TRANSNATIONAL CORPORATIONS AND SERVICES : Some Recent Developments and Possible Explanations.

Dissertation submitted to the Jawaharlal Nehru University
in partial fulfilment of the requirements
for the award of the Degree of
MASTER OF PHILOSOPHY

Saumyajit Bhattacharyya

CENTRE FOR ECONOMIC STUDIES AND PLANNING
SCHOOL OF SOCIAL SCIENCES
JAWAHARLAL NEHRU UNIVERSITY
NEW DELHI - 110067
1990

CENTRE FOR ECONOMIC STUDIES & PLANNING
SCHOOL OF SOCIAL SCIENCES
JAWAHARLAL NEHRU UNIVERSITY

New Campus
NEW DELHI 110 067

D E C L A R A T I O N

This dissertation titled 'TRANSNATIONAL CORPORATIONS AND SERVICES : SOME RECENT DEVELOPMENTS AND POSSIBLE EXPLANATIONS' *being submitted to the School of Social Sciences, Jawaharlal Nehru University, by* SAUMYAJIT BHATTACHARYYA, *in partial fulfilment of the requirements of the degree of* MASTER OF PHILOSOPHY, *is entirely his own work and has not been considered for the award of any other degree either at this or any other University. We recommend that the dissertation be forwarded to the examiners for evaluation.*

DEEPAK NAYYAR
Supervisor

KRISHNA BHARADWAJ 5.1.90
Chairperson

Phones: 667676, 667557 Ext: 266/249/207 Cable: JAYENU Telex: 031 73167 JNU IN

ACKNOWLEDGEMENT

First and foremost, I want to express my gratitude to my supervisor Prof. Deepak Nayyar. Not only did he guide me throughout the course of my work with meticulous precision, he had to bear with my irregular pattern of work which is so much in contrast with his own work ethics. But, this he did with tremendous patience, always with smiling face and reassuring words. It is unfortunate that I could not channelise his guidance properly to take my work to a level which he demanded of me. My deep and sincere thanks to him.

The dissertation would not have seen the light of the day without the help of Mritiunjoy, Sumangala, Sunil. Their constant help and support saw me through my work. Perhaps, Sunil deserves a special mention, the way he took upon himself the the task of providing last minute help to all the would-be' late-submitters.

Tridib, Surajit, Jawahar, Krishna Ananth, Sujit and Gautam and Somanath have provided necessary help and support of various degree and at various stages of my work. Mr. Bose of the United Nations Library was kind enough to allow me to use the library facilities quite liberally. My thanks to all of them.

I am sure, I have in no way exhausted the list of people who have been of general help all these days. The omission is however a folly on my part and in no way reflects any evaluation of the degree of their assistance.

Though I have been greatly benefited both acedemically and otherwise by the support of all those I mention (and all those I fail to mention), it is needless to say that the responsibility for any errors and shortcomings is solely mine.

Bhattacharyya

SAUMYAJIT BHATTACHARYYA

CONTENTS

CHAPTER ONE

INTRODUCTION AND BACKGROUND

1.1 INTRODUCTION

1.1.1 : THE SETTING

In the vast and extensive literature on Transnational Corporations (TNCs), their activities in the services sector have received very little attention. This is a bit awkward, not only because the services sector is the largest in terms of its contribution both to GDP and to employment in the world economy at present, but also because for most of the developed market economies (DMEs) foreign direct investment (FDI) in services is growing at a faster rate than FDI in manufacturing. Whereas even in the early 1970s the main activities of TNCs in the services sector were in banking, finance, transportation and wholesale trade, since the mid - 1970s not only is transnationalization proceeding at a fast pace in these service but also the TNCs are getting increasingly involved in other services as well. Apart from widening of activities there has been a sea change in the form of organising these activities which is reflected, in its essence, in the ongoing diversification, integration and conglomeration of activities in the transnationalised services sector.

Perhaps this neglect in terms of available literature on this subjects, is understandable on two counts. First, the transnationalisation of services, in terms of its significance, is a recent phenomenon. Second, the analytical ambiguity which surrounds the conceptualisation of the services sector and, more importantly, the scanty existence of data for the services sector as such, let alone for the transnationalized services sector, stand in the way of any detailed analysis. However a beginning has been made in this direction and some preliminary studies either in the nature of broad surveys or studies on certain specific sectors have become available. A systematic and detailed study on different aspects of this phenomenon of increasing transnationalization of services is yet to be done.

1.1.2 : THE OBJECTIVE

This dissertation, being limited in its scope and size, cannot attempt such a task. It is a very modest attempt to draw upon the available sources in order to explore into certain central tendencies emerging in the process of transnationalization of services. The dissertation does not have any central hypothesis. Its major object is to understand the process of transnationalization of the services sector by examining and trying to explain certain recent development and issues relating to them.

First, the study explores the changes taking place in the transnationalized service sector in the forms of market structures and in the forms of organisation of production and distribution and puts forward an explanation of the central force behind the changes in terms of technological innovations in this sector, especially as embodied in data and information services.

Second, an integral aspect of the changes taking place in this sector, is the changing relationship between the transnationalized goods and services sector. The study profiles the developments in this area, briefly evaluates certain alternative views regarding this and lends support to the view that the essential feature of this development is integration and diffusion of boundaries between the transnationalized goods and services sector.

Third, the study examines the variations in the intersectoral organisational forms in the transnationalized service sector and attempts to explain them in terms of variations in the nature of sector specific advantages a TNC enjoys over its competitors.

Fourth, the study looks into certain complementarities which exist between various organisational forms (and most notably between trade and F.D.I. in services) which the TNCs can chose to supply services in a foreign country and analyses its relevance to the issue of finding a multilateral framework for trade in services.

Our study, however, is not a study exclusively concerned with service TNCs (i.e. TNCs whose activities are mainly provision of services). This is as much a study of service TNCs, as one of the relevance of the services sector for the activities of TNCs in general. (This is specially because a bulk of FDI in services is made by the non-service TNCs). It is a study which relates the phenomenon of transnationalization of services as an integral part of growth and advance of transnational corporations with all its accompanying features of permeability maneuverability, centralisation and of conglomeration of transnational capital. That is why we chose the title of the dissertation as "Transnational Corporations and Services" rather than" Transnational Corporations in services".

A clarification is necessary here. While attempting to study certain aspects of the transnationalisation of the service sector, we are in no way putting forward any theory of transnationalisation of services. Even a rudimentary attempt to put forward a theory of such a complex phenomenon as transnationalisation of services would need us to review the development of monopoly capitalism as a phase in history and would necessitate a discussion in the terrain of political economy, which lie clearly outside the scope of our dissertation.

Given the limitations of literature and data on this subject, it is not worth attempting a detailed study on any one specific aspect in the area. Another possibility is to make sector specific studies. However, mostly preliminary studies have been conducted on this and the available sources and data are too restrictive to do anything further. We have therefore, kept the scope of this dissertation broad enough to look into a number of issues central to recent developments in this area. However, these issues have been mostly been raised in various studies we have mentioned and they are not own original findings. But, given the state of the existing literature, they are quite scattered and often inadequately dealt with. There is therefore scope for drawing from these studies, bind these issues together and elaborate on them to put them in a perspective. Our attempt in this dissertation is to do that.

1.1.3 : SCOPE AND LIMITATIONS

The area we are concerned with in our dissertation as we have pointed out earlier, suffers from the lack of sufficient literature. There are two studies which draw a profile of the overall development that are taking place in the transnationalised service sector. The first one is a pioneering study by Clairmonte and Cavanagh in their article "Transnational Corporations and services: Towards a final frontier".1 The second one is a study by the United Nations Centre for Transnational Corporations (UNCTC) in their section on services (part V) in the volume "Transnational Corporations in World Development".2 The two studies are, however, very different in their nature and scope.

The study by Clairmonte and Cavanagh focuses, on the process of sectoral integration in the transnationalised services sector, which leads to the formation of service conglomerates and in the ultimate integral (i.e. goods-service) Conglomerates. The study sketches a profile of how the sector which was least penetrated by transnational capital, even in the early 1970s', is now fast getting integrated in the process of transnationalisation. As transnational capital has already penetrated in the primary and secondary sectors, its penetration in the services sector and more than that, the way in which it is diffusing the sectoral boundaries and integrating the sectors is, according to the authors, an ultimate expression of corporate power the "final frontier" which the TNCs have reached.

