respectively in 2002. Despite these developments, both the combined services-producing sectors and the combined commodity-producing sectors maintained their relative importance to GDP at constant basic prices at around 67.6% and 32.4%, respectively.

TABLE 4.2

The Growth Rates of Economic Sectors at Constant Basic Prices*
2000-2003, Percentages

	2000	2001	2002	2003(1)
Agriculture, hunting, forestry and fishing	5.4	1.8	24.5	2.6
Mining and quarrying	-5.2	5.6	14.1	-0.8
Manufacturing	5.7	5.8	12.0	4.0
Electricity and water	5.2	6.0	10.5	2.6
Construction	1.1	12.5	8.8	5.5
Total commodity-producing sectors	**3.7**	**6.5**	**12.8**	**3.5**
Trade, restaurants, and hotels	8.7	2.5	2.1	4.5
Transport, storage and communications	4.7	9.9	0.8	7.1
Finance, real estate, and business services	4.4	4.2	7.9	2.6
Social and personal services	-0.8	5.0	10.9	4.0
Producers of government services	6.5	3.2	3.1	2.4
Producers of private non-profit services to households	3.1	-3.3	8.1	3.5
Domestic services of households	10.6	17.9	8.9	4.1
Total services sectors	**5.0**	**4.9**	**2.2**	**3.7**
GDP at constant basic prices	**4.6**	**5.4**	**5.4**	**3.6**

* : Based on the Department of Statistics data.
(1) : Preliminary.

Source: www.cbj.gov.jo

In light of these developments, services sectors' contribution to the growth rate of GDP at constant basic prices increased to 2.5 percentage points for this year (1.5 percentage points for 2002), while the contribution of commodity-producing sectors dropped by 2.8 percentage points to settle at 1.1 percentage points for the year.

TABLE 4.3

The Relative Importance of Economic Sectors to GDP at Constant Basic Prices*
2000-2003, Percentages

	2000	2001	2002	2003(1)
Agriculture, hunting, forestry and fishing	3.4	3.3	3.8	3.8
Mining and quarrying	2.9	2.9	3.2	3.0
Manufacturing	15.8	15.9	16.9	17.0
Electricity and water	2.7	2.7	2.9	2.9
Construction	5.1	5.4	5.6	5.7
Total commodity-producing sectors	**29.9**	**30.2**	**32.4**	**32.4**
Trade, restaurants, and hotels	11.9	11.6	11.2	11.3
Transport, storage and communications	17.6	18.3	17.5	18.1
Finance, real estate, and business services	20.0	19.8	20.3	20.1
Producers of government services	17.6	17.3	16.9	16.7
Other services	3.0	2.8	1.7	1.4
Total services sectors	**70.1**	**69.8**	**67.6**	**67.6**
GDP at constant basic prices	**100.0**	**100.0**	**100.0**	**100.0**

* : Based on the Department of Statistics data.
(1) : Preliminary.

Source: www.cbj.gov.jo

Developments in Commodity-Producing Sectors during 2003

Industry: There was a marked slowdown in the industrial sector's performance in 2003 compared to that in 2002. The real value added for both components of the industrial sector; "mining and quarrying" and manufacturing grew at a modest rate of 3.2% against a noticeable increase of 12.3% in 2002. This slowdown reduced the sector's contribution to the growth rate of GDP, at constant basic prices, to 0.7 percentage point for this year compared to 2.3 percentage points in 2002. Nevertheless, its relative importance to GDP, at constant basic prices, remained at almost the same level recorded a year earlier (20.0% compared to 20.1% in 2002).

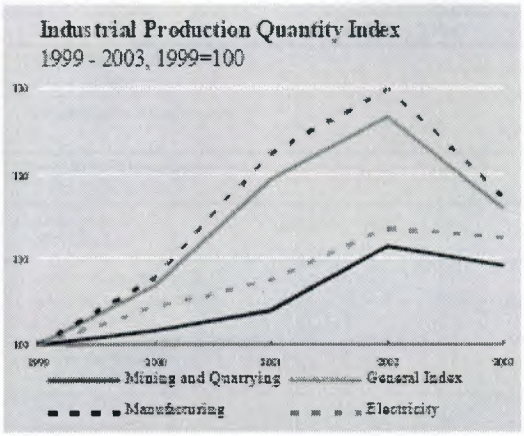
The slump experienced by this sector was due to the decline in the real growth rate of the manufacturing sector from 12.0% in 2002 to 4.0% this year, as well as the decline in

the real value added for the "mining and quarrying" sector by 0.8% against a growth rate of 14.1% in 2002.

The slackened growth of the manufacturing sector is attributed to the reduction in domestic and external demand for many of the sector's products. Available data indicate that the growth rate of manufacturing exports dropped from 20.3% in 2002 to 8.3% in 2003. Similarly, phosphate exports retracted by 5.8% for the year compared to a growth rate of 6.6% in 2002.

When considering developments in the industrial production in 2003, one would notice a decline in the industrial production index for "mining and quarrying" and manufacturing by 8.9% against a growth rate of 6.2% in 2002. This downturn is due to the drop in both the "mining and quarrying" industrial production index by 2.1%, and the manufacturing industrial production index by 9.8% against growth rates of 7.3% and 6.1%, respectively in 2002. The decline in the manufacturing industrial production index has not been uniform. While, the production indices of "food products and beverages", fertilizers, cement, "wearing apparel and textiles", and "detergents and soaps" dropped, production indices of tobacco products, pharmaceuticals, and refined petroleum products increased. It should be noted, however, that production originated in Qualifying Industrial Zones (QIZs) is excluded when calculating manufacturing industrial production index, whereas production from QIZs comprises part of the value added for manufacturing sector. With respect to the decrease in the "mining and quarrying" industrial production index in 2003, this was mainly due to a decline in phosphate production quantities by 4.9% against a growth rate of 20.9% a year earlier. Quantities of potash production however inched up by 0.3% compared to an equal but in the opposite direction growth rate in 2002.

GRAPH 4.1



Source: www.cbj.gov.jo

As for investment in the industrial sector, available data show an increase in both the number of registered industrial companies and their capital. In 2003, the number of newly registered industrial companies reached 426 with a total paid-up capital of JD 12.5 million, compared with 358 companies with paid-up capital of JD 6.7 million in 2002. Moreover, four existing industrial companies raised their capital in 2003 by around JD 17.2 million compared to also four companies which raised their capital by around JD 13.2 million in 2002.

TABLE 4.4

Main Indicators of the Industrial Sector
2000-2003

	2000	2001	2002	2003
Value added at current prices (JD million)	969.4	1,013.3	1,111.0	1,178.3
Growth rate at constant prices (%)	3.9	5.8	12.3	3.2
The deflator of the industrial Sector (1994=100)	111.7	110.3	107.7	110.7
Industrial exports (JD million)*	964.4	1,216.8	1,415.4	1,518.4
"Mining & quarrying" & manufacturing industrial production index	107.1	120.1	127.6	116.2
Number of registered industrial companies	315	384	358	426
Capital of registered industrial companies (JD million)	8.5	7.6	6.7	12.5
Outstanding credit facilities extended by licensed banks (JD million)	784.1	806.3	885.1	879.4
Outstanding credit facilities extended by the IDB (JD million)	88.4	80.4	76.2	76.7

Sources : - Monthly Statistical Bulletin / Central Bank of Jordan.
- Industrial Development Bank.
* Domestic exports excluding agricultural exports.

Source: www.cbj.gov.jo

The investments in industrial projects benefiting from Investment Promotion Law amounted in 2003 to JD 239.5 million distributed among 261 projects against JD 277.5 million distributed among 289 projects in 2002.

