

Multinational Corporations in the Global Economy

Multinational corporations sit at the intersection of production, international trade, and cross-border investment. A multinational corporation is “an enterprise that engages in foreign direct investment (FDI) and owns or controls value adding activities in more than one country” (Dunning 1993, 3). MNCs thus have two characteristics. First, they coordinate economic production among a number of different enterprises and internalize this coordination problem within a single firm structure. Second, a significant portion of the economic transactions connected with this coordinated activity take place across national borders. These two attributes distinguish MNCs from other firms. While many firms control and coordinate the production of multiple enterprises, and while many other firms engage in economic transactions across borders, MNCs are the only firms that coordinate and internalize economic activity across national borders.

It is difficult to exaggerate the importance of MNCs in the contemporary global economy. In discussing MNCs it is typical to distinguish between parent firms, the corporate owner of the network of firms comprising the MNC, and the foreign affiliates, the multiple enterprises owned by parent firms. This basic terminology allows us to gain a sense of the role that MNCs play in the contemporary international economy.

According to the United Nations Conference on Trade and Development, there are approximately 63,459 parent firms that together own a total of 689,520 foreign affiliates. In 1998 these affiliates employed approximately 6 million people worldwide. Together, parent firms and their foreign affiliates produce about 25 percent of world gross domestic product (UNCTAD 2000). The importance of multinational corporations is not limited to production, as they are also significant participants in international trade. It has been

estimated that trade within MNCs, called intra-firm trade, accounts for about one-third of total world trade. If we add to this figure the trade that takes place between MNCs and other unaffiliated firms, then MNCs are involved in about two-thirds of world trade. Thus, MNCs are productive enterprises that by definition engage in cross-border investment and are heavily involved in international trade.

Who are these firms, and where are they located? While it is impossible to provide an extensive catalog of more than 60,000 firms, table 5.2 does list the world's 100 largest MNCs, ranked by their foreign assets. These 100 MNCs, among which are many familiar names, account for more than 15 percent of all foreign assets controlled by all MNCs, and for 22 percent of total sales by MNCs. These large MNCs are based almost exclusively in advanced industrialized countries; ninety-nine of the 100 largest firms are from the United States, Western Europe, or Japan and more than 5/6ths of all parent corporations are based in advanced industrial countries (see table 5.3). Parent corporations are not exclusively a developed country phenomenon, however. Hong Kong, China, South Korea, Venezuela, Mexico, and Brazil are also home to MNC parent firms, but these firms are considerably smaller than developed country firms. Only one MNC parent based in a developing country, Petroleos de Venezuela, ranks among the world's 100 largest. The fifty largest MNCs from developing countries control only \$105 billion of foreign assets, less than ten percent of the assets controlled by the 50 largest developed country MNCs.

The distribution is reversed when we consider the affiliates. Developing countries host more than 355,324 MNC affiliates, while advanced industrialized countries host only 94,269 (UNCTAD 2000, 11-13). Within the developing world, MNC affiliates are

Table 5.2: The Fifty Largest MNCs, Ranked by Foreign Assets (1998)

Firm	Country	Industry	Foreign Assets	Total Assets	Foreign Employment
General Electric	United States	Electronics	97.4	304.0	111,000
Ford Motor Company	United States	Automotive	72.5	275.4	174,105
Royal Dutch Shell	Netherlands/UK	Petroleum	70	115	65,000
General Motors	United States	Automotive			
Exxon Corp	United States	Petroleum	54.6	96.1	
Toyota	Japan	Automotive	41.8	105.0	
IBM	United States	Computer	39.9	81.5	134,815
Volkswagen Group	Germany	Automotive		57.0	133,906
Nestle S.A.	Switzerland	Food and Beverages	31.6	47.6	219,442
Daimler-Benz	Germany	Automotive	30.9	76.2	74,802
Mobil	United States	Petroleum	30.4	43.6	22,200
Fiat Spa	Italy	Automotive	30	69.1	94,877
Hoechst AG	Germany	Chemicals	29.0	34.0	
Asea Brown Boveri (ABB)	Switzerland	Electrical Equipment		29.8	200,574
Bayer AG	Germany	Chemicals		30.3	
Elf Aquitaine SA	France	Petroleum	26.7	42.0	40,500
Nissan Motor	Japan	Automotive	26.5	57.6	
Unilever	Netherlands/UK	Food and Bev	25.6	30.8	262,840
Siemens AG	Germany	Electronics	25.6	67.1	201,141
Roche Holding AG	Switzerland	Pharmaceuticals		37.6	41,832
Sony Corp	Japan	Electronics		48.2	
Mitsubishi	Japan	Diversified	21.9	67.1	
Seagram	Canada	Beverages	21.8	22.2	
Honda Motor	Japan	Automotive	21.5	36.5	
BMW AG	Germany	Automotive	20.3	31.8	52,149
Alcatel	France	Electronics	20.3	41.9	
Philips Electronics	Netherlands	Electronics	20.1	25.5	206,236