1. Clairmonte and Cavanagh(1985).
2. UNCTC(1988).

However, being in the form of an article, the study is limited in its scope and size and therefore neither goes into elaboration and examination of various forms and tendencies inherent in this phenomenon under study, nor does it attempt any substantial explanation of this.

This study, apart from motivating us to venture into this area, provides a general direction to out work. This is particularly because the phenomena of diffusion of sectoral boundaries and concentration and conglomeration of transnational corporate capital is the central focus of our dissertation.

The study by UNCTC is a broad and somewhat detailed survey of the activities in services. It manages to put together information about a wide range of issues regarding this. This stretches from the dimensions of the TNCs in service, their activities in specific sectors, the visible trends and the role of the service TNCs in development. However, being of the nature of a broad survey, the information it puts together are often sketchy and developments are narrated often without leading them to their logical extent. However, given the limitation of literature in this area, this study by the UNCTC is by far the most useful document available, and we have used it very extensively in our study.

Another study which we have used at length is one which is not directly concerned with TNCs, but instead is a study on international transactions in services. This study is by K.P.Sauvant and mainly deals with the dimensions of transborder data flow end the international policy issues involved in this.3 Because the implications of technological change in data and communication services form a very crucial aspect of our dissertation, and in fact because we explain both the increased pace and the pattern of transnationalization of services largely in terms of technological innovations in this field this study has proved to be a very important source for us.

Apart from these studies, there are some sector specific studies, mainly conducted by UNCTC. These studies also have similar kinds of limitations as we have pointed out in case of the above mentioned UNCTC survey. Further many of the findings of these studies, were amalgamated to form a substantial part of the text of the UNCTC survey. Because of this fact and that we are not particularly interested in a detailed intersectoral analysis, we refrain from making any further comments on these studies We have, however, acknowledged these sources, whenever, we have used something specifically from these studies.

3. Sauvant(1986).

Apart from these, we have quite often used others, which include those that have studied services and TNCs separately. We refrain from making comments about these studies also. We either introduce these studies, in the text of the dissertation, whenever necessary, or acknowledge them, when their relevance is incidental or tertiary to our study.

However much more problematic than the state of the literature is the state of the available data. Very few countries publish systematic data on services. Whenever available, the data are often too aggregative. Further there is the problem of in compatability of data from different sources, mainly because of lack of standardization of categories. Given the analytical ambiguities regarding the services sector this problem, is even more acute. For all these reasons, it is difficult to make any meaningful cross country comparisons or subject the data to any cross sectional analysis. The state of corporate data is even more worrisome and is almost non existent and our study being concerned with the TNCs, this state of the data largely restricts our scope. However what causes, perhaps, the most severe limitation to work in this area is the absence of any time series data. Absence of time series data makes it difficult to make detailed comments on the intertemporal behaviour of various parameters that we are studying. It also makes it almost impossible to carry out any meaningful econometric analysis. The main data source, available to us, is the UNCTC survey, in particular the Annex B of the survey

However, while restricting the scope of the study, the state of the data has not been a particular handicap to us. This is because, we have made our study more information based, than data based. This is not so much because of lack of availability of data, but more because given the kind of issues we are dealing with and the kind of complexities that are involved in the phenomenon we are studying, our study needs more qualitative than quantitative analysis. However, data would have obviously helped our analysis. It could have made on views more specific in certain places and perhaps would have put us on a more firm ground.

However, given the fact that we are working in a particularly under researched area, this limitation perhaps is quite obvious and we have to live with it.

1.1.4 : THE STRUCTURE

The first chapter of the dissertation, apart from having this introduction, contains discussions on certain definitional issues regarding the service sector and on the role of the service sector in economic development and structural change. The latter discussion apart from providing a background presents three alternative views on role of the services sector in structural change. Though a discussion on role of services sector in structural change is not directly connected to our topic of study, in as much as these discussion either provides us with a general background or raises certain issues, which are important for our topic, we find it relevant to go into this discussion. One such important issue is the relationship between the manufacturing sector and services sector in the process of structural change.

The second chapter of our dissertation may appear slightly delinked from the rest of our study and further the chapter in itself does not have a central focus. However, our attempt here is to draw a broad profile of transnational activities in the services sector. Because our dissertation does not have a central hypothesis and revolves around certain issues posed by recent developments in the sector, we feel it is necessary to draw such a profile in order to provide these issues with a setting. This becomes even more necessary because we are pondering in an area which is relatively under-researched. However there are two important sections in this chapter which are directly relevant to the central issues of our dissertation. One of these traces the relative importance of F.D.I. with respect to trade in delivering service to a foreign country. The other traces the links between F.D.I. in services and that in manufacture.

Chapter 3 deals with the fundamental changes that are occurring in the transnationalised services sector. These changes manifest in the form of diversification, integration and conglomeration of activities in the transnationalized services sector which in the ultimate are leading to diffusion and obliteration of sectoral boundaries. The chapter analysis the reasons for this development and holds that technological innovation in data and communication technology as a central motive for these changes. It analyses the advantages these innovations have brought about for the TNCs in general and for service TNCs in particular. The case of banking and finance related services is dealt with separately to bring out the essence of these changes, because it is the sector where these changes are most pronounced.

Chapter 4 deals with the alternative forms of cross-border organization the TNCs may choose for production and distribution of services. The chapter notes sector specific variations in these and attempts to explain this. We note in this chapter that these alternative forms are often complementary and then we discuss the relevance of complementarity between FDI and trade in services for the TNCs. Its implication for the issue of a multilateral framework for trade in services is then discussed

Chapter 5 provides a brief summary of our study and makes some concluding comments.

1.2 : SERVICES DEFINITION CATEGORISATION

All though we are quite familiar with the distinction between goods and service, it is difficult to formulate any unique definition for services. This is not because of any analytical shortcoming. It is, rather reflection of the heterogeneity and diversity of the range of activities which are normally classified as services.

A common sense perception of services in often made in terms of their physical characteristics of invisibility, intangibility and non storability.4 In this sense services can be conceived as activities pertaining to production and

4. Services are non-storable unless embodied in goods.

consumption of non materials and in the Marxist scheme of analysis the services sector under capitalism, is the non material commodity producing sector.5

A more sophisticated definition or a perception of services is provided by T.P. Hill which, marks the differences between goods and services very clearly. To quote: ".....A service may be defined as a change in the condition of a person, or of a good belonging to some economic whit, which is brought about as a result of the activity of some other economic unit, with the prior agreement of the former persoh or economic unit .... Services are consumed as they are produced in the sense that the change in the condition of the consumer unit must occur simultaneously with the production of that change by the producer ...... The fact that services must be acquired by the consumers as they are produced means that they cannot be put into stock by producers ..... it in a logical impossibility because a stock of changes is a contradiction in terms."6

Whatever may be the analytical difficulties in defining services, there is hardly any difficulty in identifying service activities. The pioneering work in this direction was done by Colin Clark7 who categorised the economy into

5. Commodity is used here in the Marxist sense, i.e., something which is exchanged for value.
6. Hill(1977).
7. Clark(1940).

three sectors -the primary (comprising agriculture & fishing), the secondary (mining and manufacture) and a residual category for services, the tertiary sector (comprising of commence, transport, communication finance, insurance, real estate, government and professional services).

1.3 : THE ROLE OF SERVICES IN ECONOMIC DEVELOPMENT

1.3.1 : BACKGROUND

The analytical distinction between material products and services date back to the physiocrats and to Adam Smith,8 who treated services as unproductive activities, which do not play a role in creating surplus for the economy but are performed and consumed out of the existing surplus of the economy. It was Marx,9 who first distinguished between services produced outside the capitalist circuit for production for personal, domestic and community consumption devoid of profit motive and services produced by a capitalist enterprises for profit motive and treated the latter as a productive activity.

8. Smith(1955).
9. Marx(1978).

1.3.2 : THREE ALTERNATIVE VIEWS

There are three broad patterns in which the role of the service sector has been visualised. These we can classify as demand based stage theories of structural change, the labour productivity based hypothesis and the Marxist theories.

The main proponents of the demand based stage theory was Colin Clark.10 He visualised the development of an economy in stages. in the first stage agricultures dominates as an economic activity, in the second stage the manufacturing sector dominates as the share of agriculture in GDP and in employment decline, and in the third stage the services become the dominant economic activity by share of GDP and of employment.