Credit facilities extended by licensed banks to the industrial sector declined by a narrow margin of 0.6% at the end of 2003 compared with their level at the end of 2002, to JD 879.4 million, thus comprising 16.7% of total credit facilities extended by licensed banks. By contrast, credit facilities extended to the industrial sector by the Industrial Development Bank (IDB) increased by 0.7%, compared to their level at the end of 2002 to JD 76.7 million at the end of 2003.

Agriculture: The agricultural sector recorded a modest growth in 2003 compared to 2002. The real value added for this sector grew by 2.6% compared to 24.5% in 2002. As a result, the sector's contribution to the growth rate of GDP at constant basic prices, declined from 0.8 percentage point in 2002 to 0.1 percentage point in 2003. Despite the sluggish performance of this sector, it maintained its relative importance to GDP at constant basic prices recorded in the previous year which amounted to 3.8%. The slowdown in the agricultural sector is mainly due to the decrease in the production of a number of agricultural products, particularly olives and tobacco. Consequently, the decline in agricultural production led to a rise in agricultural products' prices, measured by GDP deflator for the agricultural sector, by 5.4% against a decrease by 13.2% in 2002.

As for agricultural exports, these had risen in value in 2003 by 10.8% compared to 4.6% in 2002. The increase was the outcome of a rise in both the price index and the quantity index of agricultural exports by 5.2% and 4.4%, respectively, against a reduction in the former by 8.0% and a rise in the latter by 15.4% in 2002.

The investments benefiting from the Investment Promotion Law that are geared towards the agricultural sector rose by JD 0.8 million in 2003 above its 2002 level to JD 5.9 million distributed among 16 projects compared to 13 projects a year before.

TABLE 4.5

Main Indicators of the Agricultural Sector
2000-2003

	2000	2001	2002	2003
Value added at current prices (JD million)	120.9	124.3	134.6	145.6
Growth rate at constant prices	5.4	1.8	24.5	2.6
The deflator of the agricultural sector (1994= 100)	77.4	78.2	67.9	71.6
Quantity index of the agricultural exports (1994= 100)	108.8	104.7	120.8	126.1
Price index of the agricultural exports (1994= 100)	117.4	142.9	131.4	138.2
Number of registered agricultural companies	2.0	3.0	15.0	10.0
Capital of registered agricultural companies (JD million)	0.02	0.07	0.43	0.10
Outstanding credit facilities extended by licensed banks (JD million)	128.0	105.5	102.9	98.8
Outstanding credit facilities extended by the Agricultural Credit Corporation (JD million)	106.8	107.8	110.9	109.4

Source: Monthly Statistical Bulletin / Central Bank of Jordan.

Source: www.cbj.gov.jo

Credit facilities extended to the agricultural sector by licensed banks at the end of 2003 declined by 4.0% below their level at the end of 2002, to JD 98.8 million, equivalent to 1.9% of total credit facilities extended by licensed banks as at the end of the year. Moreover, credit facilities extended by the Agricultural Credit Corporation decreased also by 1.4% compared to their level in 2002 to reach JD 109.4 million at the end of 2003.

Construction: The real value added for the construction sector continued to grow at a slower pace for the second year in a row, as its growth rate amounted to 5.5% for 2003 compared to 8.8% in 2002. The slower pace of growth in this sector can be attributed to the state of uncertainty that enveloped the region, particularly during the first half of the year, in addition to some problems that hindered construction activities in the second half of the year. These problems are the rise in the prices of reinforcement steel and mal distribution of quantities of cement sold, because large contracting companies purchased large quantities of cement thus reducing the quantities available in the market for smaller contractors.

A closer look at the main indicators associated with the construction sector reveals a mixed picture for 2003. On the bright side, the number of construction companies that were registered in 2003 rose by 16 from the year before, to 59 companies. By contrast, their capital dropped sharply from JD 4.3 million in 2002 to JD 2.9 million this year. The quantities of cement sold in the domestic market increased in the year by 4.4% compared to an increase of 9.9% in the year before. The number of construction permits issued climbed in 2003 by 5.2% against only 0.9% in 2002, and the licensed building areas increased by 11% compared to 20.3% in 2002. Licensed building areas designated for residential purposes in 2003 took the lion's share (80%) of the total licensed building areas of 8,108.8 thousand square meters.

Credit facilities extended by licensed banks to the construction sector increased in 2003 by 5.2% to JD 804.5 million at the end of the year against an increase of 4.9% during 2002, thus representing 15.3% of the total credit facilities extended by licensed banks.

TABLE 4.6

Main Indicators of Construction Sector
2000-2003

	2000	2001	2002	2003
Value added at current prices (JD million)	203.3	231.0	251.7	279.3
Growth rate at constant prices (%)	1.1	12.5	8.8	5.5
The deflator of the construction sector (1994=100)	86.1	86.9	87.1	91.6
Outstanding credit facilities extended by licensed banks (JD million)	744.9	728.9	764.9	804.5
Number of registered construction companies	74.0	67.0	43.0	59.0
Capital of registered construction companies (JD million)	4.9	3.5	4.3	2.9
Quantity of cement sales to domestic market (in thousands of tons)	2,188.7	2,417.7	2,656.3	2,774.4
Number of permits (thousand)	17,925	21,248	21,433	22,555
Licensed area for building (thousands of sq.m.)	4,921.5	6,071.9	7,306.8	8,108.8

Sources : - Monthly Statistical Bulletin / Central Bank of Jordan.
- Jordan Cement Factories Company.

Source: www.cbj.gov.jo

As for the Housing and Urban Development Corporation (HUDC), it completed in 2003 the implementation of eight projects of developing lands for residential purposes at a total cost of JD 12.7 million. These projects had developed some 1,526 units in the form of plots of land served with public utilities. HUDC began in 2003 the process of implementing another number of projects related to land development for residential purposes with an estimated total cost of JD 4.9 million, in addition to projects that were already started in 2002 whose total cost is estimated at JD 9.2 million.

Electricity and Water: The growth rate of the real value added for "electricity and water" sector decreased from 10.5% in 2002 to 2.6% in 2003. This decline reflects the slower performance of other sectors, most of which experienced a slowdown during 2003.

Developments in Service-producing Sectors in 2003

The "transport, storage and communications" sector recorded in 2003 a marked real growth of 7.1% compared to a growth rate of 0.8% in the year before. This led to an increase in the relative importance of this sector to GDP, at constant basic prices, from 17.5% in 2002 to 18.1% in 2003. Similarly, its contribution to the growth rate of GDP at constant basic prices rose to 1.2 percentage points compared to 0.1 percentage point in 2002, and thus taking the lead among all economic sectors in driving economic growth in 2003. Growth in this sector was the outcome of the convergence of several factors, foremost among of which were the large expansion in the activities of communications companies operating in the Kingdom, stronger performance of air and land transport, especially the activities of Ports Authority, and the improvement in the performance of storage activities, which are closely linked to imports, as the latter experienced an increase by 12.6% for the year.

The "finance, insurance, real estate and business services" sector experienced a slowdown in 2003 compared to the year before. The real value added for this sector grew

by 2.6% against 7.9% growth in 2002. The sluggish growth was the result of the sharp reduction in the growth rate of "finance and insurance services" from 34.0% in 2002 to 5.3% in 2003. However, the value added from real estate services rose by 1.4% against a decline by 0.3% in 2002. Improvement in the performance of real estate activity can be partially attributed to an increase in real estate purchases in the Kingdom by citizens of neighboring countries in the first half of the year.

"Producers of government services" sector experienced a slowdown in 2003 compared to the year before. The value added from such services recorded a real growth rate of 2.4% against 3.1% in 2002. This decline led to the reduction in this sector's relative importance to GDP at constant basic prices by 0.2 percentage point below its level a year earlier to 16.7%.