News Corp	Australia	Media	20.0	30.7	
Phillip Morris	United States	Food/Tobacco	19.4	55.9	
British Petroleum	UK	Petroleum	19.2	32.6	37,600
Hewlett-Packard	United States	Electronics	18.5	31.7	
Total SA	France	Petroleum		25.2	
Renault SA	France	Automotive	18.3	34.9	45,860
Cable and Wireless Plc	UK	Telecommunication		21.6	33,740
Mitsui & Co. Ltd	Japan	Diversified	17.9	55.5	
Rhone-Poulenc SA	France	Chemicals/Pharmaceuticals	17.8	27.5	
Viag SA	Germany	Diversified	17.4	32.7	
BASF AG	Germany	Chemicals		26.8	
Itochu Corp	Japan	Trading	16.7	56.8	2,600
Nassho Iwei Corp	Japan	Trading	16.6	40.4	2,068
Du Pont	United States	Chemicals	16.6	42.7	
Diageo Plc	UK	Beverages		29.7	63,761
Novartis	Switzerland	Pharmaceuticals/Chemicals	16.0	36.7	71,403
Sumitomo Corp	Japan	Trading/machinery	15.4	43.0	
ENI Group	Italy	Petroleum	14.6	49.4	23,239
Chevron Corp	United States	Petroleum	14.3	35.5	8,610
Dow Chemical	United States	Chemicals	14.3	23.6	
Texaco Inc	United States	Petroleum	14.1	29.6	
BCE Inc	Canada	Telecommunication	13.6	28.2	
Xerox	United States	Photo Equipment	13.5	27.7	

Source: United Nations Conference on Trade and Development, 1999.

Table 5.3: Parent Corporations and Affiliates By Region

	Parent Corporations Based in Economy	Foreign Affiliates Located in Economy
Developed Economies		
<i>Western Europe</i>	37,580	61,594
<i>United States</i>	3,387	19,103
<i>Japan</i>	4,334	3,321
Developing Economies		
<i>Africa</i>	167	3,669
<i>Latin America and Caribbean</i>	2,019	24,345
<i>Asia</i>	9,883	327,310
<i>Central and Eastern Europe</i>	2,150	239,927

Source: UNCTAD 2000, 11-13.

highly concentrated in a relatively small set of countries. Thirteen countries in East Asia and Latin America host 331,748 MNC affiliates, about half of the total affiliates worldwide. China alone hosts 235,681 affiliates. MNCs have also invested heavily in Eastern and Central Europe during the 1990s, creating a total of 239,927 affiliates in this region. Here too affiliates are concentrated in a few countries; the Czech Republic, Hungary, and Poland host 135,997 of the affiliates active in this region. While these figures on the location of affiliates are interesting, they are misleading to some extent. As we saw in chapter four, the vast majority of foreign direct investment flows into advanced industrialized countries rather than the developing world. Thus, even though there are more affiliates based in developing countries than in advanced industrialized countries, the affiliates created in advanced industrialized countries tend to be larger and more capital intensive than the affiliates created in developing countries.

