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## Swedish Direct Investment in Low-Cost Countries

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# Industriens Utredningsinstitut

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## SWEDISH DIRECT INVESTMENT IN LOW-COST COUNTRIES

by

Thomas Andersson and Håkan Hellström

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# Swedish Direct Investment in Low-cost Countries

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April 1994

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## Abstract:

*While Swedish multinational firms expanded manufacturing in the industrial cores of Western Europe and North America in the late 1980s, their employment in third world countries contracted markedly. Predominantly large Swedish firms manufacture in the developing world, operations have been highly concentrated to a few locations and there has generally been a small propensity to export. There has been a considerable relocation of investments, however, with expansion occurring in those major host economies where wages are relatively low and accompanied by strong productivity growth. Together with trade liberalization and improved prospects for economic recovery in the developing world, increased investment flows to neighbouring Eastern Europe signal a revival of operations in low-cost countries.*

## **Introduction<sup>1</sup>**

The developing countries as well as Eastern Europe are in great need of increased investment, which to some extent must come from abroad. An important role in this context is played by foreign direct investment (FDI), through which so-called multinational firms establish ownership and control over foreign affiliates. In contrast to lending, FDI is associated with firm-specific assets, the transfer of which can contribute new technology, employment opportunities and human skills. At the same time, there is a widely spread fear in developed countries that a relocation of ventures to low-cost countries leads to deindustrialization and a loss of jobs.

Beginning in the 19th century, the developing world received mainly FDI motivated by access to natural resources (Lipson, 1985). Gradually, ventures have rather exploited low costs in manufacturing of mature, standardized goods, as first expounded in Vernon's (1966) theory of the product life cycle. Although multinational firms deepened their international integration of operations in the 1980s, involving an intensified specialization of production, the developing world obtained a declining share of global FDI. Meanwhile, small industrialized countries in Western Europe emerged as major sources of such investment. Multinational firms from these countries mainly expanded in the economic centres of North America and Western Europe. This applies not least to Sweden, which had the largest outward flows relative to the size of the economy in the decade as a whole. At the same time, Swedish-based firms actually reduced their total manufacturing in the developing world.

As FDI from small industrialized countries is not very well known, this paper surveys manufacturing by Swedish multinational firms in low-cost countries. Studying mainly

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1 Financial support from SWEDECORP is gratefully acknowledged.

employment in manufacturing affiliates between 1978 and 1990, the focus is on the scope and nature of production, not on transfers of capital per se.<sup>2</sup> It is also pointed out that a general revival of FDI to low cost countries has been observed in recent years. With employment data yet unavailable for this period, the paper reports a notable increase in investment flows to Eastern Europe. We begin by discussing the need of external capital in developing countries and the contribution of FDI.

### **Need of External Capital**

Populated by some four fifths of mankind, the developing world incorporates a far from homogeneous set of countries, peoples and cultures. While it is impossible to find any single denominator for all this diversity, all developing countries can be said to suffer from a general abundance of labour and shortage of capital. The latter does not only concern financial means but also modern technology and human capital in the form of skills in management, distribution, and so forth. Even though developing societies possess traditional technologies and knowledge which may have been sustainable for thousands of years, the demand for modern products, the population explosion, the increasing burden on the natural environment, etc., make it a matter of extreme urgency for developing countries to increase their access to capital in a broad sense.

Some developing countries try to raise funds domestically by stimulating savings. Even though savings are high in many cases, there are limits to what can be done in societies where consumption may be painfully low. When capital is scarce and, hence, the

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2 This is possible due to utilization of IUI's unique data set covering the foreign operations of all Swedish multinational firms in manufacturing. This data is based on a questionnaire which has been sent out about every fourth year covering the period between 1965 and 1990, and which has had a response rate above 90 percent throughout. It should be noted that ABB, resulting from the merger of ASEA and the Swiss company Brown Boveri, is not included for 1990 since the Swedish ownership did not surpass 50 percent.

marginal return relatively high, one might expect that developing countries would attract funds from abroad. In practice, however, capital flows to developing countries have been restrained for several reasons. Imperfections in financial markets due to, e.g., political risk, limited taxing power for the government, and risk of panic among creditors, severely restrict the ability of developing countries to obtain portfolio investment. With growing public deficits in developed countries as well as a widely spread feeling that too much of traditional aid-funds are squandered in the bureaucracies of recipient countries, there has been a stagnation in the transfer of official capital to developing countries as well.

The one remaining major source of capital in developing countries is that of FDI, i.e. equity investment undertaken by multinational firms which are mostly based in industrialized countries. Such investment is not motivated by cross-country differences in the marginal return to capital, but by the advantages of internalizing firm-specific assets in certain locations (Dunning, 1977; Caves, 1982). Because the investors carry the entrepreneurial risk of operations, they typically require an expected rate of return which is higher than the market interest rate. On the other hand, multinational firms exploit their special abilities in foreign affiliates, which may lead to an upgrading of local factors of production, including labour, domestic firms, public authorities, etc., that they cannot claim full compensation for.