The logic of this argument runs in terms of establishing an analogy between the transition from the first to the second stage and that from the second to the third stage. However, whereas, Clark forwards a clear reasoning such as the operation of Engels' law, the development of synthetic substitutes and the growth of labour productivity in the agricultural sector to explain the fist phase of transition, no such clear reasoning is forwarded for the second phase of transition. However a

10. Clark op.cit.

notion which is inherent in Clark's work, is that with the progress of the society, there will be a tendency towards saturation of demand for manufactured goods, and a shift of demand towards services, as human needs become more subjective. Clark however also notes the fact that this shift would occur also because of an increase in labour productivity in manufacturing sector.

A major limitation of this theory is that there is no objective reason for such structural shift in demand away from manufacture towards services. (unlike the case of Engels law). In terms of Clark's theory the services sector is the representative sector of the highest phase in the progress of an economy. There is therefore scope for dynamic activities in that sector. However, logically extending this theory that activity should also be paralleled with a decline in the share of manufacture in terms of GDP and employment. However observed in terms of world GDP and employment whereas a structural shift towards services is visible in case of employment, no such shift in visible in case of GDP. In fact, both the sectors have almost the same share. This suggests that whereas there has been an increase in labour productivity in manufacture, no structural demand shift in favour of services has taken place.

A hypothesis is often put forward, that the services sector is the employer of the last resort.11 This is explained in terms of stagnation of labour productivity in services, whereas in manufacture labour productivity continues to rise. The labour force in the manufacturing sector thus forced out to seek employment in this residual low productivity service sector. This theory thus stands in its essence polar opposite to the earlier one. Such a view however, can hardly explain dynamic changes that are visible in the service sector. The services sector, in terms of this view, plays the role of a residual sector in the process of structural change

The third way of viewing the role of services in economic development is provided by various Marxist analysis. As we have already mentioned, Marx himself initiated the analysis of services under capitalist institution. But the study of services in the monopoly phase of capitalism was made by many later day Marxists like Lenin, Baran, Sweezy and Braverman to name a notable few.12 Their views are often not contained in formal studies on services, but are spread in various other studies they have done. We present here a brief summary of whatever can be an assimilated position from all these theories, without mentioning the contribution of individual theorists.

11. Among others this has also been put forward in Rowthorn and Wells(1987).

12. Lenin(1978), Baran and Sweezy(1973) and Braverman(1974).

In Marxist analysis the service sector neither remains a sector which only absorbs residual manpower, nor a sector which grows only at the final stage of economic development. The banking and the financial services represent the flow of finance capital and are structurally separated from the other producer services. The process of amalgamation of banking and industrial capital is in no way a new phenomenon, it is rather visualised as a characteristic feature of monopoly stage of capitalism - it is an expression of the form capital takes under monopoly capitalism and thus represent a break from competitive phase of capitalism. The growth of business services like marketing, advertisement and legal services are also seen as necessary services which are created because of the specific need of the modus operandi of monopoly capital. The creation and growth of new services however do not give ground to Clark's notion of a demand-shift toward services. For in the view of Clark the services appear to be the ultimate frontier for the utilitarian consumer, who is otherwise saturated with material products. In the Marxist view, on the contrary, development of such services are in no way a reflection of consumer sovereignty. They are rather an avenue to serve the growing complexity of organisation of production on the one hand and to create consumer demand on other. This is because of the peculiar form that competition takes under monopoly capitalism where price competition is controlled and collusive practices are followed, where the economic surplus tend to rise but does not find avenues for investment in the existing sectors, where product differentiation and creation of new products become rules of the game, and as a result it becomes a necessary for consumers to continuously want new products. These services are therefore involved on the one hand in the creation of such consumerism and on the other hand in the co-ordination, supervision and management of production and exchange in such a corporate form.

A logical corrolary of this theory is that the material producing sector is expected to the increasingly service intensive. This tendency should be more pronounced in the transnationalised sector because the TNCs being the supreme expression of forms of organisation under monopoly capitalism, the intensity and diversity of their necessity of and involvement in services is expected to the most pronounced here.

The Marxist view however allows the co-existence of high and low productivity sectors under this uneven phase of development and therefore can also explain the existence of a residual low productivity service sector outside the domain of monopoly capital.

We have now discussed three alternative theories of the role of service in economy growth and structural change. The focus of our dissertation being on transnationalisation of services and not on the role of services in structural change, we will not be directly involved in attempting to judge the comparative merits of these theories.

CHAPTER TWO

A PROFILE OF THE ACTIVITIES OF THE TRANSNATIONAL CORPORATIONS IN THE SERVICES SECTOR

The production and distribution of services, till about the mid 1970s were within the confines of national boundaries and of domestic capital. However since the mid 1970s this sector has increasingly fallen in the ambit of transnational capital. The TNCs, the activities of which in the service sector were rather limited,are now significantly involved in the activities of the sector. The share of the services in the world Foreign Direct Investment stock which was less than 15% in the 1950s has increased to about 40% in the 1980s.1

This chapter aims to draw a profile of the activities of TNCs in the services sector. However, before we start exploring the dimensions of the TNCs in services, certain preliminary issues need to be discussed. Section 2.1 deals with the following questions: How important is FDI as a form of delivery of services abroad compared to trade? What is the nature of relationship between FDI in services and that in manufacture? Section 2.2 deals with the dimensions of transnational corporations in services.

This chapter lacks a central focus and is rather loosely structured. However, in a relatively unresearched

1. UNCTC(1988).

area such as the one we are venturing into, it is perhaps necessary to have an overall profile, if only to provide a backdrop for the ensuing discussion..

2.1 : CERTAIN PRELIMINARY ISSUES

2.1.1 : A COMPARISON BETWEEN FDI AND TRADE IN SERVICES

Given the limitation that most services are untradable (production and consumption of a service being simultaneous, trade requires the producer and consumer to be at the same place) it is expected that FDI will be a more important form of delivering services abroad. However the above statement needs the following qualifications:

(i) Traditionally some services can be embodied in goods and thus can be transported and traded. A more important case of service trade is however transportation, as an activity itself. In fact in many countries specially in the LDCs shipping is a very important component of trade.

(ii) With the development of modern technology, trade possibilites in many services have increased.

(iii) Though FDI and trade are alternative forms of delivering services across the national boundaries, it should not be thought that trade and FDI in services are complete substitutes or even competing forms of delivering services. On the contrary, the two are closely linked and have developed various forms of complementarities.

Systematic and comparable data2 are available for five major DMEs only - the US, FRG, UK, Japan and Canada. That our subsequent observations are limited only to these five countries is not perceived to be a serious limitation for our analysis, given the fact that these five DMEs control as much as three fourths of world FDI stocks(in the service sector) and one third of world trade in services.

Available evidence does confirm that FDI is in fact more important than trade as a form of delivering services abroad. The available data shows that the total export of services from these five DMEs, in 1981, was $127 billion. In comparison the sales of foreign affiliates of service TNCs abroad total $340 billion. The difference is more pronounced in the case of the US, where the respective figures were $35 billion and $185 billion. The greater reliance of major DMEs on FDI as opposed to trade as the main channel of delivery of services to foreign markets is once again confirmed if we compare the trade to foreign affiliates'sales ratio of services to that of manufacture. For the US, the ratio was 1:5 for service exports in 1982, while it was less than 1:3 for manufacturing exports.3

2. ibid., Sauvant(1986).
3. Sauvant(1986).

Similarly, for imports, the ratio of service import to sales by foreign affiliates in the US was 1:4, as compared to 1:1 for manufacturing imports. The pattern for other DMEs is also reflected in the above example because they are the major source of service import and FDI in the US. Further, if we consider the period between 1974 and 1982 where both service exports and imports grew at a rate of a little above 10% per annum, the corresponding figure for sales of services by foreign service affiliates of US firms abroad and by foreign firms in the US grew by more than 20% per annum.

2.1.2 RELATIONSHIP BETWEEN FDI IN SERVICES AND MANUNFACTURE

The available information and data suggest that from mid 1970s service FDI has been more dynamic than manufacturing FDI. This has resulted in rising shares of services in both outward and inward FDI stock(and also in the corresponding flows) in total for the major DMEs.

A relevant question here is that whether the faster rate of growth of FDI in services in anyway implies any decline in the importance of manufacturing FDI.

We do not find any evidence to suggest that the increasing share of service FDI implies a relative decline in the importance of manufacturing FDI. On the contrary FDI in services seems to have some form of complementarity with

FDI in manufacture. This can be demonstrated by the following facts. First, a significant part of the FDI in services is made by TNCs involved in manufacturing. However very few countries make available data on the magnitude of FDI by nonservice TNCs in services. From the data available only for four countries - UK, US, Japan and FRG - it is possible to draw some inferences about this magnitude.