For what specific purposes do firms engage in foreign direct investment? MNC investment can be divided into three broad categories. First, MNCs engage in cross-border investment to gain secure access to supplies of natural resources. For example, the American copper mining firm Anaconda made large direct investments in mining operations in Chile in order to secure copper supplies for production done in the United States. Indeed, as table 5.4 illustrates, petroleum and mining is the third most important industry represented in the top 100 MNCs, with 11 of the largest firms engaged in either oil production or mining.

Second, MNCs invest across borders to gain access to foreign markets. Much of the cross-border investment in auto production undertaken within the advanced industrialized world fits into this category. During the 1980s and early 1990s, Japanese

Table 5.4: Industry Composition of the Top 100 MNCs

	1990	1998
Electronics/electrical equipment/computers	14	17
Motor Vehicle and Parts	13	14
Petroleum (exploration, refining, distribution) and Mining	13	11
Food, Beverages, Tobacco	9	10
Chemicals	12	8
Pharmaceuticals	6	8
Diversified	2	6
Telecommunications	2	6
Trading	7	4
Retailing	-	3
Utilities	-	3
Metals	6	2
Media	2	2
Construction	4	1
Machinery/engineering	3	-
Other	7	5
Total	100	100

Source: UNCTAD 2000, 78.

and German automotive MNCs such as Toyota, Nissan, Honda, BMW, and Mercedes built production facilities in the United States in response to concerns that barriers to market access would limit the number of cars they would be allowed to export into the American economy from Japanese and German plants. During the 1960s, many American MNCs made direct investments in the European Union to gain access to the common market being created there. As table 5.4 indicates, the auto industry is the second most heavily represented industry among the largest MNCs, accounting for 14 of the top 100 MNCs.

Third, MNCs make cross-border investments to improve the efficiency of their operations, by rationalizing production and trying to exploit economies of specialization and scope. An increasingly large share of cross-border investment in manufacturing fits into this category. In electronics and computers as well as in the auto industry, firms allocate different elements of the production process to different parts of the world. In computers, electronics, and electrical equipment, for example, which account for seventeen of the largest 100 MNCs (see table 5.4), the human and physical capital-intensive stages of production such as design and chip fabrication, are performed in the advanced industrialized countries, while the more labor-intensive assembly stages of production are performed in developing countries. In the auto industry, the capital-intensive design and production of individual parts such as body panels, engines, and transmissions is performed in developed countries, and the more labor-intensive assembly of the individual components into automobiles is performed in developing countries.

Multinational corporations' activities in the postwar international economy have evolved over time. It is common to divide this evolution into two distinct periods, the immediate postwar period spanning the years 1945 to 1960 and a second period since 1960. Two features characterized the immediate postwar period. First, American firms dominated foreign direct investment. Concerned with postwar reconstruction and unwilling to risk the balance of payments consequences of capital outflows, European and Japanese governments had little interest in encouraging outward direct investment. As a consequence, American firms dominated MNC activity, accounting for about two-thirds of the new affiliates created in this period. Second, the bulk of MNC investment during this period was oriented toward Europe for the purpose of manufacturing. The push to invest in Europe was given additional impetus at the end of the 1950s by the creation of the European Economic Community, and thus the early 1960s saw a rapid increase in the amount of market-oriented investment by American firms in the Common Market countries. Other direct investments flowed to developing countries, Canada, and Australia for natural resource extraction. In short, American MNCs engaged primarily in market- and natural resource-oriented foreign direct investment dominated the immediate postwar period.

Both of these characteristics of MNC activity have changed dramatically since 1960. The early dominance of American firms has been increasingly diminished as European and Japanese firms began to engage in foreign direct investment. The increased role of other industrialized nations has more recently been accompanied by the emergence of foreign direct investment by MNCs based in the Asian NICs and in Latin America. Thus, while American firms continue to play a large role, they are not nearly as

dominant today as they were in the early postwar years. At the same time, the relative importance of market- and natural resource-oriented direct investment has fallen and that of efficiency-oriented investment has risen. As Dunning (1996) notes, MNCs increasingly view “each of their foreign affiliates and, frequently, their associated suppliers and industrial customers, not as self-contained entities, but as part of a regional or global network of activities. New investments are increasingly undertaken as part of an integrated international production system.” The shift to efficiency-oriented investments and integrated international production systems has been made possible in large part by developments in communications technology and, as we saw in chapter four, by the reduction in trade barriers achieved through the GATT process.