In other words, host countries tend to gain from inward direct investment through spill-over effects on their domestic resource base. Such impacts hinge on the purpose of operations, however, and the kind of organization adopted by investors. Given free trade, for example, multinational firms can specialize their operations in accordance with country-differences in factor costs, which favours export oriented investment. Barriers to trade rather stimulate ventures that are motivated by sales on the local market.

## **New Investment Patterns**

In the last decades, conditions for FDI in developing countries have changed along with new attitudes towards multinational companies. The 1970s saw a massive wave of so-called expropriations or nationalizations of foreign equity. According to Williams (1975), as much as 12 per cent of all foreign assets in developing countries were nationalized in the 1960s and early 1970s. Towards the end of the 1970s, however, the nationalizations virtually ceased and have hardly been visible since.

There are several explanations for this turnaround. Developing countries generally improved their ability to gain from operations under foreign ownership, multinational firms reorganized their operations in a way which made affiliates more dependent on their organizations as a whole, increased access to portfolio investment made it more important for developing countries to secure a sound reputation as business partners in order to become eligible for borrowing, and so forth (Kobrin, 1984; Minor, 1987).

All in all, the developing countries have entered a state in which they almost universally call for increased FDI. In fact, most countries provide incentives, competing among each other for projects (Andersson, 1991). Still, the flows to the developing world generally dried up in the 1980s. Table 1 shows its notable reduction in the share of FDI, which is attributed to a decline in Latin America and Africa. There are several reasons for this shift, including: generally more uncertain conditions in the world economy, debt problems in many developing countries, a shift in economic power between the market-economies of the West and East Asia, and new forms of protectionism in developed countries. Nevertheless, the export-oriented economies in East Asia have strongly increased their share of total FDI.

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**Table 1: Inward stock of FDI, by region 1975-1990, percent**

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<u>Region</u>	<u>1975</u>	<u>1985</u>	<u>1990</u>
Developed market economies	75.1	75.0	80.8
of which:			
United States	11.2	29.0	25.9
Western Europe	40.8	28.9	39.5
Developing Countries	24.9	25.0	19.2
of which:			
Asia	5.3	7.8	9.9
Africa	6.7	3.5	2.1
Latin America	12.0	12.6	7.3

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*Source:* UNCTC (1988) and UNCTAD (1993)

The 1980s also saw major changes in the organizational and industrial characteristics of FDI. Improved information technology paved the way for a greater specialization of internationally integrated networks of operations and the establishment of new ventures was generally replaced as mode of entry by acquisition of existing companies, which allowed for synergy effects with already established assets. Meanwhile, natural resource based industries as well as manufacturing operations based on low labour costs declined in importance. Services and manufacturing based on modern technologies and high knowledge intensity became more prominent. Although services today account for most FDI, ventures in manufacturing are predominant in the Swedish case. It should be stressed, however, that sectoral boundaries are generally becoming blurred. Irrespective of industry, firms have to master a range of skills. The choice of hardware may, for example, be determined by associated software, financing and after sales services, etc. Multinational firms must increasingly address diverse needs on a global scale.

There have also been major changes in the origin of investment. In particular, small countries in Western Europe have experienced much enlarged outflows, with the most



**Table 2: Number of employees in Swedish multinational firms, 1974-1990, all companies, percent**

<u>Region/Activity</u>	<u>1978</u>	<u>1986</u>	<u>1990</u>
Employed in Sweden	58	51	39
Employed Abroad	42	49	61
<b>Type of Company Abroad</b>			
Manufacturing Affiliates	31	35	43
Sales Affiliates	7	10	10
Others	4	4	8

*Source:* IUI

conspicuous increase occurring in Sweden. Any decomposition of sales, production or employment in Swedish-controlled manufacturing illustrates that the internationalization process has advanced to a spectacular degree. The home country share of the total work force engaged by Swedish multinational firms shrank from 58 to 39 percent between 1978 and 1990, with the most speedy contraction in 1986-1990 (Table 2).

The most dramatic expansion abroad took place in manufacturing affiliates, whose average share of total employment (at home as well as abroad) rose from 31 percent in 1978 to 43 percent in 1990. Consequently, these units had more employees by 1990 than the parent companies. The focus is here primarily on manufacturing affiliates, which exert more far-reaching impacts on host countries than sales affiliates. Regarding industrial belonging, operations are classified in accordance with the characteristics of affiliates.

The geographical distribution of employment in manufacturing affiliates is shown in Table 3. The changes over time resemble those in the total stock of FDI presented in Table 1. In contrast to the global pattern, however, Swedish multinational firms have all along had their major operations in Western Europe, and particularly in the European

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**Table 3: Geographic distribution of employees in manufacturing affiliates of Swedish multinational firms abroad, 1978-1990, percent**

<u>Region</u>	<u>1978</u>	<u>1986</u>	<u>1990</u>
EC	59	51	55
EFTA	7	7	5
North America	10	21	23
Other industrialized countries	4	4	3
Developing countries	20	17	14

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*Source: IUI*

Community (EC). After a declining share between 1978 and 1986, when North America advanced strongly, the EC again gained in importance in the late 1980s. The developing world obtained a diminishing share.