"The trade, restaurants and hotels" sector's value added grew, at constant basic prices, by 4.5% compared with 2.1% in 2002. This higher growth led to an increase in the sector's contribution to the growth rate of GDP at constant basic prices from 0.2 percentage point in 2002 to 0.5 percentage point in 2003. Nevertheless, the relative importance of this sector to GDP at constant basic prices remained almost at the same level recorded in 2002 (11.3% against 11.2% in 2002). The real growth in this sector was the outcome of the growth in both "wholesale and retail trade" by 4.3%, and "restaurants and hotels services" by 6.4% (6.4% and -24.7%, respectively in 2002).

As for the **tourism sector** in particular, its performance was impacted in 2003 by the conditions of uncertainty that prevailed in the region, especially in the first half of the year. These conditions led to a reduction in the growth rate of its value added at current prices from 8.6% in 2002 to 3.6% in 2003. Consequently, the sector's relative importance to GDP at current basic prices declined by nearly 0.2 percentage point to 4.6%.

A closer look at various indicators of tourism sector reveals a mixed picture. While the number of arrivals from foreign countries increased in 2003 by 5.8%, the number of arrivals from Arab countries declined by 5.5%. Moreover, while eight non classified

hotels pulled out of the tourism industry, five classified hotels joined in. Accordingly, total number of hotels (both classified and non-classified) decreased to 458 compared to 461 hotels in 2002. Nevertheless, both the number of hotel rooms and their occupancy rates increased in 2003 to 19.7 thousand rooms and 33.7%, respectively compared to 19.4 thousand rooms and occupancy rate of 32.0% in 2002. Moreover, the number of tourist nights rose from 3.5 million in 2002 to 3.8 million in 2003. All in all, these developments resulted in a reduction in the ratio of tourism income to GDP at current basic prices from 9.7% in 2002 to 9.4% in 2003. The number of workers in the tourism sector declined also by as many as 400 workers to reach 22.1 thousand workers in 2003.

TABLE 4.7

Main Indicators of Tourism Sector
2000 - 2003

	2000	2001	2002	2003
Number of arrivals (million)	4.6	5.2	5.5	5.3
Gross tourism income/GDP at current basic prices (%)*	10.0	9.1	9.7	9.4
Value added of tourism sector at current prices (JD million)**	260.0	252.3	274.1	284.0
Value added/GDP at current basic prices (%)	5.1	4.6	4.8	4.6
Outstanding credit facilities extended by licensed banks (JD million)	155.2	171.0	173.5	172.8
Outstanding credit facilities extended by the IDB (JD million)	32.5	33.5	33.6	32.9
Number of hotels	452	472	461	458
Number of rooms (thousand)	17.5	19.2	19.4	19.7
Room occupancy ratio (%)	39.5	30.5	32.0	33.7
Employees in hotels (thousand)	9.8	11.4	10.3	10.5
Employees in tourism sector (thousand)	21.5	22.9	21.5	22.1

Sources : - Monthly Statistical Bulletin / Central Bank of Jordan.
- Ministry of Tourism and Antiquities.
- Industrial Development Bank.
* : Gross tourism income according to the balance of payments data.
** : CBJ estimates.

Source: www.cbj.gov.jo

Credit facilities extended by licensed banks to tourism sector declined slightly during 2003 by 0.4% compared with a growth of 1.5% in 2002 to reach JD 172.8 million by the year end, thus representing 3.3% of total credit facilities extended by licensed banks.

Similarly, credit facilities extended to this sector by the IDB retracted by 2.1% compared to their level at the end of last year to reach JD 32.9 million at the end of 2003.

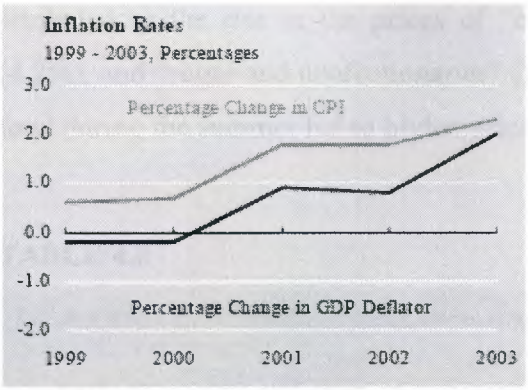
"Other services" sectors recorded in 2003 a decrease in their real value added by 10.6% compared to a decline of 34.5% in 2002. The lesser decrease is attributed to improvements in domestic services of household and the producers of private nonprofit services, as well as the expansion in health and educational services offered by the private sector.

4.3.2 PRICES

The inflation rate in the Kingdom, measured by the percentage change in the Consumer Price Index (CPI), recorded an increase of 2.3% in 2003 compared to 1.8% in 2002. Despite this modest increase in the inflation rate, it remains within acceptable bounds, considering that it is close to the prevailing inflation rates in industrial countries. The increase in the inflation rate is attributed to the administrative decisions that took place in 2003, which called for raising both the prices of fuel products and the General Sales Tax rate on some basic goods. In particular, these decisions resulted in an increase in the prices of "fuels and electric", transportation, and food items group.

Similarly, inflation, measured by GDP deflator, rose to 2.0% in 2003 compared to 0.8% in 2002. This rise was the outcome of the increase in both commodity producing sectors' deflator by 3.2% and deflator of services-producing sector by 2.2%, on the one hand, and the decline in the deflator of net taxes on products by 0.9%, on the other.

GRAPH 4.2



Source: www.cbj.gov.jo

- **Consumer Price Index (CPI)**

The CPI rose in 2003 by 2.3% compared to 1.8% in the year before. The rise was mainly due to higher prices in both "other goods and services", and food items. Combined, these two groups contributed to some 1.9 percentage points to the inflation rate. Following are some of the major changes that impacted CPI components:

1. Prices of "other goods and services" group, which includes "transportation and communications", education, medical care, and other, rose by 5.0% in 2003 against a rise of 5.1% in 2002 (Statistical Annex, Table 8). Therefore, this group maintained the same contribution it made to the inflation rate in 2002 (1.1 percentage points). Much of the increase in the prices of this group came as a result of the increase in the prices of "transportation and communications" (6.3%), and education (6.5%).

2. Prices of the housing group rose in 2003 by 2.4% compared to 2.3% in 2002. Therefore, this group contributed nearly 0.7 percentage point to the rate of inflation in 2003. Higher prices in this group were due to the rise in the prices of "fuels and electric" (7.0%), as a result of the government decision to raise the prices of petroleum products, and to the rise in the prices of "housing and related expenses" by 2.3%.

. Prices of food items group, which has the largest weight among the components of 'PI, rose by 1.8% in 2003 compared to 0.2% in the year before. This increase is ttributed to the rise in the prices of "cereals and their products" (5.3%), vegetables 4.2%), and "sugar and confectionaries" (2.8%). The death of large numbers of domestic owl during the summer led to higher prices in "meat and poultry" by 3.9%.

TABLE 4.8

Inflation Rates: Consumer Price Index Components, 2000-2003, Percentages

Groups	2000	2001	2002	2003
Food items	-0.7	0.3	0.2	1.8
Housing	1.4	1.8	2.3	2.4
Clothing and footwear	0.6	1.2	-0.6	-4.0
Other goods and services	2.8	4.7	5.1	5.0
General index	0.7	1.8	1.8	2.3

Source: www.cbj.gov.jo

4. By contrast, prices of "clothing and footwear" group, which has the least weight among components of the CPI, declined by 4.0% in 2003 against a decline of 0.6% in 2002. This decrease in prices of this group is due to abundance of supplied quantities (locally produced and imported). Available data indicate that the Kingdom's imports of clothing and footwear rose in 2003 by 9.3%.

4.3.3 EMPLOYMENT AND POVERTY ALLEVIATION

In 2003, the government continued its efforts aimed at confronting the problems of poverty and unemployment, as they are considered among the most serious challenges to the Jordanian economy. To this end, the government has been actively engaged in a number of programs aimed at creating new employment opportunities, expanding training and rehabilitation programs for human resources, and securing the financial support needed for developmental and social funds. To reduce poverty, the government has recently embarked on a new program aimed at supplementing poor families income and securing funding for small-scale income-producing projects.