In summary, during the last fifty years multinational corporations have grown to play a centrally important role in the international economy. MNCs are, in many respects, the driving force behind the deepening integration of the global economy. The central importance of MNCs in the contemporary international economy raises a large number of issues that we explore in the pages that follow. Most of these issues can be subsumed under a single question: What are the economic and political consequences of MNC activity? To answer this question we look first at the economics of multinational corporations, examining why firms engage in foreign direct investment and how FDI affects economic activity in the countries that host it. We then turn our attention to the political economy of MNCs, examining the nature of the bargaining relationship between MNCs and host-country governments and governments’ efforts, unsuccessful to date, to craft an international investment regime.

The Costs and Benefits of MNC Activity

How are host countries affected by MNC activity? While it is clear that MNCs are motivated to engage in foreign direct investment to raise their profitability, it is less obvious what impact these investments have on the countries that receive them. In fact, most of the controversy surrounding MNC activity arises from disputes over how foreign direct investment affects the host country. Some argue that FDI is highly beneficial to the host country, while others argue that MNCs have a negative impact on host countries, particularly in the developing world. Here we look closely at two well-developed perspectives on the impact of foreign direct investment on host countries and then briefly consider what the existing empirical evidence suggests about the accuracy of these competing perspectives.

The benign model argues that MNCs make a significant contribution to economic development.¹ Foreign direct investment is an important mechanism through which savings are transferred from the advanced industrialized world to the developing world. Because developing countries usually have low savings, FDI can usefully add to the capital available for physical investment. Moreover, because MNCs create fixed investments, this form of cross-border capital flow is not subject to the problems often posed by financial capital flows. Fixed investment is substantially less volatile than financial capital flows, and thus does not generate the kinds of boom and bust cycles we saw in chapter 8. In addition, because MNCs invest by creating domestic affiliates, direct investment does not raise host countries' external indebtedness. Of the many possible ways in which savings can be transferred to the developing world, therefore, direct

¹These terms are borrowed from Moran (1999).

investment might be the most stable and least burdensome for the recipient countries.

The benign model also suggests that MNCs are important vehicles for the transfer of technology to host countries. Because MNCs control proprietary assets, which are often based on specialized knowledge, the investments they make in developing countries often lead to this knowledge being transferred to indigenous firms. In Malaysia, for example, Motorola Malaysia transferred the technology required to produce a particular type of printed circuit board to a Malaysian firm, which then developed the capacity to produce these circuit boards on its own (Moran 1999, 77-8). In the absence of the technology transfer, the indigenous firm would not have been able to produce these products. Technology transfer can in turn generate significant positive externalities with wider implications for development (see Graham 1996, 123-130). Externalities arise when economic actors in the host country that are not directly involved in the MNC-local affiliate technology transfer also gain from this transaction. If the Malaysian Motorola affiliate, for example, was able to use the technology it acquired from Motorola to produce inputs for other Malaysian firms at a lower cost than these inputs were available elsewhere, then the technology transfer would have a positive externality on the Malaysian economy.

In addition to transferring technology, the benign model suggests that MNCs transfer managerial expertise to developing countries. Greater experience at managing large firms allows MNC personnel to organize production and coordinate the activities of multiple enterprises more efficiently than host country managers. This knowledge is applied to the host country affiliates, allowing them to operate more efficiently as well. Indigenous managers in these affiliates can then move to indigenous firms, spreading

managerial expertise into the host country.

Finally, the benign model suggests that MNCs enable developing country producers to gain access to marketing networks. When direct investments are made as part of a global production strategy, the local affiliates of the MNC and the domestic firms that supply the MNC affiliate become integrated into a global marketing chain. This opens up export opportunities that indigenous producers would not otherwise have. The Malaysian firm to which Motorola transferred the printed circuit board technology, for example, wound up supplying not only Motorola Malaysia, but also began to supply these components to eleven Motorola plants worldwide. These opportunities would not have arisen had the firm not been able to link up with Motorola Malaysia.

