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Book Review — Digitized Version

[Book Review of] Dunning, John H.: Explaining international production, London, Unwin Hyman, 1988

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Dunning, John H., *Explaining International Production*. London, Boston, Sydney, Wellington 1988. Unwin Hyman. XVII, 378 pp.

Dunning, John H., *Multinationals, Technology and Competitiveness*. London, Boston, Sydney, Wellington 1988. Unwin Hyman. XIX, 280 pp.

These two monographs contain a collection of essays of one of the leading specialists on international production, most of them previously published and re-edited, some entirely new. The main theme of both books is the author's "eclectic approach", first propounded as a general theory of international production in the late 1970s. The first monograph ("Explaining International Production") focusses on the contribution of the eclectic approach to an understanding of the foreign direct investment activities of multinational enterprises, whereas the second aims at explaining the interface between technology, competitiveness and international production from the angle of the eclectic paradigm.

Roughly speaking, the main conclusion of the eclectic paradigm of international production is that a firm will engage in foreign value-adding activities if the following three necessary and collectively sufficient conditions are satisfied:

(i) The potential foreign investor possesses ownership advantages in comparison to firms of other nationalities in serving certain foreign markets. These ownership advantages largely rest on the possession of intangible assets like superior product innovations, production management, organization and marketing systems, innovatory capacities, non-codifiable knowledge, "bank" of human capital experience or access to financial sources, which are, at least for a limited period of time, exclusive or specific to the firm possessing them.

(ii) It must be more beneficial to an enterprise possessing ownership advantages to use them itself instead of selling or leasing them to foreign firms, i.e. there must be incentives to internalize the use of ownership advantages through an international extension of existing value-added chains (internalization advantages). Above all, internalization advantages arise if foreign direct investments enable a firm

- to avoid the costs of enforcing property rights or search and negotiation costs,
- to protect the quality of their intermediate or final goods,
- to avoid the costs of the buyers' uncertainty about the nature and the value of the intangible assets to be sold, or
- to engage in cross subsidization, predatory pricing, or transfer pricing.

(iii) It must be in the interest of the potential investor to utilize ownership advantages in conjunction with some immobile factors located in foreign countries (location advantages). Otherwise, foreign markets would be served entirely by exports. Locational advantages arise if the endowment of a foreign country with immobile production factors like land, physical capital, or immobile, high-qualified labour is superior to that of domestic locations or if the institutional settings with regard to the education system, the infrastructure provisions, the tax system, or the degree of market regulations are more advantageous abroad. Moreover, incentives to shift or diversify production locations also arise if exports are impeded due to high communications and transportation costs as well as tariff and non-tariff trade barriers.

The eclectic approach has considerably improved the understanding of the foreign direct investment activities of multinational enterprises. Being based on the pathbreaking work of Hirsch,¹ it has been the first theory of international production which deduces the determinants of foreign direct investment by comparing the efficiency of alternative internationalization strategies. A brief glance at the characteristics of foreign

¹ Hirsch, Seev, "An International Trade and Investment Theory of the Firm". *Oxford Economic Papers*, Vol. 28, 1976, pp. 258–270.

direct investments clearly elucidates the advantages of this approach. By definition, foreign direct investments serve as a means to exercise more or less strong influence on the operation and production of foreign firms. As a consequence, foreign direct investments, in contrast to portfolio investments, transfer not only financial capital but also other production factors such as commercial and technological knowledge, or marketing experiences to foreign countries. Thus, the establishment of foreign subsidiaries can be regarded as a specific strategy to utilize existing intangible assets at foreign markets. However, firms can also exploit their intangible assets abroad by producing exportable goods and services or by engaging in cross-border licensing and international management contracts. As a consequence, foreign direct investment, foreign trade, and cross-border licensing are competing internationalization strategies. As it is ambiguous at first sight which internalization strategy will be advantageous for a single firm in a certain market, the determinants of foreign direct investments have to be derived on the basis of opportunity costs. Moreover, in contrast to the traditional theories of foreign direct investment, the eclectic approach simultaneously takes into account ownership, location as well as internalization advantages and thus provides a theoretical base for an empirical cross-industry, multi-country analysis of international production.

However, the undisputed economic value of the eclectic approach is not sufficient to justify a publication of two monographs containing a collection of essays which have been previously published in easily accessible sources. The interested reader rather expects that the value of the synopsis is greater than the sum of its constituent parts. From this viewpoint, the value added of the two monographs differ to a considerable extent.