The UNCTC study has measured the degree of involvement in FDI by non-service TNCs in the service sector by usin g two methods. The first one is the percentage of foreign service affiliates of non-service parent TNCs in the total number of foreign affiliates in services. The second is the percentage of FDI stock in services controlled by the service affiliates of non-service TNCs in the total FDI stock in services. The results are presented in table 2.3 As we can see from the table, the magnitude of involvement is highest in the case of the US, where both measures show percentages of over 50(in 1984). The level is less significant for the other three DMEs though even in their case the relevant percentages are as high as 30. Further, a comparison of the magnitudes between 1977 and 1984 suggests that their importance may be rising over time. More support can be found in the data provided by the US Department of Commerce which shows that of the total assets of the foreign affiliates of the US TNCs in manufacture, about 30% are held by their service affiliates. More importantly, wholesale trading affiliates belonging to manufacturing TNCs hold about 77% of total assets of all US wholesale trading affiliates.(Table 2.4)

Thus, inspite of the growth in the share of service FDI there is no evidence to suggest that there has been a structural shift in favour of service investment. Rather it suggests that a complementary relationship may exist between the the transnationalised parts of the goods and the service sectors. One of the reasons for this is that manufacturing may have become more service intensive. This phenomenon has also been called, by some, the industrialisation of services. Having noted the not insignificant role of non-service TNCs(that is to say TNCs whose main activities lie outside the service sector), we would like to emphasise that the dominant role in the transnationalisation of the service sector has been played by the service TNCs(by which we mean TNCs whose main activities lie in services).

The question of integration between the goods and the services sector will be dealt with in detail in chapter 3. We will now examine some important features of service TNCs.

2.2 - TRANSNATIONAL SERVICE CORPORATIONS - DIMENSIONS

2.2.1 : SHARES OF MAJOR DMEs IN TRANSNATIONAL ACTIVITY IN SERVICES

In Section 2.1.2, we have seen that the F.D.I. stock in services is controlled by very few DMEs. Because the service transnational corporations are responsible for a large part of the FDI one can obviously expect that the bulk of transnational activity is carried out and controlled by TNCs from the DMEs.

The control may be reflected by any of the following possibilities:

i) Presence of a comparatively large number of TNCs (or their affiliates) originating from these DMEs.

ii) The TNCs from the DMEs control overall large shares of total assets and total revenues of the TNCs in specific service sectors.

iii) A few TNCs from the DMEs dominate the entire transnationalized segment of specific service sectors.

Our, attempt here is to find support for the above propositions. The discussion is at a disaggregated level of countries and sectors to see whether specificity of a country of origin or a sector affects the nature of the control.

The discussion is mainly based on disaggregated firm level data on service TNCs in various service industries. The data base used is from the UNCTC study and comprises data on 15 to 30 largest firms in 16 service industries. That we have considered only the large firms should not affect the conclusions of our study because the bulk of the transnational activities by service TNCs are carried out by the large firms.

a) Presence of a large number of TNCs (or their affiliates) originating in DMEs.

Out of the total 304 service TNCs concerned as many as 290 come from USA, Japan and the major Western European Nations. The US alone has a share of forty five percent of these TNCs, the share of Japan and Western Europe being twenty two percent and twenty eight percent respectively. If we go by the number of total foreign affiliates of these TNCs, the share of the US seems to be much more. Of 23,118 foreign affiliates recorded, 14,120 originate in the US (about 61%). (Refer Table 2.5)

If we consider the nature of domination by the DMEs in the major groups of services, i.e. finance-related, business-related, trade-related and consumer services, we can see that whereas in finance and trade related services only 30% of the TNCs originate in the US, in business services, transportation and consumer services 60% of the

TNCs are from the same country. However, this difference is mainly because of the large divergences in Japan's share between these sectors. Thus whereas Japan's share in the number of corporations is 36% in finance related services and 43% in trade related services, her shares are negligible in the case of the other two groups of services (with the exception of construction).

The pattern of country shares varies widely across the sixteen different services industries considered. In most of them the US takes the leading position with notable exceptions only in three cases, viz., banking, wholesale trade and reinsurance. Out of the first 30 transnational banks considered, the US has only three whereas Japan has seventeen, the rest belonging to Western Europe. In wholesale trade, of the major nineteen TNCs, none belong to the US. Thirteen of these have their headquarters in Japan. (The ten largest transnationals in this sector are all Japanese). In Reinsurance, the leading TNCs are from Switzerland and FRG, while the US has only four of the fourteen TNCs considered. In all other sectors, the TNCs from the US dominate.(Table 2.5)

b) Control over large shares of total assets or total revenue by TNCs from DMEs.

If we consider the share of assets, revenue and other such indicators to see whether a similar pattern of domination exists, even there, we find that the US TNCs account for a high to moderate share over transnational service activities in almost all services with the exception of wholesale trading and banking. It is to be noted that data in this form is available only for finance related, trade related and business related services, and not for consumer services. Japan's share is, as expected, high in wholesale trade and banking and moderate in financial services and insurance. The areas in which the US presence is low are the areas in which the Japanese service TNCs dominate (such as banking and wholesale trade). The Japanese have moderate control over other finance related services but have almost no presence in the business and consumer services. The Western European TNCs have moderate to low shares in all sectors, except for Reinsurance where their share exceeds more than two-thirds, with Germany and Switzerland dominating.

c) Domination by a small number of TNCs:

In all the sectors, the leading TNCs control disproportionate amount of revenue or assets. Of the 16 sectors considered, the largest firms in 12 belong to the US, and those in the remaining 4 are from Japan, U.K., Switzerland and France. The asset or revenue share of the top fifteen percent of the TNCs in each case (ie., the top three firms when there are twenty or less TNCs in all and the top five when there are twenty to thirty TNCs in all) ranges between 30 to 65%. This control by the top fifteen percent is greatest in the case of reinsurance, wholesale trade and retail trade. Further if we compare the relative ranking of these firms between 1986 and 1980 (or 1976) whenever data is available, the top three firms have maintained their ranks in most cases and in no case has the position of the top most firm been altered with the exception of banking. There has been considerable change in ranking of the other firms. This suggests that these sectors may have "leadership" features of oligopoly, where the leaders aim at maintaining their shares, whereas the rest of the firms are left to fight it out among themselves.

2.2.2 : DEGREE OF TRANSNATIONALISATION OF THE TRANSNATIONAL SERVICE CORPORATION

So far, what we have been examining in this chapter does not throw any light on the degree to which the service TNCs have achieved transnationalisation. The basic feature of transnationalisation is not the presence of oligopolistic giant firms in a sector but the internationalisation of production and the geographical spread of the firms across national boundaries.

In general the degree of transnationalisation in services is expected to be less than that in the goods producing sector mainly because services have come much later in the process of transnationalisation. However, what we are interested in is to examine and explore the variations in the degree of transnationalisation within the service sector itself. The UNCTC study has found that there is considerable variations in the degree of transnationalisation within the service TNCs depending on the characteristics of the industry and the country of origin of the TNC. However the study does not go into the explanations for these variations. We will attempt to explain the findings of the study.

It is impossible to find any exact measure of the extent of transnationalisation because TNCs have various means and levels of control over their international activites and often such forms of control go beyond the level of formal equity participation. However, to get an idea of the extent of foreign content and control, sales, revenue, assets and profits of the foreign affiliates are often used as possible indicators. Given the limitations of available data, the number of foreign affiliates which an industry has can be a proxy for the extent of transnationalisation. However, this measure should be interpreted with caution because the mere presence of an affiliate does not necessarily imply that such an affiliate is involved in sales of services in any significant manner. The UNCTC study has used the number of affiliates as one of the main indicators of the degree of transnationalisation. The analysis is based on the rage of largest firms in different service industries. A separate exercise has been done in the case of the US, because aggregate data on share of affiliates in sales and assets are available. We summarise the main findings of the study below.

a) Variations in the degree of transnationalisation across industries:

Both the measures of degree of transnationalisation - the number of foreign affiliates and the sales, revenue, assets and profits of foreign affiliates - show considerable variations across industry groups. Banking and wholesale trading appear to be the most transnational. Construction, advertising and some other business services like engineering services also show a high degree of transnationalization. This is specially so for the US as seen by the second measure. On the other hand reinsurance, retail trade and some other business services are the least transnationalized ones.

b) Variations in the degree of transnationalization across countries:

The US comes out to be the most transnationalized and Japan the least with Western Europe as a group coming in between. Thus 95 TNCs of the US have 6,585 foreign affiliates, whereas Japan with 65 TNCs and Western Europe with 75 TNCs have 2540 and 4356 foreign affiliates respectively.