The malign model focuses on many of the same elements as the benign model, but argues that these factors often operate to the detriment of host country economic development. First, rather than transferring savings to developing countries, the malign model argues that MNCs reduce domestic savings. Savings are reduced in two ways. First, it is argued that MNCs often borrow on the host country capital market rather than bring capital from their home country. MNC investment therefore “crowds out” rather than adding to domestic investment. Second, it is suggested that MNCs earn rents—above normal profits—on their products and repatriate most of these earnings. Host country consumers therefore pay too much for the goods they buy, with negative consequences on individual savings, while MNC profits, which could potentially be a source of savings and investment in the host country, are transferred back to the home country. The amount of domestic savings available to finance projects therefore falls.

The malign model also argues that MNCs exert tight control over technology and

managerial positions, preventing the transfer of both. The logic here is simple. As we saw above, one of the principal reasons for MNC investment arises from the desire to maintain control over proprietary assets. Given this, it is indeed hard to understand why an MNC would make a large fixed investment in order to retain control over proprietary technology, and then once having done so begin to transfer this technology to host-country firms. Managerial expertise is not readily transferred either, in large part because MNCs are reluctant to hire host-country residents into top-level managerial positions. Thus, the second purported benefit of MNC—the transfer of technology and managerial expertise—can be stymied by the very logic that causes MNCs to undertake FDI.

Finally, the malign model suggests that MNCs can drive domestic producers out of business. This can happen in one of two ways. On the one hand, domestic firms producing in the same sector will face increased competition once an MNC begins selling in the domestic market. Using best practices for management and state of the art technology, MNCs can often under-price local firms, thereby driving them out of business. Second, MNCs often desire to assemble their finished goods from imported components. As a result, domestic input producers in the same industry will find that as the domestic producers they supply are driven out of business, they have no one to sell their intermediate goods. Thus, local input suppliers can also be driven out of business by MNCs.

The benign and the malign models depict dramatically different consequences from MNC investment in developing country economies. Which of these two models is correct? The short answer is that both are; foreign direct investment is sometimes beneficial for and at other times detrimental to the host countries. Two studies, now

somewhat dated, are suggestive in this regard. One study examined 88 MNC affiliates operating in six countries (Lall and Streeten 1977). The authors found that in two-thirds of the cases foreign direct investment had a positive impact on the host country, and in one-third of the cases the impact was negative. A similar study was conducted about ten years later. Focusing on 50 foreign direct investments, this study found that between half and three quarters of the foreign investments yielded net benefits to the host countries, while one-quarter to one-half of the projects imposed net costs onto the host country (Encarnation and Wells 1986). Thus, foreign direct investment sometimes operates in the manner suggested by the benign model, and at other times it operates as the malign model suggests.

What determines whether any particular investment will be beneficial or detrimental to the host country? It is extremely difficult to say anything systematic or conclusive in response to this question. A range of considerations are important, including the specific agreement between the host-country government and the MNC upon which the investment is based. While any broad generalizations must therefore be treated with considerable caution, one can suggest that some types of investment begin with a bias against host country development while other types of investment do not carry an initial bias. Market oriented and natural resource investments both carry biases that can limit the contribution they make to economic development in host countries. First, both types of investment take place under conditions of limited competition. Foreign affiliates in the extractive industries often gain monopoly control over the resource deposits of a given country, for example, while affiliates producing for the host-country market are often protected from external competition by high tariffs. The absence of

competition results in large rents accruing to firms operating in these areas, with associated efficiency losses for the host country. Moreover, both types of investment can have a negative impact on domestic producers in the host country. UNCTAD suggests, for example, that recent investments by MNCs in copper mining in Chile may have substituted for investments that otherwise would have been made by the Chilean national copper company (CODELCO), “which is the largest copper mining enterprise in the world and operates with state-of-the-art technology” (UNCTAD 1999, 173). Finally, neither resource oriented nor market oriented investment offers many opportunities for domestic producers to link into international marketing networks. For all of these reasons we might expect host countries to be most likely to suffer costs from natural resource and market-oriented investments.