“Explaining International Production” offers an in-depth discussion of a sharply outlined theme, namely the determinants of foreign direct investment activities of multinational enterprises from the perspective of the eclectic paradigm. Due to the straightforward reasoning and the clear structure, this monograph is more than just a collection of independent essays. The analysis starts with a detailed description of the main tenets of the eclectic approach (Ch. 1 and 2). Chapter 3 examines the contribution of the eclectic paradigm to an explanation of the growth of international production over the past century. Chapter 4 sketches some relationships between earlier theories of international production and the eclectic approach. Chapters 5–7 examine the ability of the eclectic approach to explain the changing propensity of countries to be direct investors as they move through different stages of economic development, and discuss the determinants of intra-industry international production as well as non-equity forms of foreign involvement from the perspective of the eclectic paradigm. Chapters 8–10 contain the empirical work of the author. The hypotheses of the eclectic approach are tested with regard to U.S. direct investment in U.K. manufacturing industry in the 1950s, Japanese direct investment in U.K. manufacturing in the 1980s as well as foreign direct investment in the international hotel industry and in the business service sector. Chapter 11 discusses the relationship between the changing forms of organization of international business and the effort of countries to capture the benefits of regional integration. Chapter 12 points to the uses and limitations of the eclectic approach with regard to the development of an interdisciplinary approach of international production. The final chapter speculates about the extent to which the eclectic paradigm might require modification to take into account some of the changes likely to take place in the form and character of international production in the 1990s.

In “Multinationals, Technology and Competitiveness”, the author tries to explore “some aspects of the interface between technology, competitiveness and the role of multinational enterprises (MNE) in the modern world economy” (p. 1). Unfortunately, the interface between the single essays of this monograph is not very close. Only Chapters 4, 5 and 6 (“Multinational Enterprises, Technology Transfer and National

Competitiveness”, “Inward Direct Investment from the USA and Europe’s Technological Competitiveness” and “The Changing Role of MNEs in the Creation and Diffusion of Technology”) are directly related to the general theme of the collection. All other essays mainly deal with some side-aspects. After some introductory remarks, the author first presents an overview of the main factors influencing the growth of international business over the past century (Ch. 2). The following chapter takes a historical look at the changing characteristics of international technology transfer undertaken by multinational enterprises. Chapters 4–6 contain the central part of the collection. It is shown that technology acts as an important means of improving competitiveness and that foreign direct investment is the main institutional mechanism for the international transfer of technology. In Chapter 7, the author examines the factors making for the decentralization of research and development activities undertaken by pharmaceutical multinational enterprises and the choice of country in which research and development is located, whereas Chapter 8 turns its attention to the way in which the technology transfer by multinational enterprises to the newly industrializing countries has affected the technological competitiveness of the investing countries. Chapters 9 and 10 focus on the structural adjustment problems of the United Kingdom and examine the way in which outward and inward direct investment has aided and inhibited adjustment. Finally, Chapter 11 discusses the role of government in influencing the location of economic activity by multinational enterprises, whereas Chapter 12 focusses particularly on the way in which multinational enterprises can promote the integration of national economies.

In summary, “Explaining International Production” may be of value not only to economists, international business analysts and policy-makers who are interested in one of the most skillful theories of international production, but also to economic researchers who have specialized on international business and who already know a substantial part of the author’s work included in this collection, whereas “Multinationals, Technology and Competitiveness” may be of value to economists who want to have an easy access to those essays of the author dealing with a relatively broad spectrum of themes from international production to technological development and international competitiveness.

Jürgen Stehn

Elfring, Tom, Service Sector Employment in Advanced Economies. A Comparative Analysis of its Implications for Economic Growth. Aldershot, Brookfield, Hong Kong, Singapore, Sydney 1988. Gower Publishing Company Ltd. XII, 238 pp.

The continued employment growth of the service sector is an important stylized fact of the long-run economic performance of the industrialized countries. This fact has attracted the attention of economists and policymakers, especially since it became obvious that almost all additional employment opportunities during the eighties were created in the service sector. Stagnating employment and rising unemployment in the European economies during the mid-seventies to the mid-eighties, and at the same time an employment miracle in the US with nearly 20 mil. additional jobs spurred the interest to examine the causes of the rise of the service sector. This is exactly what Tom Elfring’s book concentrates on: The shift to services in seven OECD countries between 1960 and 1984 and an assessment of the role of this sector for economic growth (p. 1).

As Elfring points out, large parts of his investigation deal with the development of internationally comparable estimates, especially productivity estimates. He labels his