Within this framework, government efforts focused on the implementation of both Social Safety Net and Enhancing Economic and Social Productivity programs. Thus, several projects and activities related to the basic needs of the poorest groups were implemented in the Kingdom, foremost among these are infrastructure and housing projects for the poorest families, as well as school nutrition programs for students in public schools in poor areas. Previous efforts, along with other factors, resulted in a reduction in the unemployment rate by 0.8 percentage point compared to its level in 2002 to stand at 14.5% in 2003.

- **Institutions Concerned with Employment and Poverty Alleviation**

Social and development funds continued to implement government policies aimed at alleviating poverty, providing training, and creating job opportunities. Following are highlights of the funds' accomplishments in 2003:

National Aid Fund (NAF)

The NAF continued in 2003 to offer social services aimed at combating poverty and alleviating its severity through offering recurring cash assistance (income supplement assistance) and emergency aid to the poor people who are unable to work. On the other hand, it continued providing physical rehabilitation opportunities and supporting projects for the poor who are able to work. In addition, the NAF continued with providing educational loans and health insurance to the fund's beneficiaries who lack the financial means. As for the fund's total volume of spending on its various social programs, this markedly increased in 2003 by 25.6% to a total of JD 51 million.

TABLE 4.9

Total Expenditures of National Aid Fund Distributed by Program
2002-2003

Program	Expenditures (JD Thousand)		Number of beneficiaries	
	2002	2003	2002	2003
Recuring cash assistance*	38,048	47,777	66,450	67,755
Emergency aid**	394	512	10,224	13,576
Physical rehabilitation	107	166	543	722
Disabled program	1,911	2,352	5,383	6,213
Educational loans	75	124	392	594
Total	**40,535**	**50,931**	**82,992**	**88,860**

*: Complimentary income aid.
**: OrDinary & exceptional aid.

Source: www.cbj.gov.jo

Development and Employment Fund (DEF)

The DEF continued in 2003 the implementation of awareness campaigns and training programs and providing financing for the poor, those of low incomes and the unemployed, either directly by the fund or indirectly through approved intermediaries. The fund also multiplied its outreach efforts to centers of productivity enhancement that are spread throughout the governorates to finance projects whose feasibility studies have been prepared through these centers. The fund focused its efforts on expanding the scope of its services to cover various areas in the Kingdom through the establishment of the Mobile Lending units in the north and south regions, and the Fund's Window unit at the Bureau of Civil Service.

The lending activity of the fund witnessed a tangible improvement in 2003 in comparison with last year. The value of loans extended by the fund increased by JD 1.4 million compared to its level in the last year to amount to JD 7.2 million this year. Thus the DEF's contribution to the creation of employment opportunities rose to 3,413 job opportunity in 2003 compared to 2,967 in 2002.

TABLE 4.10

Development and Employment Fund Lending Activities by Sector
2000 - 2003

Sector	Total Financing (JD Thousand)		Number of Projects	
	2002	2003	2002	2003
Services	3,196	5,161	1,486	1,654
Industrial / Handicrafts	531	814	113	104
Industrial/Agriculture	126	112	96	25
Tourist	198	185	21	20
Households	1,785	917	2,328	3,199
Total	**5,836**	**7,189**	**4,044**	**5,002**

Source: www.cbj.gov.jo

Handicrafts and Small-Scale Loan Fund (HSSLF)

In 2003, the HSSLF, a subsidiary of the Industrial Development Bank (IDB), continued offering easy-terms financing services, aimed at funding small-scale and handicrafts projects that employ fifteen workers or less.

The lending activity of this fund witnessed a marked improvement in 2003, as the number of loans increased and so did their value by 67.6% and 88.5% respectively, compared to their levels in 2002. The rise is attributed to the widening of the range of activities financed by the fund to include new projects, such as physical fitness centers, pharmacies, outfitting and furnishing hotels, leased and tourists' apartments.

TABLE 4.11

Handicrafts Fund lending Activities by Type
2002 - 2003

Type of Activity	Total Financing (JD Thousand)		Number of loans	
	2002	2003	2002	2003
Food products	161.8	141.9	26	16
Clinics & Medical Laboratories	142.5	161.6	15	13
Metal works	80.9	59.8	15	9
Maintenance	79.5	185.5	11	19
Construction works	38.5	163.0	6	16
Other	229.7	669.8	38	113
Total	**732.9**	**1,381.6**	**111**	**186**

Source: www.cbj.gov.jo

4.3.4 OUTPUT, PRICES AND WAGE POLICIES

In 2003, the government continued the implementation of its policies and adopted new measures related to output and prices in various economic sectors and domains. These measures aimed at supporting structural reform efforts and completing the updating of legislative and legal frameworks that are suitable for economic activities.

- **Privatization**

The privatization program gained momentum in the past six years (1998-2003), as 58 projects were implemented during that period, including the sale of government shares in 49 companies that had been listed in Jordan Investment Corporation's portfolio.

As of the end of 2003, privatization proceeds amounted to JD 703.5 million, of which JD 471.6 million were really utilized. Thus the balance of privatization proceeds at the end of 2003 amounted to JD 231.9 million, of which JD 50 million were allocated to housing financing. Available balance, therefore, at the end of 2003 is in the neighborhood of JD 181.9 million.

Following are some of the most important activities and accomplishments of the privatization program in 2003:

a. Royal Jordanian

A technical team was assembled on 3/9/2003 to completely supervise operations related to all consultative aspects of the privatization of Jordan Airmotive Limited Company (JALCO), and Jordan Aircraft Maintenance Company (JORAMCO). An advertisement was placed on 10/12/2003, in local and international newspapers for the sale of the two companies. The privatization process of both companies is expected to be completed during 2004.

b. The Manufacturing Sector

On 11/9/2003, almost half of the government stake in the Arab Potash Company (26% of a total 21.7 million company shares) were sold to the Canadian company PCS for US$ 8 per share, with a total value of US$ 173.3 million (the net value of sale after subtracting brokerage commission amounted to US$ 123.1 million). That leaves the remaining stake of government shares in the company at 26.9% of total number of shares.

c. Postal Services

1. On 11/6/2003 the Post Law was amended so as to set the stage for the important and essential role that the postal sector will play in supporting the e-government program, promoting competition and enhancing the role of the Telecommunications Regulatory Commission in regulating the postal sector.

2. The Council of Ministers, on 30/12/2003, approved the strategic choices for the privatization of the Jordan Post Company, which came down to the selection of the strategic partner option, and enlisting the services of one of the world's top consultation firms to begin the privatization of this company. The transaction is expected to be completed during 2004.

d. Stations for the Technical Inspection of Motor Vehicles / Licensing of Drivers and Vehicles Administration

The Council of Ministers approved, on 16/1/2003, the formation of an ad hoc committee that will oversee the technical and financial aspects of the privatization of stations for the technical inspection of motor vehicles. The Council also approved, on 13/5/2003, the implementation of the privatization project in accordance with tender documents prepared by the ad hoc committee. On 7/12/2003, the offer made by the Jordan Investment and Finance Bank to provide consultation services was selected from amongst 16 bids. The privatization project is slated for completion during 2004.

e. Projects of the former Ministry of Supply (the Mill, Silos, Regular and Refrigerated Warehouses)

The Council of Ministers approved, on 18/11/2003 the break up of the mill, which is part of the Jordan Silos and Supplies Company (JSSC), from the mother company as a prelude to its privatization during 2004. The mill was registered on 4/1/2004 as a limited liability corporation wholly owned by JSSC. The privatization process of the subsidiary company is expected to be completed by the end of 2004.

f. Government holdings in other companies

1. National Shipping Lines Company was sold in early 2003 to Al-Salam Company for JD 1.7 million; the total price paid for all shares offered for sale, which amounted to 59% of the capital, of which JD 540 thousands, the value of 225 thousand shares, owned by the government and the remainder was distributed among the other shareholders.