### **Structure of Swedish FDI**

In value terms, direct investment is mainly undertaken by large firms, especially in distant regions. Note the dominating position attained by the 13 company groups that have more than 10 000 employees. Only these have extensive operations in developing countries, where some 9 percent of their total labour force is engaged (Table 4). Small firms retain most activities at home while their expansion abroad almost entirely has been confined to Europe. The smallest firms report no manufacturing at all in developing countries (although small Swedish multinational firms are the least well represented in the data). The importance of the home base shrinks continuously with firm size, as does the spread of operations.

These differences partly reflect a noteworthy variation between companies of different size in their access to competence. Table 5 presents the reported structure of

employment in Swedish firms categorized as small, subcontractors and large as of the late 1980s.<sup>3</sup> Large firms have the greatest share of specialists and white-collar workers while subcontractors have relatively many uneducated workers. Blue-collar workers are relatively less represented in large firms. As shown by Braunerhjelm (1991), Swedish subcontractors have low R&D intensity and tend to account for simple operations. Many of them had big problems coping with the internationalization of the 1980s.

As in large firms, the estimates presented in Table 6 indicate that global operations engage a high proportion of specialists and white-collar workers. The share of unskilled workers, which are estimated to have considerably lower wages than both white-collar and blue-collar workers, is even smaller in global operations than in large firms. Meanwhile, it has been observed that a greater share of employees are engaged in services throughout the industrial spectrum (Braunerhjelm, 1992). The average size of multinational firms operating in developing countries, and their relatively large

**Table 4: Total number of employees in Swedish multinational firms 1990 according to size, total in thousands, regional distribution in percent**

<u>Number of employees</u>	<u>Number of firms</u>	<u>Total employment</u>	<u>Geographic distribution</u>			
			<u>Sweden</u>	<u>EC+EFTA</u>	<u>Other Ind.</u>	<u>Developing</u>
1 - 199	28	3	70.7	21.4	7.8	0.0
200 - 999	44	23	61.1	33.9	4.3	0.7
1000 -1999	16	23	61.1	29.1	8.6	1.1
2000 -9999	11	62	47.0	36.9	12.8	3.7
10000 -	13	581	42.3	35.1	13.5	9.1

Source: IUI

3 The category of small manufacturing firms have between 20 and 200 employees, large firms are above this limit while subcontractors are defined by the presence of a single, dominating customer. The subcontractors are of varying size, but have about 200 employees on average (Braunerhjelm, 1991). Most multinationals belong in the category of large firms.

**Table 5: Distribution of employees in Swedish firms in terms of categories; small firms, subcontractors and large firms, 1989, percent**

<u>Category of employees</u>	<u>Small</u>	<u>Subcontractors</u>	<u>Large</u>
Executive staff	5	3	2
Specialists*	9	7	11
White-collar**	16	15	29
Blue-collar**	46	35	25
Unskilled	24	40	33

\* Includes middle management

\*\* White-collar and blue-collar workers have formal education corresponding to Senior Secondary School or University

Source: Braunerhjelm (1991)

**Table 6: Employment categories for the global operations of Swedish multinational firms, 1988, percent and 000' Swedish kronors**

<u>Category of employees</u>	<u>Percentage of total employees</u>	<u>Percentage of total labour costs</u>	<u>Labour costs per employee, 000' SEK</u>
Executive staff	3	5	357
Specialists*	7	12	290
White-collar**	31	31	181
Blue-collar**	25	26	186
Unskilled	34	26	136
Total	100	100	179

\* includes middle management

\*\* White-collar and blue-collar workers have formal education corresponding to Senior Secondary School or University

Source: Calculations by IUI

share of skilled personnel, demonstrate the presence of a considerable barrier to manufacturing in developing countries. At the same time, there is a strong potential for technological spill-overs in the host economy. This has been further supported by studies of R&D-activities and training expenditures which have been shown to result in higher productivity in manufacturing affiliates (Fors 1993; Andersson, 1994).

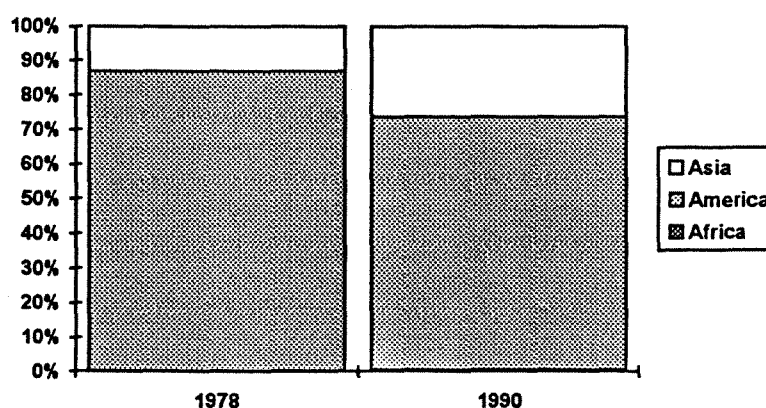
## Changing Pattern of Employment

Whereas their total work force abroad increased considerably, manufacturing affiliates of the Swedish multinational firms sharply reduced their number of employees in developing countries after 1986. As of 1990, about 42 thousand were employed in the developing world. Of this, more than one third belonged in electronics and one third in machinery and transports together, totalling 70 percent. As a comparison, these industries accounted for only 50 percent of total employment in affiliates of Swedish multinational firms in industrialized countries.