Efficiency-oriented investments seem to carry fewer of the biases and offer the greatest chance that MNC activity will have a positive impact on host countries. The industries in which these investments occur are usually quite competitive internationally, hence the MNC’s drive for cost reduction measures, and the level of rents is correspondingly lower. Such investments can (but don’t always) create backward linkages to domestic input producers, and thus can promote rather than retard local firm growth. In particular, efficiency-oriented investments often “crowd-in” rather than “crowd out” investments by domestic firms. For example, it has been estimated that Intel’s decision to construct a microprocessor plant in Costa Rica will likely give rise to additional investments by 40 Costa Rican firms (UNCTAD 1999, 172). Finally, the international orientation of such firms creates opportunities for local firms to link themselves to global marketing networks. The research reported by Encarnation and

Wells (1986) is consistent with the notion that efficiency-oriented investments contain fewer of the biases against development that are present in natural resource and market-oriented investments. All of the export-oriented projects in the sample of MNC affiliates that they examined provided benefits to the host country. For all of these reasons we might expect host countries to benefit the most from efficiency-oriented investments.

The case of Singer Sewing Machines experience in Taiwan is suggestive of the potential benefits available through well-managed foreign direct investment. Singer first began producing in Taiwan in 1964.² At the time there were a number of local sewing machine producers using old technology and lacking standardization and therefore unable to compete in international markets. As a condition of Singer's investment, the Taiwanese government imposed domestic content requirements, insisting that Singer source 83 percent of its parts from Taiwanese producers within one year. In addition, the Taiwanese government imposed substantial conditions to ensure technology transfers. Singer was required to provide the local parts producers with standardized blueprints, and make available technical experts to assist in local firms' efforts to produce the specified parts. In addition, Singer was obliged to allow Taiwanese sewing machine producers to use the same parts it sourced from local parts producers at a cost close to the world price for these parts. Finally, an export requirement was imposed; Singer was required to increase its exports from Taiwan rapidly.

Singer complied with all of these requirements. Technical and management experts were dispatched to train local parts producers and to reorganize the production system within Taiwan. Technical assistance was also provided to local sewing machine

²Based on UNCTAD 1999, 211.

producers—the very firms that comprised Singer’s competition—at no cost to these firms. Blueprints and part specifications were provided to all local parts producers, thereby allowing them to work to common specifications and standards. Finally, Singer held classes for local parts producers in the technical and managerial aspects of the business.

As a direct result of these measures, substantial transfers of technology occurred, and significant backward linkages between the final sewing machine producers and the parts suppliers occurred. By the late 1960s Singer was sourcing all of the parts for its sewing machines produced in Taiwan from Taiwanese firms (except the needles). Moreover, 86 percent of Singer’s local production was exported. In addition, Taiwanese sewing machine producers became more competitive internationally. As local parts became standardized and of greater quality, Taiwanese sewing machine producers also became able to export to foreign markets.

In summary, MNC activity is sometimes beneficial for host country economic development, and at other times is detrimental to such development. One might suggest that natural resource investments are the least likely to offer substantial benefits to host countries, while efficiency oriented investments are the most likely to offer substantial benefits to host countries. Market oriented investments are likely to fall somewhere in between these two types, sometimes offering benefits, and at other times imposing costs. It is important to re-emphasize the tentativeness of these broad generalizations. As we will see in the next section, MNC activity has historically been subject to political considerations. As a consequence, the impact of any particular investment on any particular host country is shaped by the particular agreement between the firm and the

host country government. These agreements can transform a natural resource investment into a highly beneficial proposition for a host country, and they can transform an efficiency-oriented investment into a highly costly one. In other words, while the preceding discussion is suggestive, the effect that any particular foreign direct investment will have on any particular host country will depend greatly on the specific details of the case.

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