2. The government stakes in both the General Maintenance Company (175 thousand shares, or 25% of the total company shares) and Jordan Free Markets Company were sold for JD 91 thousands and JD 129 thousands, respectively.

g. Agriculture Sector

The Council of Ministers approved, on 23/9/2003 procedures for the sale of the Agricultural Marketing and Processing Company (AMPCO). Three investors made proposals for purchasing the company. The evaluation of these proposals is underway, and the privatization of the company is expected to be completed during the first quarter of 2004.

h. Queen Nour Technical College (QNTC)

The Council of Ministers approved, in April 2003, the implementation of the privatization of QNTC program. Two committees: steering and technical, were formed to follow up on the project. The privatization process is expected to be completed in the first quarter of 2005.

- **Investment, Wages and Prices**

Complementing government efforts aimed at updating and developing the legislative environment, a royal decree was issued in 2003 approving a package of temporary laws, most of which purport to regulate, develop and support the investment environment in Jordan. An important feature of these laws is their call for the establishment of the National Resources Development and Investment Institute, pursuant to Development of Investment Environment and Economic Activity Law of 2003. The Institute is designed to work as an investment umbrella for companies and institutions interested in investment. Following is an overview of these laws and their objectives:

1. Development of Investment Environment and Economic Activity Law of 2003: the law aims at developing and regulating the investment environment, and activation of commerce and trade in the Kingdom in accordance with a general investment strategy. The strategy is to be implemented through increasing the competitiveness of various economic sectors and activities, and by providing consultation and technical support for interested investors.
2. Investment Law of 2003: this law supplants Investment Law No. 16 of 1995. The Higher Council for Investment was thus annulled pursuant to the new law, and in stead, Investment Incentives Commission was established. The new law offers more flexibility and aims at reinforcing the principles of free market and competition.
3. Investment Promotion Law of 2003: the law aims at attracting, encouraging and promoting local and foreign investment in the Kingdom, by means of identifying available investment opportunities and assisting investors by providing them with needed data and one-stop service.
4. Development of Economic Projects Law of 2003: the law aims at developing,= sponsoring and supporting economic projects in the Kingdom, as well as increasing the volume of exports and export opportunities abroad, by providing assistance to interested parties in preparing strategies for economic projects; and enhancing their competitiveness, and their administrative, technical and export

abilities. The law also aims at contributing to the growth and development of national exports in accordance with the approved government policy.

_The Council of Ministers' decision adopted in August of 2002, which provided for raising the minimum wage from JD 80 a month to JD 85 a month, as of the beginning of 2003, came into force.

_The cost of living allowance for government civil employees was increased by JD 3 a month as of May 2003.

_The prices of petroleum products were raised as of 7/5/2003 by varying rates ranged between 6% and 20% (these are mentioned in detail under Fiscal Measures and Legislation).

Source: Central Bank of Jordan, www.cbj.gov.jo

CHAPTER FIVE

JORDAN IS ATTRACTING FOREIGN DIRECT INVESTMENT

5.1 OVERVIEW

Since 1992 Jordan has undertaken the implementation of a significant number of laws and initiatives designed to improve the business environment. One of the primary goals of these reforms has been to create an administrative and policy framework that would be attractive to foreign direct investment (FDI). With the passage of the Investment Promotion Law of 1995, the country was well on its way towards realizing the favorable investment climate.

While there remains much room for improvement, particularly in the reduction of bureaucratic impediments and regulatory procedure, foreign industrialists and entrepreneurs investing are demonstrating their confidence in Jordan by not only in the well publicized stockholdings in privatized industry, but also in newly created, wholly foreign-owned enterprises.

5.2 JORDAN'S INVESTMENT ENVIRONMENT AND ATTRACTIVENESS FOR FDI

A comprehensive analysis of Jordan's commercial policy environment was completed in 1998 by the consulting firm. Overall, Jordan offers to private investors one of the most favorable commercial policy regimes in the Middle East. Jordan's policy climate also compares favorably with those of many industrialized (OECD) nations and most other countries. This study further stated that Jordan's import and export policies are the best in the region, while its tax and labor regimes are "among the most business friendly in the world". While Jordan lacks the natural resources, low cost labor and market size of some of its neighboring countries, a brief look at certain factors that investors who use the services of the Jordan Investment Board tell us influenced their decisions in Jordan's favor may help to explain this recent upturn in investment.

- **Tax Law and Investment Promotion Law**

The Jordanian Tax Law provides a 100 percent exemption on income derived from exports. This same exemption applies to income earned in the agricultural sector. The Investment Promotion Law exempts all fixed assets that are imported for a project from payment of taxes and fees. This exemption also applies to new assets that are later imported for expansion or modernization.

- **Transfer of Capital and Profits**

Any foreign investor may freely transfer capital and profits outside Jordan in any convertible currency. Proceeds from the sale or liquidation of investments are also free of all transfer restrictions. Foreign workers and managers may keep accounts in Jordanian banks in any convertible currency, and may freely repatriate any salaries or other remuneration.

- **Ownership of a Project and Ownership of Property**

Foreign investors may own the whole or part of any project with the exception of projects in the commercial, trade and construction sectors where foreign ownership is limited to 50 percent. Land for industrial and residential purposes may be purchased or leased by foreigners throughout Jordan.

- **Labor and Work Permits for Foreign Workers**

Jordan's Labor Law of 1996 bestows upon employers the requisite discretion in terms of engaging and dismissing employees, and the country's reputed supply of competent, well educated labor, at a competitive cost, weighs in Jordan's favor. When needed, permits for foreign workers and managers are issued by the Ministry of Labor and the Ministry of the Interior. These permits are renewed annually, and coordination on the foreign investor's behalf with the concerned Ministries is one of the services offered by the Jordan Investment Board (JIB) (www.jordaninvestment.com).

- **Registration**

Registration of a new company is undertaken through the office of the Controller of Companies of the Ministry of Industry and Trade, and is a simple procedure which can be accomplished in a matter of hours. Any approvals required from other agencies and municipalities can be facilitated for the foreign investor through the services of the staff of the Jordan Investment Board.

- **World Trade Organization (WTO)**

At the close of 1999 Jordan was accepted into the WTO. Its accession was the culmination of a series of legislative reforms to improve the investment environment, which proceeded throughout 1998 and 1999. As a result of these reforms Jordan has been removed from the USA's "watch list" of countries not respecting intellectual property rights.

5.3 ACTIVE SECTORS FOR FDI

- **Information Technology**

Development of the IT sector received a new incentive with the appearance of His Majesty King Abdullah II before the World Economic Forum in Davos on January 2000. His Majesty's emphasis on the development of the hi-tech industry attracted the attention of the world's leading IT companies, and industry giants such as Oracle, Sun Microsystems and Cisco that participated in Jordan's first International IT Forum held on March. Preceding His Majesty's address in Davos was the REACH Initiative, an action plan to strengthen Jordan's IT sector which was developed in response to King Abdullah's request for a concrete proposal.

REACH

_ Regulatory Framework

_ Estate (Infrastructure)

_ Advancement Programs

_ Capital

_ Human Resource Development

This action plan, developed through the stewardship of the Jordan Computer Society,

has served to unite and energize the Jordanian IT community. The REACH Initiative document focused on the benefits and advantages that Jordan's IT sector has to offer in the area of software development and IT services as follows:

_ Low Start-up Capital Requirements: Making it relatively easy and less risky for market entry by Jordanian firms, even small operations.

_ Favorable Location and Position in the Regional Market: Talented labor force, bilingual Arabic/English capabilities, historical trade relationships in the region, time zone advantages.