Whereas the degree of transnationalisation shows how far the process of transnationalisation has spread, it does not indicate the geographical pattern of the spread. A relevant question here is: How much the degree of transnationalisation has reached the LDCs? In the following section we shall examine the geographical spread of foreign affiliates of service TNCs between DMEs and LDCs.

2.2.3 : GEOGRAPHICAL SPREAD OF AFFILIATES

The main issues which we should address in the study of geographical spread of affiliates are whether the affiliates are evenly spread across DMEs and LDCs, or whether there is a bias in favour of DMEs. If there is a bias, we need to examine whether it is industry - specific.

We may expect that a greater proportion of affiliates will be in DMEs, given the usual belief that structural transformation, to a service economy takes place in a developed economy. However, there are ample reasons for investment to take place in LDCs, because the service sector has come to play major role in many LDCs, both in terms of share of GDP and employment, resulting in sufficient demand for services in LDCs. Investment in the service sector of LDCs may therefore be advantageous, given the normal notion of cheap labour in LDCs. Our immediate interest in this section is to examine the pattern of geographical spread of affiliates and to identify any country specific or industry specific characteristics, if any.

Data on geographical distribution of affiliates are for 246 TNCs. These TNCs have a total of 13,697 affiliates. Of these, 13,619 operate in market economies (both developed and developing countries, the other 78 being in socialist economies). Of these, 13,619 affiliates (62%) are in developed market economies and the rest (38%) in developing countries.

However, the patterns of geographical location of affiliates differ between the three major country groups - US, Japan and Western Europe. The majority of service TNCs from Japan have their affiliates in LDCs (about 58%). Of these, more than two-thirds are located in Asia. For the TNCs from the US, however, the Western European Market economies provide the main outlet for service investment, though the involvement in Latin America is also very significant. The Western European TNCs invest mostly in each others territories and in the US. The share of affiliates in LDCs for both the US and Western Europe is much less when compared to Japan. The absolute number of US affiliates in LDC is, however, much higher than other groups, because the US has a much higher degree of transnationalization. Looking at industry-wise distribution, it is banking, wholesale trade, construction and legal service TNCs which have a high share of their affiliates in LDCs. Of the total affiliates of wholesale trading (of the 304 TNCs considered here) fifty eight percent are located in LDC. The corresponding percentage of LDCs share of total affiliates in each of banking, construction and legal services are fifty one percent, forty eight percent, and forty four percent respectively.(Table 2.6)

There are two aspects of the above discussion which we feel are worth noting. First, is the sub-sector specific domination of Japan and the US. Second, when seen in terms of shares, the far higher Japanese involvement in LDCs. US domination is explained by the fact that US TNCs have been among the most aggresive of their species, backed as it was by a domestic economy which until recently was the most powerful market economy in the world. This is true also of TNC behaviour in the service sector, as has already been noted in section 2.2.2. Japanese domination in trading and finance has a somewhat different explanation. Japan's domination in trading owes its origins to the zaibatsus of the Meiji period when these trade and finance houses controlled her overseas trade during a phase which also coincided with her expansionist one. The modern sogo shoshas are descendents of these zaibatsus and thus have the collective experience of ages of international wholesale trading. The Japanese domination of finance is a far more recent phenomena, in fact a mid-eighties one, before which it was the US which had dominated this field too. The necessity for Japanese banks to go multinational arose when Japan decided to start investing the BOP surplses either as portfolio or as FDI. As earlier on in the US case, when Japanese firms decided to go out to invest the banks followed suit.

As far as the discussion which follows is concerned the most important fact which has emerged from this chapter is that the service sector has seen fairly rapid transnationalisation and that non-service TNCs have emerged as not insignificant players in the game. The last is particularly significant for we will have reason to look at the blurring of boundaries between goods and services in some detail in later chapters.

TABLE 2.1

ESTIMATED WORLD TRADE & FDI IN SERVICES, 1981 (IN $ BILL.)

Country	Expors of Services	Sales of Foreign Service Affiliates
U.S.	35	185
U.K.	34	65
F.R.G.	32	40
Japan	19	38
Canada	7	12
Sub Total	127	340
World Total	358	454

Source: UNCTAD TD/B/341/Rev.

U.S. Department of Commerce: International Direct Inv. : Global Trends and the U.S. Role (Washington: 1984)

UNCTC: Trends and Issues in FDI & Related Flows (NY, UN '85)

TABLE 2.2

OUTWARD STOCK BY COUNTRY GROUP IN SERVICE FDI AND TOTAL FDI

(currencies in millions)

Year	CANADA (Canadian $)		F.R.G. (Duetche mark)		JAPAN (US $)		U.K. ( )		U.S. (US $)	
	Services	Total	Services	Total	Services	Total	Sevices	Total	Services	Total
1975	2991	10526	20560	49081	6302	15942	2975.8	10117.7	30242	124212
1976	3308	11491	23120	54774	7681	19405			33354	136936
1977	3936	13509	24000	60767	9202	22210			38496	149848
1978	4817	16422	30494	70330	11303	26809	6663	19214	44962	167804
1979	5114	20496	36826	84485	13594	31804			56725	189285
1980	6986	26967	44631	101918	15943	36497			65672	220163
1981	8318	33847	47173	109234	19925	45403	9914.7	28545.1	71178	234121
1982	9746	35558	56396	123497	24806	53131			69211	227841
1983	11666	37793	69334	145605	29944	61276			76710	230503
1984			71326	147794	37059	71431	26377	75715	58724	236558
1985					46272	83649			61816	250722
1986					64051	105970			94888	276075

Source: UNCTC, official national sources, as quoted in TNCWD, UNCTC 1988.

TABLE 2.2b

OUTWARD FOREIGN DIRECT INVESTMENT FLOWS IN SERVICES, 1975-80 AND 1981-85*

Country	Average Annual Flows		Share of Services		Change Between 1975-80 and 1981-85 (Percentage Points)
	1985-80	1981-85	1975-80	1981-85	
JAPAN	4.0	9.4	41.8	62.2	+ 20
FEDERAL REPUBLIC OF GERMANY	8.9	12.7	49.1[1]		
UNITED STATES	15.6	9.1	34.3	53.2	+ 19
UNITED KINGDOM	2.3	5.0	43.6	38.2	- 5
CANADA	1.7	3.8	20.2	30.9	+ 11

* In Billions of national currencies and percentage

[1] 1977-80

Source: UNCTAD, based on national data.

TABLE 2.2c

INWARD STOCK OF FOREIGN DIRECT INVESTMENT IN SERVICES, SELECTED HOST DEVELOPED COUNTRIES, BY DESCENDING ORDER OF SHARE IN SERVICES, VARIOUS YEARS

COUNTRY AND CURRENCY	YEAR	TOTAL FDI	FDI IN SERVICES	SHARE OF SERVICES IN TOTAL TDI (5)
FRANCE	1980	89.7	33.1	37
(Billions of Francs)	1985	129.0	81.7	63
UNITED STATES	1974	26.5	11.51	43
(Billions	1980	83.0	37.7	45
of Dollars)	1985	182.9	92.2	50
	1986	209.3	111.2	53
FEDERAL	1976	78.9	26.3	33
REPUBLIC OF	1980	93.9	36.4	39
GERMANY	1984	112.8	50.1	44
(Billions of deutsche mark)	1985	119.1	54.9	46
UNITED	1971	5.62	0.62	11
KINGDOM	1981	30.0	6.0	20
(Billions of pounds)	1984	38.5	13.3	35
JAPAN	1975	1.5	0.3	18
(Billions	1980	2.9	0.7	22
of dollars)	1983	4.9	1.2	25
	1986	7.0	2.0	29
CANADA	1980	61.6	15.4	25
(Billions of Canadian dollars)	1984	81.8	23.6	29