A decomposition of investment into regions of developing countries provides a heterogeneous picture. The major change in the period studied consisted in a substantial reduction of employment in Latin America, which used to be entirely

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**Figure 1: Distribution of employment in manufacturing affiliates of Swedish multinational firms, by region of developing countries, 1978 and 1990, percent**



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Source: IUI

predominant, while employment recorded high growth in Asia (Table 7). In 1978, only about 10 percent of the total work force in developing countries were employed in Asia. As of 1990, the share had increased to more than 25 percent. Africa's share had also increased, but from a very low level (Figure 1). Traditionally, the main attraction of Africa has been its natural resources and Swedish multinational firms have established manufacturing mainly in chemicals and metal products. In the following, the focus will be on Asia and Latin America.

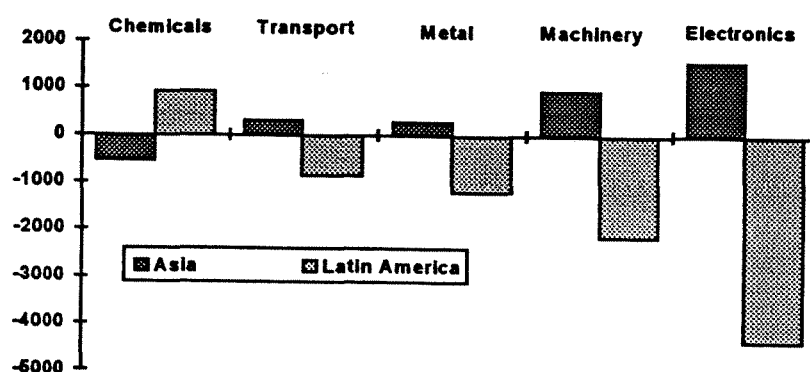
**Table 7: Employment in developing countries, manufacturing affiliates of Swedish multinational firms, total and by selected industries, 1978, 1986 and 1990**

	<i>Chemicals</i>			<i>Metal Products</i>			<i>Machinery</i>		
	1978	1986	1990	1978	1986	1990	1978	1986	1990
<i>North Africa</i>	126	154	0	0	0	0	0	0	0
<i>Other Africa</i>	0	303	0	30	34	63	0	0	0
<b><i>Total Africa</i></b>	<b>126</b>	<b>457</b>	<b>0</b>	<b>30</b>	<b>34</b>	<b>63</b>	<b>0</b>	<b>0</b>	<b>0</b>
<i>South Asia</i>	382	5,595	306	1,058	1,241	1,200	2,240	3,433	3,322
<i>ASEAN</i>	890	169	419	151	24	103	186	239	0
<i>Other ANIEs</i>	0	0	0	24	0	204	0	0	58
<b><i>Total Asia</i></b>	<b>1,272</b>	<b>5,764</b>	<b>725</b>	<b>1,233</b>	<b>1,265</b>	<b>1,507</b>	<b>2,426</b>	<b>3,672</b>	<b>3,380</b>
<i>Central America</i>	1,108	1,100	1,075	282	592	373	194	1,647	52
<i>Argentina/Chile</i>	1,156	1,669	989	1,097	142	136	434	398	679
<i>Brazil</i>	1,316	1,696	1,318	2,035	1,868	1,765	5,402	4,913	3,672
<i>Other Latin America</i>	667	906	1,789	75	42	19	520	636	0
<b><i>Total Latin America</i></b>	<b>4,247</b>	<b>5,371</b>	<b>5,171</b>	<b>3,489</b>	<b>2,644</b>	<b>2,293</b>	<b>6,550</b>	<b>7,594</b>	<b>4,403</b>
<b><i>TOTAL</i></b>	<b>5,646</b>	<b>11,592</b>	<b>5,896</b>	<b>4,752</b>	<b>3,943</b>	<b>3,863</b>	<b>8,976</b>	<b>11,266</b>	<b>7,783</b>
	<i>Electronics</i>			<i>Transport</i>			<i>Total</i>		
	1978	1986	1990	1978	1986	1990	1978	1986	1990
<i>North Africa</i>	0	0	0	0	0	0	126	154	0
<i>Other Africa</i>	0	0	0	0	0	0	30	337	305
<b><i>Total Africa</i></b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>156</b>	<b>491</b>	<b>305</b>
<i>South Asia</i>	0	0	0	0	0	0	3,680	10,269	4,861
<i>ASEAN</i>	526	2,048	2,089	405	276	711	2,158	4,696	5,877
<i>Other ANIEs</i>	0	0	0	0	0	0	69	0	262
<b><i>Total Asia</i></b>	<b>526</b>	<b>2,048</b>	<b>2,089</b>	<b>405</b>	<b>276</b>	<b>711</b>	<b>5,907</b>	<b>14,965</b>	<b>11,000</b>
<i>Central America</i>	2,755	4,415	5,393	0	32	0	4,500	7,884	6,893
<i>Argentina/Chile</i>	717	405	71	814	915	1,057	4,286	3,848	2,932
<i>Brazil</i>	9,590	1,780	2,038	5,306	4,178	5,100	24,019	15,012	13,893
<i>Other Latin America</i>	3,633	3,611	4,830	990	246	99	6,169	5,441	6,737
<b><i>Total Latin America</i></b>	<b>16,695</b>	<b>10,211</b>	<b>12,332</b>	<b>7,110</b>	<b>5,371</b>	<b>6,256</b>	<b>38,974</b>	<b>32,185</b>	<b>30,455</b>
<b><i>TOTAL</i></b>	<b>17,221</b>	<b>12,259</b>	<b>14,421</b>	<b>7,515</b>	<b>5,647</b>	<b>6,967</b>	<b>45,037</b>	<b>47,641</b>	<b>41,760</b>