_ Human Resources Intensity: An open and liberal environment which encourages an enthusiasm for developing IT skills.

_ No Distance or Transportation Restraints: Inputs and outputs are transmitted electronically. Jordan's telecom infrastructure is a positive advantage in the region. Mining Jordan has recently entered into a technical cooperation project with the United Nations Conference for Trade and Development (UNCTAD), the purpose, among others, being to *modernize the legal framework of the mining and minerals sector in order to make it even* more investor friendly.

It is expected that material progress will be made in this sector, as demonstrated by the overall reforms that have been noted above. Investment by foreign companies in Jordan's mining sector has proceeded at a steady pace, enhancing downstream development of Jordan's phosphate and Dead Sea mineral deposits.

Notable among the recent investments by foreign corporations is the joint venture between the Arab Potash Company and the American firm, Albemarle Holdings. This represents a USD120 million injection of FDI which will concentrate on bromine-based products. Other recent, large FDI projects in the mining sector are the joint venture, and the stockholding of 40 percent by the French company, Ciments Lafarge, in the Jordan Cement Factories Company (The Arab Bank, R E V I EW, October 2000).

- **Jordan's Unique QIZ**

Jordan's Qualifying Industrial Zone allows producers to qualify a product for export to the United States which will, once approved and qualified, enter the US market through US Customs duty free. This cost advantage, plus the fact that the United States has imposed no

quotas on Jordan for garment exports, makes our country very attractive to garment manufacturers. The QIZ is drawing investment from all quarters, and to date over a dozen firms from Jordan, Hong Kong, India, Pakistan, Sri Lanka and Taiwan have established manufacturing operations. Total investment has climbed to the tens of millions of US dollars, and 6,000 new jobs have been created. For many Jordanians such employment represents their first opportunity to work in an industrial environment and, for many middle and upper level Jordanian managers, an opportunity to stay and work at home rather than to seek employment abroad. QIZ projects now in the JIB's pipeline of pending investments should exceed 100 million dollars in the next two years, creating an additional 20,000 new jobs.

- **Tourism**

Since 1994, the number of foreigners visiting Jordan has increased by almost 49 percent. Gross tourism receipts reached JD 605 million (USD 852 million) in 2001, accounting for almost 12 percent of the gross domestic product (GDP). Job creation has also been a key benefit, with about 10,000 people in Jordan directly employed in the tourist industry in hotels, restaurants, travel and tourism agencies and transportation.. FDI has played a substantial role in joint ventures with locals in hotel and tourism-related development. International class hotels built by Sheraton, Movenpick, Four Seasons and others rise in Amman and Aqaba, and for the tourist attractions of the Dead Sea and Petra.

5.4 WHY INVEST IN JORDAN?

5.4.1 Market Size

TABLE 5.1

Indicators	Jordan	regional average	emerging countries average
GNP per capita (PPP dollars)	3880	6042	6010
GNP per capita	1630	6133	3899
Human development index	0,714	0,730	0,697
Wealthiest 10% share of national income (%)	30	29	32
Urban population percentage	74	71	59
Percentage under 15 years old	42	35	32
Number of telephones per 1,000 inhabitants	87	153	148
Number of computers per 1,000 inhabitants	14	51	53

Source: www.moodys.com

Data such as GNP, GDP, per capita income, growth rates, population, and level of industrialization are good indicators of market size and future sales in Jordan.

Despite the slowdown in real GDP growth rate during the year (3.3%), compared to that of previous year (4.8%), the recorded growth rate in 2003 is considered, from whatever perspective, good, especially in light of heightened conditions of uncertainty that prevailed in the region for the greater part of the year. This clearly shows the high degree of flexibility that the Jordanian economy enjoys in withstanding shocks. Growth in 2003 was fairly broad-based, with "transport, storage & communications" (7.1%), "trade, restaurants and hotels" (4.5%), manufacturing (4.0%), "finance, insurance, real estate, and business services" (2.6%), and "producers of government services" (2.4%) registering strong advances in 2003.

TABLE 5.2 Economic Growth Rates

2000-2003, Precentages

At current prices	2000	2001	2002	2003
GDP	3.8	5.8	5.7	5.3
GNP*	5.7	6.4	4.7	5.4
GNDI**	7.7	3.9	5.7	11.8
At constant prices				
GDP	4.1	4.9	4.8	3.3
GNP	5.9	5.4	3.9	3.3
GNDI	8.0	3.0	4.8	9.6

* : Represents gross domestic product plus net factor income from abroad.

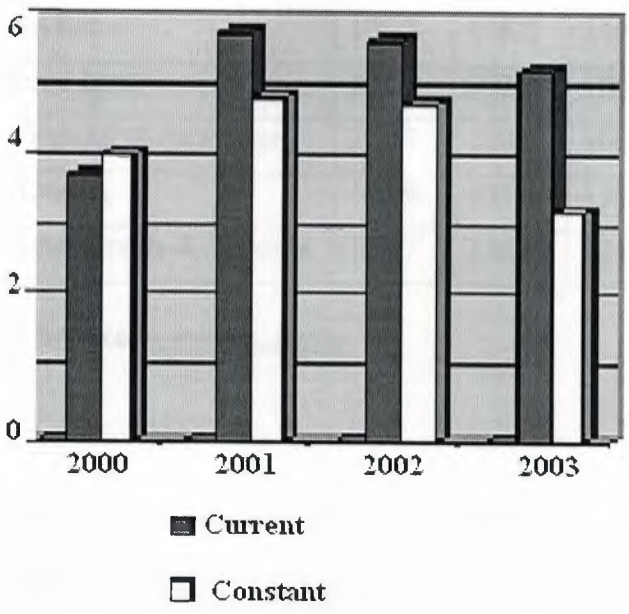
** : Represents gross national product plus net other current transfers from abroad.

Source: www.doc.gov.jo

GDP at current market prices grew in 2003 by 5.3%, to reach JD 7,056.2 million, against a growth rate of 5.7% in the year before.

Gross National Product (GNP) at current market prices recorded a growth rate of 5.4% against 4.7% in 2002. As a result of the remarkable increase in net other current transfers from abroad in 2003 by JD 620.9 million, Gross National Disposable Income (GNDI) grew by 11.8%, compared to 5.7% a year before, to reach JD 9,369.6 million in 2003.

CHART 5.1 Growth Rate of GDP at Market Prices 2000-2003, Percentages



Source: www.cbj.gov.jo

The real growth recorded in 2003 was primarily driven by the growth in service-producing sectors, which, combined, contributed to nearly two thirds of the recorded real growth rate. This growth was achieved within an environment marked by relative stability in the general price level, as inflation rate, measured by the percentage change in the Consumer Price Index, did not exceed 2.3%.

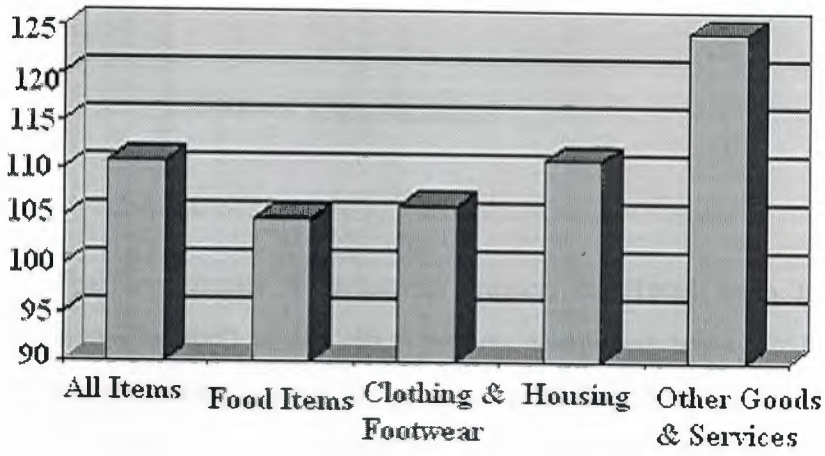
Despite the slowdown, the recorded real growth rate in 2003 had surpassed the population growth rate of 3%, thus bringing up real per capita GDP by 0.4%.