1Does not include banking and petroleum related services

2 Excluding banking and insurance. Services include agriculture and mining

SOURCE: UNCTC, based on various officla and other sources

TABLE 2.3

SERVICE AND INDUSTRIAL TRANSNATIONAL CORPORATIONS, SELECTED HOME COUNTRIES*

ITEM	UNITED STATES						FEDERAL REPUBLIC OF GERMANY		JAPAN		UNITED KINGDOM
	Excluding Banks			Including Banks							
	1977	1982	1984	1977	1982	1984	1976	1985	1977	1984	1981
No. of TNCs											
TOTAL	3078	2008	1995	3189	2141	--	2589	3963	1223	1488	--
SERVICES	1093	690	673	1024	823	--	1097	1863	409	541	--
NO. OF AFFILIATES											
TOTAL	23219	17213	16751	24666	18339	--	9059	14964	3589	4937	--
CONTROLLED BY SERVICE PARENTS	5870	4058	3943	6838	5119	--	--	--	1538	1916	--
IN SERVICES	12711	9457	9085	13595	10339	--	5258	9429	1586	2671	--
STOCK OF FDI AS A PERCENTAGE OF TOTAL FDI											
CNTROLLED BY SERVICE TNCs	18	14	--	21	19	--	29	32	--	--	24
IN SERVICES	37	33	31	41	38	37	42	48	38	52[4]	34

Source: UNCTC, based on official sources
[1]Excluding individuals
[2]Excluding banks and insurance companies
[3]Excluding oil, banking and insurance
[4]1985

TABLE 2.4

UNITED STATES: TOTAL ASSETS OF NON-BANK FOREIGN AFFILIATES, BY INDUSTRY OF US PARENT AND BY INDUST
OF AFFILIATE, 1982 (Percentages)

Industry Parent (Origin)	All Indus-tries	Industry of affiliates (Desination)					
		Petro-leum	Manu-facturing	Whole-sale Trade	Finance, (excluding banking), insurance & real estate	Business and other services	Other industri
All Industries	100	26.0	35.4	7.7	21.5	2.6	6.9
Petroleum	100	73.1	6.8	1.3	12.6	0.6	5.6
Manufacturing	100	3.5	62.1				4.5
Services:							
Wholesale Trade	100	4.3	23.2	52.0	9.8	4.9	5.7
Finance (excluding banks), insurance & real estate	100	5.6	9.5	1.5	79.1	1.4	3.0
Business & Other services	100	(10.1)	5.5	2.4	15.9	61.5	4.6
Other industries	100	(8.1)	7.1	3.4	29.4	4.1	47.9

contd..

Industry Parent (Origin)	All Industries	Industry of affiliates (Desination)					
		Petroleum	Manufacturing	Wholesale Trade	Finance, (excluding banking), insurance & real estate	Business and other services	Other indus
All Industries	100	100	100	100	100	100	100
Petroleum	31.5	88.7	6.0	5.0	18.5	7.1	25
Manufacturing	50.6	6.8	88.8				32
Services							
Wholesale Trade	1.9	0.3	1.3	13.1	0.9	3.5	1
Finance (excluding banks), insurance & real estate	9.6	2.0	2.6	1.9	35.8	5.1	4
Business & other services	1.2	--	0.2	--	0.9	29.9	0
Other industries	5.0	--	1.0	--	6.9	7.6	34

Source: US, Dept of Commerce, <u>Survey of Current Business</u> Vol. 65, Nov. 12 (Dec. 1985) as quotec in TNCWD, UNCTC, 1988.

TABLE 2.5

TRANSNATIONAL CORPORATIONS IN SERVICES AND THEIR FOREIGN AFFILIATES, BY HOME COUNTRY AND INDUSTRY, 1986

	NO. OF TNCs					NO. OF FOREIGN AFFILIATES				
	TOTAL	UNITED STATES	JAPAN	WESTERN EUROPE	OTHER DMEs	TOTAL	UNITED STATES	JAPAN	WESTERN EUROPE	OTHER DMEs
<u>Finance Related Services</u>										
Banking[1]	30	3	17	10	--	1858	531	578	749	--
Securities and Financial Services	17	8	7	1	1	453	254	86	7	106
Insurance	26	10	7	9	--	933	392	33	508	--
Reinsurance	14	4	1	9	--	195	62	3	130	--
<u>Trade Related Services</u>										
Wholesale Trade	19[2]	--	13	2	1	2329[2]	-	1640	468	195
Retail Trade	22	10	5	6	1	253	139	19	88	7
<u>Business Services</u>										
Accounting	17	13	--	4	--	4782	3570	--	1212	--
Advertising	16	9	2	5	--	918	738	17	163	--
Market Research	9	7	--	2	--	209	123	--	86	--
Legal Services	15	7	--	6	2	95	59	--	30	6

contd...

	NO. OF TNCs					NO. OF FOREIGN AFFILIATES				
	TOTAL	UNITED STATES	JAPAN	WESTERN EUROPE	OTHER DMEs	TOTAL	UNITED STATES	JAPAN	WESTERN EUROPE	OTHER DMEs
<u>Construction</u>	20	6	8	6	--	321	111	93	111	--
<u>Other Services</u>										
Publishing	14	7	--	5	2	749	93	--	393	263
Transportation[3]	27	11	5	10	1	602	107	71	411	13
Airlines	21[4]	10	2	6	1	1615[4]	414	103	933	56
Hotels	21	16	--	5	--	1317	1032	--	285	--
<u>Sub-Total</u>	246	95	65	75	8	13697	6585	2540	4356	590
Fast-food and Restaurant chains	16	16	--	--	--	6489	6489	--	--	--
<u>TOTAL</u>	304	137	67	86	9	23118	14120	2643	5574	646

<u>Source</u>: UNCTC

[1] Data are for 1985
[2] Includes 3 companies from the Republic of Korea with 26 foreign affiliates
[3] Other than air transportation
[4] Includes one company each from Saudi Arabia and Singapore, together with 109 foreign affiliates.

TABLE 2.6

GEOGRAPHICAL DISTRIBUTION OF SERVICES-FOREIGN AFFILIATES BY COUNTRY OF ORIGIN AND DESTINATION, 1986 (Percentages)

Home Country	Developed Countries Geographical Distribution	Developing Countries Geographical Distribution
United States	61	39
Japan	42	58
Western Europe	73	27
Other DMEs	64	36
Total	62	38

Source: UNCTC (1988), based on Annex B.2 to B.17.

CHAPTER 3 : DIVERSIFICATION, INTEGRATION AND CONGLOMERATION IN THE TRANSNATIONALIZED SERVICE SECTOR - A MANIFESTATION OF TECHNOLOGICAL INNOVATION

The transnationalized service sector has undergone far reaching changes in the present decade. The service TNCs are in the process of diversification and integration of activities. This chapter will analyze the nature of these changes and examine the role of technological change, especially as embodied in data and information technology, in this process.

It is not possible, given the scope of the dissertation, to sketch in detail the changes taking place in individual service sectors. Nevertheless the case of finance related services has been separately dealt with because changes in this sector have been most pronounced and far reaching. In fact, the first section of this chapter, Sec.3.1 attempts a brief discussion of the background to such changes in finance related services and then attempts to explain the causal factors underlying them. We argue that technological innovations, specially in the sphere of computers and data technology, have been a central motive factor behind these changes. Section 3.2 discusses the advantages which accrue to TNCs in general with the use of these of innovations, with particular reference to service TNCs. Section 3.3 examines the implication of these changes for the behavioral patterns of service TNCs, namely patterns of control, as a result of the integration of these technological innovations.

1.1 : DIVERSIFICATION AND INTEGRATION IN THE TRANSNATIONALISED BANKING AND FINANCE SECTOR

The process of diversification and integration of activity has reached a complex level in finance related services. This sector was earlier segmented into separate institutions with a rigid division and a clear demarcation of operations, like commercial banks, security firms, thrift institutions, financial management institutions, insurance companies and credit card issuers. In this decade, these institutions are breaking their traditional boundaries of operation and also diversifying into each other's activities, across the sector. The driving force behind these changes are the financial conglomerates whose activities span all kinds of financial operations. However, the leading institutions in this field are still the commercial banks and to understand the nature of the changes in this sector and their causes, we have to examine the development of banks.

1.2 : DEVELOPMENTS IN THE SECTOR

From the mid-seventies, which saw the emergence of petrodollars with the first oil shock in 1972-73, the character of transnational banking underwent a major change. Before the emergence of petrodollars, foreign operations of TNBs were mainly limited to the assistance of non-financial TNCs abroad. Important functions included the financing of foreign trade and provision of credit in local currencies to the affiliates of the TNCs.

With the oil revenues being banked with the TNBs, the need to recycle them also arose, for the cost, in terms of interest, of simply holding them would have been difficult for the banking system to sustain. With the DMEs in recession, the banks had to look elsewhere to invest a part of the petrodollar funds, even though the DMEs still remained the major users of these funds. Buoyant commodity prices, along with the belief that these would rule in the medium term, led banks to invest in the Newly Industrialised Countries (NICs). For the NICs, this coincided with a fall in official development lending and was(private bank credit, that is) seen by them to be a source of funds, where supposedly no strings were attached, unlike those of the IMF and the World Bank. Since the amounts involved in these transactions were large, new mechanisms for lending which allowed the lender to share the risk with other lenders, emerged - e.g. syndicated loans.