Source: IUI

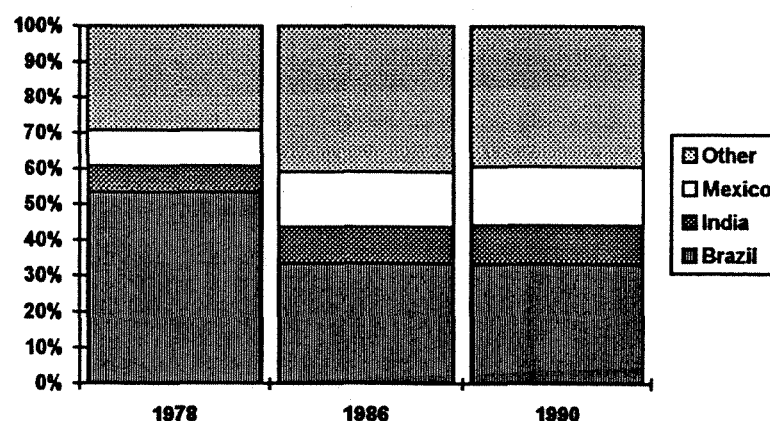
We have seen that the number of employees in Swedish manufacturing affiliates has expanded in one of the major regions of developing countries, and contracted in the other. On the level of individual industries, Figure 2 verifies the presence of a substantial reshuffling of employment between these two regions. There is an obvious pattern of decreases and increases matching each other. With the exception of chemicals, which is the only industry which had a net increase of employment in the

**Figure 2: Number of employees, by industry, changes between 1978 and 1990**



Source: IUI

**Figure 3: Distribution of employment, percent**



Source: IUI

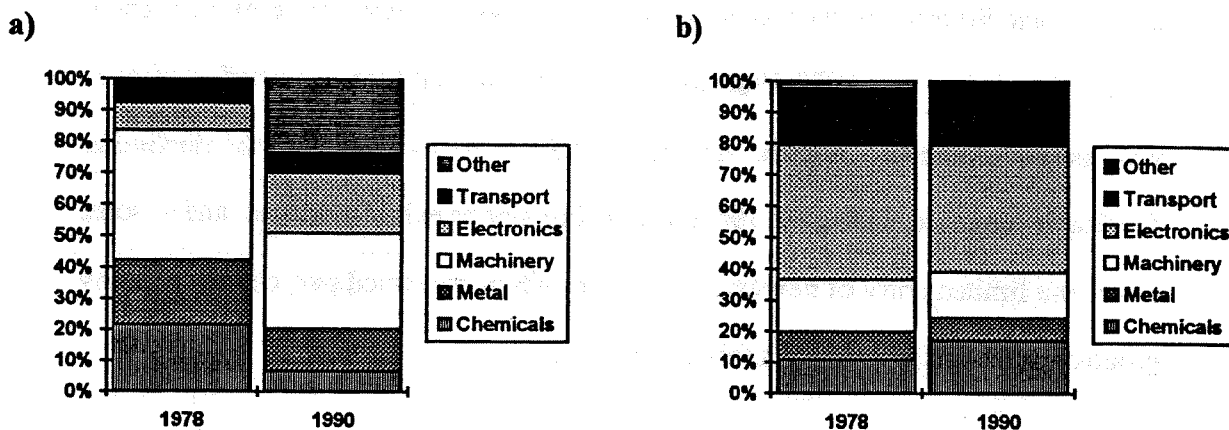
developing world between 1978 and 1990, employment fell in Latin America and rose in Asia. Chemicals, machinery and electronics recorded large fluctuations in the number of employees while metal products and transports were relatively stable.

The data also shows that industries tend to concentrate in certain areas. In Asia, metal products and machinery are found mainly in South Asia while electronics and transports are located mostly in ASEAN. As for Latin America, Brazil accounts for the bulk of machinery, metal products and transports while Central America has become an increasingly important location for electronics affiliates. On the whole, however, manufacturing is highly concentrated in a few host countries. Some 70 percent of third world employment in Swedish manufacturing affiliates was found in three countries as of 1970: Brazil, India and Mexico (Figure 3). While Mexico and India have continued to gain in importance, employment diminished drastically in Brazil between 1978 and 1986. In fact, Brazil, and to some extent Argentina and Chile, accounted for most of the reduction which took place in Latin America at that time. Most of the simultaneous increase in Asia occurred in Malaysia and Singapore. Between 1986 and 1990, however, employment again retreated in Asia while it was roughly stable in Latin America.