TABLE 5.3 Consumer Price Index

Indicator (1998=100)	2001	2002	2003
All Items	106.3	108.2	110.74
Food Items	102.7	102.9	104.76
Clothing & Foot wear	111.2	110.6	106.15
Housing	105.9	108.3	110.91
Other Goods & Services	112.7	118.5	124.35

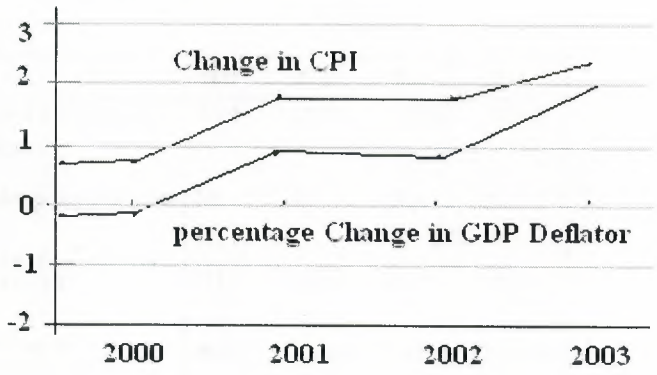
Source: www.nic.gov.jo

CHART 5.2 Consumer Price Index (2003)



Source: www.nic.gov.jo

Inflation Rates
2000-2003, Percentages



Source: www.cbj.gov.jo

The investments in industrial projects benefiting from Investment Promotion Law amounted in 2003 to JD 239.5 million distributed among 261 projects against JD 277.5 million distributed among 289 projects in 2002. Credit facilities extended by licensed banks to the industrial sector declined by a narrow margin of 0.6% at the end of 2003 compared with their level at the end of 2002, to JD 879.4 million, thus comprising
16.7% of total credit facilities extended by licensed banks. By contrast, credit facilities extended to the industrial sector by the Industrial Development Bank (IDB) increased by 0.7%, compared to their level at the end of 2002 to JD 76.7 million at the end of 2003.

TABLE 5.4 Main Indicators of the Industrial Sector

2000-2003

	2000	2001	2002	2003
Value added at current prices (JD million)	969.4	1,013.3	1,111.0	1,178.3
Growth rate at constant prices (%)	3.9	5.8	12.3	3.2
The deflator of the industrial Sector (1994=100)	111.7	110.3	107.7	110.7
Industrial exports (JD million)*	964.4	1,216.8	1,415.4	1,518.4
"Mining & quarrying" & manufacturing industrial production index	107.1	120.1	127.6	116.2
Number of registered industrial companies	315	384	358	426
Capital of registered industrial companies (JD million)	8.5	7.6	6.7	12.5
Outstanding credit facilities extended by licensed banks (JD million)	784.1	806.3	885.1	879.4
Outstanding credit facilities extended by licensed banks (JD million)	88.4	80.4	76.2	76.7

Source: www.cbj.gov.jo

5.4.2 Ease and Compatibility of Operations

- **Unique and Strategic Location**

_Situated at the convergence of Europe, Asia and Africa

_Transportation hub of the Middle East

_Access to the Red Sea through the Port of Aqaba, and other ports via neighboring countries

- **Access to Major International Markets**

_ Access to the US market, the free trade agreement that was ratified in 2001

_Duty & quota free access to the US market through the Qualifying Industrial Zones (QIZ).

_Duty frees access to EU markets.

_ Access to more than 10 Arab countries through the Arab Free Trade Agreement

_ Bilateral agreements and favorable protocols with over 20 countries

_Member of the Multilateral Investment Guarantee Agency (MIGA)

- **Attractive Investment Climate**

_Total customs exemptions on imported fixed assets

_Ease of licensing and registration procedures

_Revenues on exports are exempted from income taxes until the end of 2006

_Export industries are not subject to customs duties on imported raw materials

_Free repatriation of capital, profits and salaries

5.4.3 Costs and Resource Availability

- **World Class Infrastructure and Communications**

_State Telephone Company operates on a commercial basis, with 40% of the company privatized.

_Choice of privately–owned Internet service providers.

_Direct Royal Jordanian flights to 47 major cities in Europe, the Middle East, the Far East, North Africa and North America served by 26 international airlines.

_Modern highway network.

_Major trucking lines ensuring the movement of raw materials to and from the port of Aqaba as well as into and from ports of neighboring countries.

- **Qualified and Competitive Human Resources**

_Abundant and competitive workforce

_Young and highly educated population

_89% of the population are literate

_17% of Jordanians receive higher education

5.4.4 Red Tape

1. The Investment Promotion Law exempts all fixed assets that are imported for a project from payment of taxes and fees. This exemption also applies to new assets that are later imported for expansion or modernization.

2. Registration and permission of a new company is undertaken through the office of the Controller of Companies of the Ministry of Industry and Trade, and is a simple procedure which can be accomplished in a matter of hours.

3. Any foreign investor may freely transfer capital and profits outside Jordan in any convertible currency. Proceeds from the sale or liquidation of investments are also free of all transfer restrictions. Foreign workers and managers may keep accounts in Jordanian banks in any convertible currency, and may freely repatriate any salaries or other remuneration.

4. Foreign companies can easily obtain permits for expatriate personnel and managers, and these permits are issued by the Ministry of Labor and the Ministry of the Interior. These permits are renewed annually, and coordination on the foreign investor's behalf with the concerned Ministries is one of the services offered by the Jordan Investment Board (JIB).

5. Land for industrial and residential purposes may be purchased or leased by foreigners throughout Jordan (www.jodaninvestment.com).

5.5 RISK ASSESMENT

Domestic demand along with a foreign demand and tourism rebound have been underpinning the economy. That trend has been benefiting most sectors (manufactured products, construction, transportation, hotels, water, and electricity), which should permit company solvency to improve. However, the recovery has been accompanied with a sharp increase in imports moreover affected by oil prices. That has contributed to increasing the current account deficit despite favourable trends on tourism and exports of goods, notably textile products headed for the United States. Debt reliefs granted by the Paris Club and official transfers have nonetheless permitted limiting external financing needs.

Fiscal deficit reduction and the country's dependence on international aid have remained the main policy focus for Jordanian authorities. That will necessitate a speedup of company restructuring and pursuit of austerity policy, two objectives difficult to implement in a social context marked by high levels of poverty and unemployment. Moreover, uncertainties continue to cloud the region's geopolitical outlook, which could affect tourism and investment (www.moodys.com).

- **COUNTRY RATING**

Rating: B

An unsteady political and economic environment is likely to affect further an already poor payment record.

MIDDLE EAST	
KUWAIT	A2
QATAR	A2
UNITED ARAB EMIRATES	A2
BAHRAIN	A3
OMAN	A3
ISRAEL	A4
SAUDI ARABIA	A4
EGYPT	B
IRAN	B
JORDAN	**B**
TURKEY	B
LEBANON	C
LIBYA	C
SYRIA	C
YEMEN	C
IRAQ	D

www.moodys.com

5.6 INCENTIVES AND BENEFITS

A. Income and Social Service Taxes Exemptions:

Projects approved by the Investment Committee enjoy a ten year exemption from income and social services taxes at the following rates depending on the sector and the area in which the project is located:

Projects in zone A 25%

Projects in zone B 50%

Projects in zone C 75%

Where a project is expanded, improved or modernized so as to increase its production capacity, it shall receive an additional year of exemption for every increase of production, which is not less than 25%, for a maximum of four years.

B. Customs Tax Exemptions:

1 Imported fixed assets required for the project are exempted from customs taxes and fees for a period of three years starting from the date approval is granted.