In the rush to tap the new market that followed, both lending and borrowing was indiscriminate. The dollar was a depreciating currency (most of the loans were dollar denominated) and real rates of interest were low. In the early eighties, both the dollar and real interest rates started rising. Coupled with the fact, that even where these loans had financed development plans, these projects were all medium term ones, whereas the loans used to finance them were, mostly, short term, made servicing loans difficult. By 1982 servicing stopped and the banking system was faced with a full scale crisis. The early eighties also saw the plummeting of oil prices and consequently the surplus funds going to banks also declined. The crisis made banks far more cautious in lending to NICs.

From the reduced volume of international loanable funds, the DMEs started getting a larger share of credit. The emergence of US as the major debtor nation in the world increased the share of DMEs in the international borrowing. Due to all the above reasons, the importance of developing countries, as both sources and outlets of funds, declined drastically in the 1980s.

The decline in the importance of syndicated bank loans was further accentuated by the growing involvement of banks in the securities market in the early eighties. Increasing volumes of world financial transactions are now taking securitized forms.1 However, one of the main reasons for this diversification on the part of banks was the debt crisis itself. After the debt crisis, one of the main attempts of the TNBs has been to strengthen their financial position and to try and improve their capital-asset ratios. The banks have an incentive in limiting the growth of their balance sheet assets and seeking ways of generating income through off balance sheet activities. The participation in the securities market has generated incomes and not added to assets, giving rise to only contingent obligations. This has not merely been individual actions by certain banks, but coordinated action by transnational banks as a whole. This can be seen from the BIS (Bank for International Settlements) directive which requires banks to be far more careful about their capital base so as to prevent them from taking more loan risks than they can cope up with. According to a new rule instituted by BIS(Bank of International Settlements) in 1987, to be implemented by 1992, banks will now be ranked by profitability (mainly

1. UNCTC(1988).

returns on equity) and not by assets.2 This is making the banks look outwards and to depend on stock markets for fresh capital. Hence the banks have been making use of new instruments to lengthen their maturities, to increase their liquidity (by having more tradeable assets), and to spread risks by using hedging instruments such as interest and currency swaps.

The main change in strategy for the big banks has been to find ways and means to increase their revenues, especially their non-interest or fee incomes. The sale of services is one such prominent avenue. Use of teller machines, direct communication lines from banks to corporations which allow automatic trading of foreign exchange and computerisation of mortgages and letters of credit are steps in this direction. With such new and varied instruments at hand and with the development of information and communication technologies, the long standing dichotomy between deposits acceptance and loan creating activities of a commercial banks on the one hand, and the fee generating and underwriting activities of the securities and financial firms on the other, is breaking down.

2. The Economist, 25-31 March, 1989.

1.3 : SOME EXPLANATIONS

The current crisis in transnational banking may have motivated the banks to move away from their traditional operations. However, the nature of changes are so fundamental that this cannot be the basic motive for such a structural change. Moreover, diversification of activities is a natural feature of transnational corporate behaviour.

This leads us to the question as to why the diversification did not take place earlier; whether there was anything specific at that juncture which prompted such diversification and integration of activities. Formally, the main cause which may have prevented such diversification of activities on the part of banks is the set of stringent domestic and international banking laws which used to prevail in almost all the major DMEs. The early eighties have seen a wave of deregulation, thus liberalizing the banking laws and allowing the banks much more freedom to go into various complementary fields. However, that merely begs the question as to what made these regulations change.

Often the changes in these regulations were not deliberate and preplanned, rather they came by default, because these regulations were already being flouted in the realm of practice. For example, in the US at the beginning of this decade, short term interest rates were on the rise. However, banks had a ceiling on interest rates which could be paid on deposits and funds were getting channelised to the unregulated market. As a preventive measure the Government was forced to do away with interest rate ceilings on the banks. Exchange controls to regulate capital movements have now been abandoned in many DMEs mainly because such instruments had been rendered ineffective by growth in the volume of international financial transactions through various other channels. In the same way in the sphere of US banking, recent legislations have been passed allowing banks to make various out-of-state acquisitions and take part in other financial markets.

This, however, is not to argue that these liberalization measures were completely forced on the National Governments or the Central Banking authorities. On the contrary, the philosophy of liberalizations is consistent with the political approaches of the existing regimes in most DMEs.

Though the changes in regulations explain to a large extent the diversification that has taken place, it cannot be treated as an exogenous factor which affects the system, because as we have seen, regulations were changed many times precisely when the older regulations were flouted.

A basic factor which, we think, would explain diversification is the immense technological progress which has taken place in the sector, especially in telecommunication and data services. Microelectronics has been able to merge computer and telecommunication technologies as a result of which computers and other electronic devices can communicate with each other. A consequence of this is the emergence of data flows, resulting in a collapse of time and space. If such flows cross national boundaries, they are called Transborder Data Flows (TDF). These data flows can be the object of trade or international transactions or a flow of information within TNCs. Thus TDF is a service in its own right which can be traded across national boundaries. But its main importance lies in the fact that it has turned out to be a core service for other goods and services.

1.4 : TECHNOLOGICAL INNOVATION IN DATA AND COMMUNICATION SERVICES - ITS IMPLICATIONS FOR TNCs

As has already been mentioned, data and communication technology is assuming the role of a core service for other goods and services sectors, in this section we will examine its role in the process of transnationalization. Section 3.2A deals with features of technological change in data and communication services for TNCs in general. Section 3.2B examines how these changes can enhance the possibility and scope of transnationalization of services.

1.5 : BROAD RAMIFICATIONS OF TECHNICAL CHANGE

Here we discuss certain broad features of the technological change referred to earlier. These features, though interrelated, are being discussed separately to highlight some of their more important ramifications.

1.6 Production and managerial flexibility

Use of electronic and data technology creates flexibility in the production process through changes in programming or by programming to order. An implication of this is that there can be inducement for small batch production. At another level, the development of telematics also results in greater managerial flexibility and enables corporations to overcome diseconomies of scale. We will explain the above in some detail below.

The greatest disadvantage of small scale production is its high cost structure (in an industry which has increasing returns to scale). Large scale production reduces unit costs by economizing on fixed cost and enabling bulk purchases. A major shortcoming of large scale production, however, is its inability to make changes according to consumer specification, because its basic principle of operation is standardisation of products. Data technology, once set up, allows changes in design at very little cost. Products can now be designed according to consumers' tastes or idiosyncrasies and as each batch appears to be exclusive to the consumer, the benefits of price discrimination can be reaped and most of the consumer surplus mopped up.

The advantage of such small batch production is that the benefits of low fixed cost per unit and those of bulk purchases are not lost because the effective scale of operation can remain the same. The production structure thus in no way loses the advantages, in cost and volume, of large scale production, but manages to create effective product differentiation with the same production process. Thus data technology creates the possibility of small batch production, which, however, is not synonymous with small scale production. The other advantage is that supply can be synchronized with demand and in the process the problems and costs of stock piling can be reduced.

We now come to the issue of managerial flexibility. One of the reasons why large scale production entails diseconomies of scale is managerial problems of coordination and supervision. The new developments in telematics not only allow direct control over the shop floor from the managerial office, but also helps to coordinate distant activities in various workshops, at different levels of production, and even across national boundaries. The use of telematics thus introduces a lot of flexibility at the level of centralized decision making, allowing the manager to choose between different production processes and if necessary, to shift from one to the other, without being forced to dismantle the entire production structure existing at a point of time.