While the industrial structure has been fairly stable in Latin America, there have been large changes in Asia (Figure 4). Here, affiliates in chemicals, metals and machinery employed a smaller share of the total in 1990 than in 1978, whereas employment advanced in electronics and "others". The geographic distribution on the other hand, has been more stable in Asia than in Latin America where Brazil and Colombia accounted for smaller shares of total employment in 1990 than in 1978. In this region, employment has expanded particularly in Venezuela and Mexico (Figure 5).

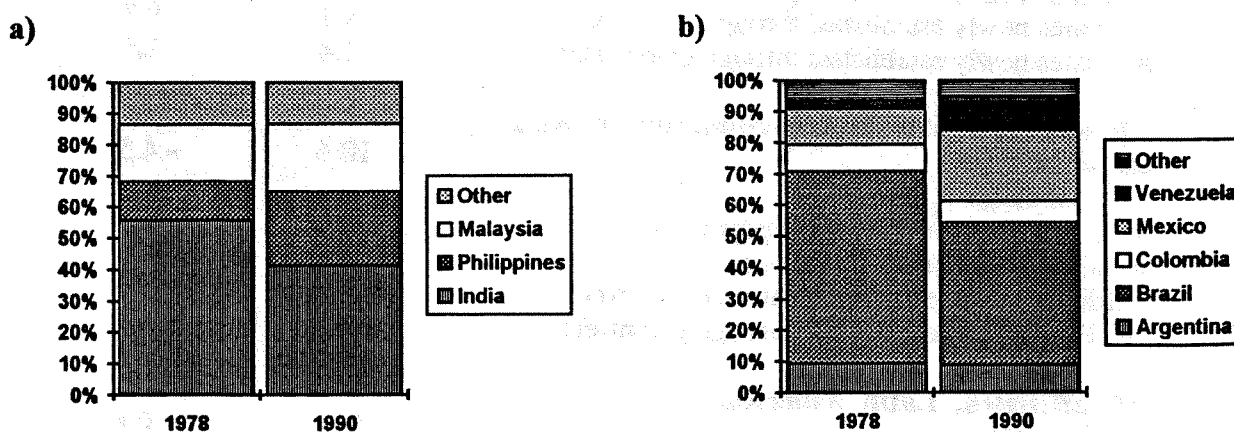


**Figure 4: Distribution of employees in Swedish multinational firms by industry, in a) Asia and b) Latin America, percent**



Source: IUI

**Figure 5: Distribution of employees in Swedish multinational firms by country, in a) Asia and b) Latin America, percent**



Source: IUI

In order to trace the sources of employment changes, Table 8 reports i) growth within affiliates which remained in the company groups, ii) decline due to the drop-out of affiliates and iii) establishment of new affiliates. Figures are given in terms of average annual change between 1979-1986 and 1987-1990 for total foreign manufacturing as well as manufacturing in Latin America and Asia. As can be seen, the decline in developing countries in the late 1980s was mainly due to exit of affiliates, and to some extent the limited entry of new ones. Affiliates which remained part of the company groups recorded high growth in this period.

**Table 8: Change in employment, by category of manufacturing affiliates of Swedish multinational firms; all regions, Latin America and Asia; average annual percentage change 1979-1986 and 1987-1990**

<u>Kind of activity</u> <u>employees</u>	<u>Average annual change in the number of</u>	
	<u>1979-1986</u>	<u>1987-1990</u>
<b>All affiliates, all regions and industries*</b>	1.6	3.1
Of which:		
Affiliates which remain in the population**	- 0.5	2.0
Affiliates which leave the population*	- 6.6	- 12.1
Affiliates newly established through takeover*	4.1	9.3
Affiliates newly established through greenfield*	2.4	1.5
<b>All affiliates, developing countries in Asia, all industries</b>	10.6	- 4.5
Of which:		
Affiliates which remain in the population	2.9	6.4
Affiliates which leave the population	- 2.2	- 24.4
Affiliates newly established through takeover	0.6	2.3
Affiliates newly established through greenfield	9.9	5.7
<b>All affiliates, Latin America, all industries</b>	- 3.8	- 0.6
Of which:		
Affiliates which remain in the population	1.0	4.8
Affiliates which leave the population	- 6.2	- 9.6
Affiliates newly established through takeover	0.9	3.3
Affiliates newly established through greenfield	0.9	3.5

\* The total number of employees at the beginning of the period serves as base

\*\* The number of employees at the beginning of the period in the affiliates which remain in the population serves as base