2 Imported fixed assets needed for expanding, modernizing, or developing a project are exempted from customs taxes and fees, if this results in an increase of a minimum of 25% of the production capacity.

3 Spare parts imported for the project are exempted from taxes and fees provided that their value does not exceed 15% of the total value of the fixed assets utilizing these spares.

4 Hotel and hospital projects are granted extra exemptions from customs taxes and fees on their imports of furniture and supplies for the purpose of renewal, once every seven years.

5 Any increase in the value of imported fixed assets is exempted from customs taxes and fees if the increase results from a rise in prices, freight charges or changes in exchange rates.

5.7 INVESTMENT STATISTICS

TABLE 5.6 Statistics with Investment Volumes according to Municipalities 2001

Municipality	Investments' Number	Total Investment Volume (JD)	Foreign Direct Investments Volume (JD)
Amman	243	319.861.232	72.740.603
Irbid	21	24.111.631	11.100.000
Albalqa'a	16	28.970.000	28.970.000
Karak	6	18.900.000	18.400.000
Ma'an	3	2.030.000	0
Zarqa	31	42.405.404	18.155.720
Mafraq	16	7.433.500	140.000
Madaba	4	30.370.000	12.290.000
Jaresh	4	1.060.000	50.000
Ajloun	4	2.050.000	0
Aqaba	2	420.040.000	280.000.000
TOTAL	**350**	**897.231.767**	**414.135.323**

Source: www.jordaninvestment.com

The foreign direct investments volume had been increasing since 1996 obviously to reach its peak in year 2000 recording JD438 million. But surprisingly, the FDI volume started decreasing to become only JD83 million in year 2003, as shown in table 4.4 and chart 4.1.

Therefore, governmental reforms should be taken seriously to handle this problem. I described many of these reforms in the conclusion.

TABLE 5.7 Statistics with Investment Volumes according to Municipalities

2002

Municipality	Investments' Number	Total Investment Volume (JD)	Foreign Direct Investments Volume (JD)
Amman	198	114.836.524	36.943.131
Irbid	35	20.137.743	8.959.999
Albalqa'a	13	6.886.065	700.000
Karak	5	8.230.000	6.100.000
Ma'an	4	1.280.000	150.000
Zarqa	30	125.862.500	68.140.000
Mafraq	9	9.455.000	6.580.000
Tafila	1	200.000	0
Madaba	5	648.700	0
Jaresh	5	1.755.000	275.000
Ajloun	4	1.100.000	0
Aqaba	1	10.640.000	3.545.400
TOTAL	**310**	**301.031.532**	**131.393.530**

Source : www.jordaninvestment.com

TABLE 5.8 Statistics with Investment Volumes according to Municipalities

2003

Municipality	Investments' Number	Total Investment Volume (JD)	Foreign Direct Investments Volume (JD)
Amman	189	189.909.188	66.033.925
Irbid	34	15.109.150	10.601.000
Albalqa'a	16	5.370.200	150.000
Karak	5	10.677.500	0
Ma'an	5	765.500	0
Zarqa	20	29.504.920	6.200.000
Mafraq	10	8.160.000	550.000
Tafila	1	100.000	0
Madaba	4	1.650.000	0
Ajloun	1	100.000	0
Aqaba	3	314.000	180.000
TOTAL	**288**	**261.660458**	**83.714.925**

Source: www.jordaninvestment.com

CHART 5.3

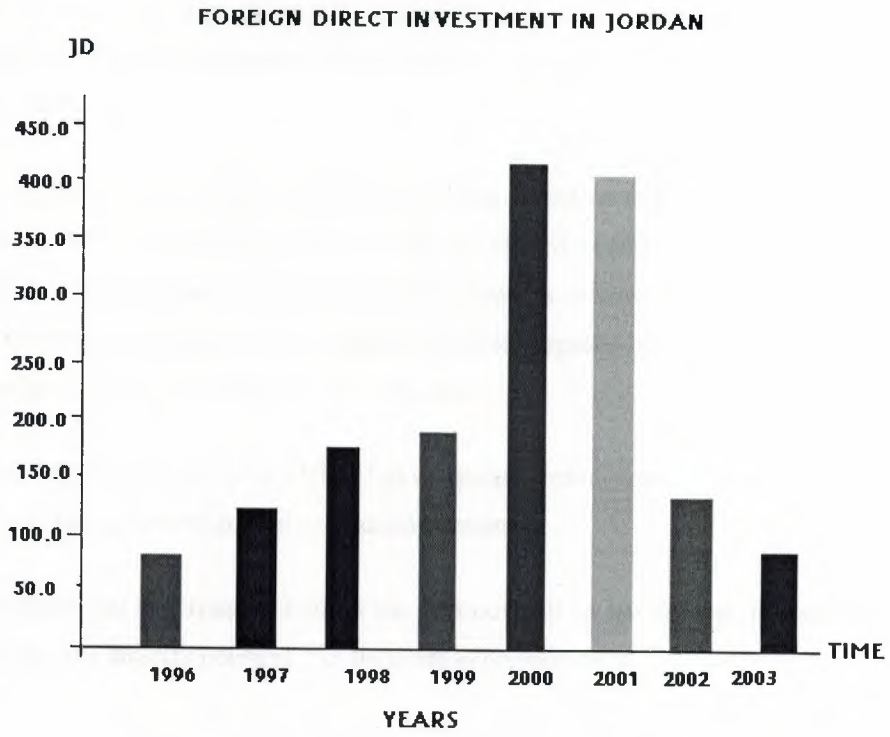


TABLE 5.9 **Distribution of Total and Foreign Investment Volume with Number of Investments**

Year	Investments' Number	Total Investment Volume (JD)	Foreign Direct Investments Volume (JD)
1996	251	347.660.382	75.785.109
1997	190	379.243.880	124.037.845
1998	201	481.673.652	154.854.675
1999	313	548.881.181	184.186.191
2000	261	793.274.826	438.378.862
2001	340	881.353.867	409.101.192
2002	310	301.031.532	131.393.530
2003	288	261.66.0458	83.714.925
TOTAL	**2154**	**3.994779778**	**1601452329**

Source: www.jordaninvestment.com

CONCLUSION

We have presented in this project a comprehensive description on FDI; advantages and disadvantages of FDIs in both home and host countries. Further, we have clarified how MNEs could make FDIs in host countries.

We explained the impact of FDI over the developing countries and we have reached to important conclusions: in which foreign investment of the developed countries is likely to make a positive contribution to a host country from developing countries whereas developing countries are less likely than developed countries to have domestic firms capable of making investments like those made by foreign investors from developed countries.

We have also found that successful MNEs follow certain techniques to choose the best locations for their operations through weeding out or scanning countries.

We have reached that the reasons behind the obvious fall in the foreign investments volume in Jordan presently are directly political, but there are economic ones:

- Political reasons; where the 9/11 events in New York affected the flow of the foreign investors to the Islamic countries generally, and middle east countries particularly.
- The Israeli-Palestinian conflict; where the last revolution (alentifada) that started in 2001 has still been affecting the attracting of FDIs negatively.
- The American allegation that Middle East countries contain terrorist groups is one of the direct reasons on decreasing the volume of FDIs in Jordan.
- The war in Iraq.
- MNEs' trends toward the gulf countries such as UAE because of the completely fully infrastructure there.

Therefore, Jordan has to hold international conferences to clarify its policies toward the foreign investor and to prove the existence of political stability. Moreover, to reach its vision to the international community in the hope that MNEs see Jordan as a target to invest in.

Jordanian government has to ease investment procedures and cut down on the bureaucratic licensing procedures of projects in areas of Jordan. In addition, bank guarantees required from foreign investors in the Qualified Industrial Zone (QIZ) must be reduced.

A proper mechanism by Jordan Investment Board (JIB) should be found for measuring FDI.

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