Source: IUI

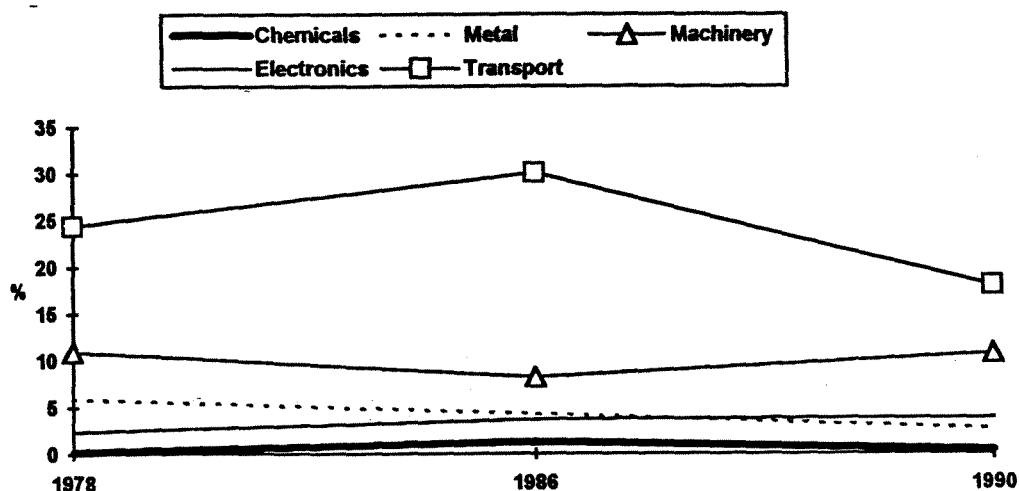
Throughout, there was a much enhanced turnover of affiliates in 1987-1990 compared to 1979-1986. In the latter period, those which were cut off accounted for an extraordinarily high number in Asia due to the dropout of a single large venture. Concerning mode of entry, we see a significant increase of employment in takeovers and decline in greenfield operations overall. In developing countries, however, greenfield operations continued to generate most employment opportunities. This applies especially to Asia, although the annual growth in this category fell from 9.9 to 5.7 percent. In Latin America, both greenfield operations and takeovers accounted for much higher growth in the late 1980s compared to the previous period.

### **Export Propensity, Wage and Productivity**

In order to cast some light on the forces shaping the above changes, this section considers the propensity of affiliates to export, the level of wages and productivity in third world manufacturing by Swedish multinational firms.

Figure 6 shows the propensity of Swedish affiliates in developing countries to export, which is relatively low compared to the average in industrialized countries, particularly in Europe. In transports, which used to have the highest level, exports fell in the late 1980s. Thus, developing countries have generally not captured investment projects which would otherwise have been located at home or in other industrialized countries. In the Swedish case, manufacturing in third world countries has mainly been motivated by sales on the local market, which is in line with the concentration of manufacturing in host countries with relatively large domestic markets, like Brazil, Mexico and India. This contrasts with some observations of FDI originating in other home countries, where a high export propensity has been reported especially in East

**Figure 6: Propensity to export, manufacturing affiliates of Swedish multinational firms in developing countries, by industry, 1978-1990, in percent of total turnover in affiliates**



Source: Central bank of Sweden

Asia. Unfavourable conditions for exports due to, e.g., trade barriers in industrialized countries and insufficient infrastructure or political instability in developing countries, consequently seem insufficient to explain the whole decline in employment.

In fact, the operations of Swedish multinational firms in third world countries recorded a stronger reduction in the period studied than foreign investment in general. At the same time, the internationalization of Swedish industry was characterized by an extreme emphasis on the industrial cores of North America and, particularly, the EC during the period studied. As shown by Belderbos (1992), Svensson (1993) and others, expansion in different countries may be subject to a certain substitutability due to intra-firm constraints in access to capital as well as administrative and human resources. We have also seen that only a few, large multinational firms have been predominant in Swedish FDI in developing countries. This is partly associated with the country's organization of development assistance, which has favoured support of large-scale firms (Andersson and Hellström, 1994).

Studying changes in employment, there is generally a clearcut, reverse relationship with the wage level, while the connection to productivity is less straightforward. On the whole, it may be noted that value added per worker was almost twice as high in Latin America as in Asia, while the wage gap was smaller. In Latin America, chemicals expanded particularly in Venezuela where the average wage was the lowest in the continent. Concerning metals, employment contracted after 1986 in Brazil and Mexico where wages increased and productivity developed relatively poorly. Instead, the industry advanced in India, which had low productivity per worker but an even lower wage. In machinery, there was an even stronger expansion in India, whose share of all employees in developing countries reached nearly 50 percent in 1990. The level of productivity approached that of the Latin American affiliates, while the average wage remained considerably lower. Again, employment was cut in Brazil parallel with a rising wage level but a decline in productivity.

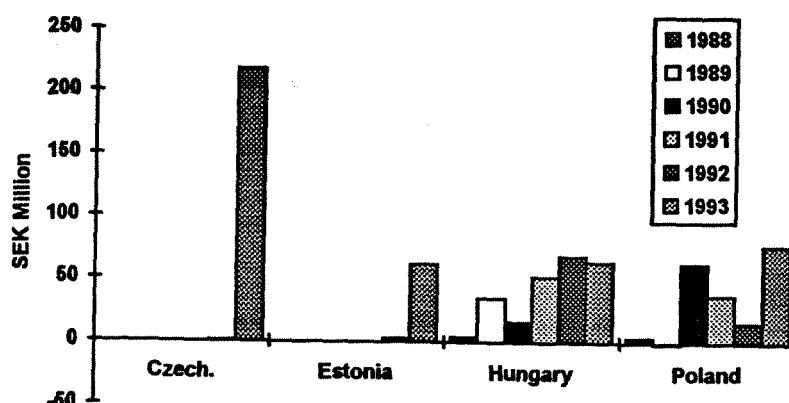
Electronics, finally, was the only expansive industry in the late 1980s, particularly in Latin America. Here, wages as well as value added per worker fell markedly during the trimming of operations in the early 1980s. The expansion which occurred in the latter half of the decade was accompanied by a certain reduction in value added, but by an even greater downturn in the wage level. Summing up, we have seen that manufacturing contracted in developing countries parallel with expansion elsewhere. Export propensity has been low and even diminished, and manufacturing has mainly been located in a few, relatively large host countries. Expansion has generally occurred where the average wage level has been relatively low, both in Latin America and in Asia.

## New Trends

Beginning in the late 1980s, a global reorientation towards the developing world became visible in FDI. In 1991 and 1992, the total flow to developing countries increased by 37 and 33 percent respectively (Miller and Sumlinski, 1994). Improved prospects for trade liberalization, the economic advancement of East Asia and signs of recovery in Latin America, make it probable that much more FDI will be directed towards developing countries in the years ahead. With continued market reform, including extensive privatization schemes, Eastern Europe is expected to attract much more investment as well, see e.g. UNCTAD (1993). The transformation of Eastern Europe opens the door for expansion in a "new" group of low-cost countries.

Unfortunately, employment figures are not yet available for the years after 1990. Looking at the flows of investment, however, Figure 7 demonstrates a strongly

**Figure 7: Swedish net FDI in Eastern and Central Europe 1988-1993, million Swedish kronors**



Source: Central bank of Sweden

increased activity by Swedish firms in the Czech Republic, Estonia, Hungary and Poland. As there were only minor flows before 1988, the increase in investment has been dramatic although its absolute magnitude is still small compared to that going to industrialized countries. The spurt began in the most advanced economies, and continued in neighbouring Estonia and the newly formed Czech Republic.

A number of observations verify that many Swedish ventures in Eastern Europe are indeed motivated by the generally low wage level, especially in those areas which are located the closest to Sweden in geographic terms. Others react to the expectations of future market growth, while privatization schemes offer new opportunities for entry. On the whole, operations in this part of the world are likely to supplement rather than crowd out operations elsewhere. The proximity of areas which are becoming viable, commercial locations while at the same time having low labour costs now reportedly make medium-sized Swedish firms more conscious about opportunities to exploit cross-country differences in factor costs.

There is a growing awareness of improved conditions in the developing world as well. This applies especially to East Asia, where Swedish multinational firms recently have stepped up their local presence in expanding markets such as China and Vietnam. Given a stable development in South Africa, greater attention may also be paid to Sub-Saharan countries in general. Meanwhile, "new" agencies in Swedish development assistance attempt to help small- and medium-sized companies transpass the initial boundary of learning how to operate in developing countries. There are specific examples of smaller firms which have acquired an ability to exploit low labour costs while training local staff in developing countries, and subsequently been able to successfully apply this competence in the Baltic states.

## **Concluding Remarks**

Parallel with their major advancement abroad and cutting back of operations at home, Swedish multinational firms reduced employment in the third world in the late 1980s. Manufacturing was concentrated in a few, relatively large host countries. There was generally a small propensity to export, meaning that few ventures in low-cost countries have covered world markets. Expansion occurred in those major host countries where wages were relatively low and was accompanied by strong productivity growth.

Swedish firms have traditionally invested less in low-cost countries than the old colonial powers. Particularly new circumstances in Eastern Europe may change this situation, which has also been indicated by a recent increase in the flows of investment to this region. At the same time, it should be stressed that political turmoil and weak infrastructure will most certainly delay recovery in several East European countries, including Russia itself, for many years to come. Meanwhile, large, growing and liberalizing markets in the developing world, such as China and India, will attract much more FDI than in the past. A well-functioning NAFTA will most certainly encourage a greater presence in Mexico too. Even parts of Africa now stir an increased interest.

Although FDI in low-cost countries much hinges on the extent to which trade liberalization can continue and political stability be maintained or improved, the potential market growth is enormous and there is good reason to expect a much greater dispersion of future FDI. This may involve a particularly large shift in the strategies of multinational firms from small industrialized countries such as Sweden, which have focused so heavily on expansion in the industrial cores of Western Europe



and North America. To what extent operations in low-cost countries will thereby become a more integrated part in international networks of production remains to be seen. It appears, however, that a greater ability to exploit business opportunities in countries with varying factor costs would raise the global reach as well as efficiency of firms, and also bring a potential for more favourable spillover effects in a greater number of countries which badly needs development.

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