Advantages due to managerial flexibility can accrue to service TNCs because it enables the coordination of activities of various local units from the headquarters. Especially for TNCs involved in consumer services, telematics allows firms to maintain heterogeneity of services produced (heterogeneity arising because of catering to specific needs of local populations) as well as to centrally controlled. Obvious examples are car rentals, tourism and travel services

1.7 Vertical and horizontal integration

Vertical integration at the level of the firm may be necessary for a variety of reasons - the existence of very high fixed costs, which once committed, may make the firm vulnerable to intermediate producers, integration of into intermediate product markets in an attempt to reduce costs, the acquisition of a new technology which may require intermediate products presently not being made in the market, as an attempt to erect barriers to entry etc. Horizontal integration comes about when a firm enters complementary product markets in an attempt to attract customers by presenting them with a wider variety of goods and services. What is common to both these types of integration is that the number of production or distribution units that have now to be managed increases and consequently could pose a problem for effective control. This is where the new data and information technology step in. They make the exchange of information across units a speedier and less expensive affair, as well as making centralised control of the production process feasible and effective. Consequently they make vertical and horizontal integration feasible wherever the possibilities exist. Tendencies of vertical and horizontal integration are in any case structural to the operations of the TNCs. The use of data services heightens such tendencies. One of the main reasons of, what has been called, "secondary uncertainties" in capitalist production is lack of information and coordination between activities of firms. Instantaneous information flows reduce such secondary uncertainties. Integration of both production stages within an industry and that between different industries can become more profitable because they can now avoid large scheduling of materials and cut down on inventory costs. The transborder data flows through transnational computer communication systems have emerged as crucial infrastructure for the international integration of production facilities. This is of special interest to the TNCs because they can now coordinate the activities of their foreign affiliates more effectively with a global perspective in mind.

1.8 Better financial management

To the TNCs, perhaps, what is at least as important as production integration is financial integration. The greater instability of international monetary and financial systems with a slower overall growth of the world economy has meant that firms and more specifically TNCs have become far more conscious about their financial aspects. The use of electronic data devices in general and that of transborder data flows in particular help to reduce these instabilities. A part of this relates to the ability of the corporations to have better financial management by reduction of fixed costs through international inventory control. Another part of it is streamlining basic financial operations. However, the major advantage of transborder data flows lies in the ability of the TNCs to transfer large volumes of financial information from the affiliates to their headquarters. Such linkages also exist between the headquarters of TNCs, on the one hand and financial institutions and foreign exchange markets, on the other. This enables the TNCs to take decisions on a day-to-day basis keeping in mind their overall global interests. Further, all these enable better corporate and financial planning. The use of transborder data flows in the manner discussed above is, given the very nature of their operations, of particular significance to banks and financial intermediaries.

1.9 Increased tradeability of services

The fact that most of the services have to be produced and consumed at the same instant and therefore at the same place, poses a serious impediment to cross-border trade in services. Data technology by linking up distant spaces instantaneously has therefore added an altogether new dimension to tradeability of services. Not only has it brought new services into the fold of trade, it has also, more importantly, increased the tradeability of some of the already traded services especially in the fields of finance and trade-related services.We have had reason to dwell on this aspect at some length later in the dissertation.

1.10 : ROLE OF TECHNOLOGICAL CHANGE IN THE INCREASED SCOPE OF TRANSNATIONALISATION

Having discussed some of the ramifications of technical change for TNCs in general, we now shift to a discussion of how these changes aid in enhancing the scope and possibility of transnationalization of services. This is not in any way an attempt to formulate a theory of transnationalization of services, i.e., it is not an attempt to explain the phenomena of increased transnationalization of services by a set of advantages which technological change has given rise to. We recognise the fact that even an attempt to formulate a theory for a phenomena such as the transnationalization of services cannot be merely in terms of certain advantages in production and organisation structure. It is a far more complex issue, for an understanding of which we have to review the development of monopoly capitalism as a phase in history and would necessitate a discussion in the terrain of political economy, taking us far afield from our area of immediate interest.

The reason for making this qualification is that we will be using certain concepts which are borrowed from a framework, well known in the literature as Dunning's "eclectic paradigm",3 often advanced as a theory of transnationalization. The paradigm explains transnationalization in terms certain advantages such as ownership, internalization and location. As mentioned already, Dunning's framework is often put forward as a theory to explain transnationalization. We however believe that Dunning's framework does not constitute a theory and merely points out certain basic factors which make it advantageous for a firm to undertake FDI(rather than domestic production or portfolio investment). It is eclectic because this set of factors is not unified on the basis of any theory but are instead drawn from various alternative theoretical premises.

Since it is of interest to us to examine the nature of advantages which certain kinds of technological progress has created for the scope of transnationalization of services

3. Dunning(1974). However a summary discussion of Dunning's work and a good critique of the same found in Casson(1987).

and not explain its causation, we find it suitable to use certain concepts from Dunning's framework to gain some analytical clarity in a largely unexplored area. We now move on to a brief discussion of the advantages elucidated by Dunning.

The ownership advantage accrues to a TNC because it possesses certain processes(technology, skills, physical and non-physical assets) which give it an edge over the local producers in either production or marketing or both.

The internalization advantage refers to gains which may accrue to a TNC because of internalizing intermediary markets. Specifically, it also answers the question as to why a firm with an ownership advantage in a certain process may not license it out. This is so because the full benefits of certain ownership advantages may not be reaped unless intermediary markets are internalised.

1.11 : OWNERSHIP AND INTERNALIZATION ADVANTAGE

We now move on to a discussion of the various ownership and internalization advantages that may accrue to TNCs because of technical change in data and communications technology. Economies of scale are perhaps a fundamental characteristic of transnational operations, they become particularly significant in sectors characterised by high fixed costs and comparatively low variable costs, provided there are no strong diseconomies in enlarged scale production. As discussed in Section 3.2.1 data technology reduces managerial diseconomies and thus makes it conducive to go in for large scale operations.

Though scale economies are important for certain service sectors like shipping, wholesale trade, communication and data transmission, economies of scope are perhaps more relevant for many service sectors where the advantages lie in increasing the range of operations and not so much the scale of operations. This is particularly significant in retail trade(where a large range of products under one roof may make it more attractive for the consumer to buy from that establishment) and services like brokerage, management and investment consultancies, travel agencies(where a large range of options as well as a package of coplementary services can be provided to the consumer). Communication technology by allowing ready transmission and storage of information has brought a sea change in the range of options which are now available to the customer at any point of time.

Privileged access to inputs, distribution and marketing channels are other forms of ownership advantage. One basis of having better market access is a better informational base. It is this informational base which gives TNCs a cutting edge vis-a-vis domestic producers.TNCs, which have a global perspective, translate this enhanced informational base about alternative inputs and markets into greater decision making flexibility as compared with domestic firms. This allows them to react faster to opportunities and situations. Communication technology enhances this flexibility by facilitating transfer of information from and to the corporate headquarters of the TNCs. A manifestation, par excellence, of this advantage is seen in the activities of financial conglomerates like American Express and big wholesale trading conglomerates like the sogo shoshas of Japan. We will have reason to examine such conglomerates in greater detail in the next section.

Another distinct form of ownership advantage for a TNC is the possession of goodwill and a widely recognised and accepted brand name for goods and services, which is more often than not seen to be superior to comparable products manufactured by domestic producers. Whereas this advantage gives TNCs a head start in terms of market shares, information technology helps in enhancing the competitive edge of TNCs by allowing greater managerial efficiency and better consumer contact. This is of even greater importance for the service sector, where the demand has a strong "human" or idiosyncratic content and desirable quality often is seen to be manifested in more superior management and better consumer contact(both direct and indirect). Modern technology goes a long way in both being able to monitor such desirable standards of quality as well as having better links with the consumer in order to enhance the composite goodwill of the corporation.

The source of monopoly power of TNCs stems from their superior access to "knowledge",[4] where knowledge comprises of technology, information, skills etc. Though generally speaking technology and know-how aspects of services is not expected to be as complex or as "hard" as that involved in manufacturing, possession of certain kinds of knowledge in terms of information, experience and skills give service TNCs the cutting edge. This is especially relevant for information and experience based services like managerial and consultancy services, accountancy firms, financial services and travel agencies. However, having access to modern technology and complementary processes of the kind that we have been discussing, itself forms a core advantage for TNCs in general and thus form a very important aspect of ownership advantage.

The internalization advantage accruing to a TNCs could come about for one of two reasons and at times perhaps due to both. First, the internalization of markets(which is what the internalization advantage is all about) is profitable when the entire monopoly rents accruing because of the

4. For a discussion on this refer to Casson(1987).

existence of an ownership advantage cannot be reaped if arms length business practices are undertaken. Second, internalization of markets may be resorted to in an attempt to gain greater control over the production and distribution process, so as to allow for greater flexibility both vis-a-vis the consumer and potential rivals. For service TNCs this is of some importance specially, in information services where the acquisition of the knowledge, in the first place, may involve very high costs, but its replicability may be relatively costless. In such a situation service TNCs may prefer to internalize rather than run the risk of a customer acquiring this knowledge and becoming a potential rival. Data and communication technology has made this process of internalization a far more feasible and profitable proposition allowing instantaneous communication between markets and between stages of production.

1.12 : TENDENCIES TOWARDS CONCENTRATION AND INTEGRATION - A MANIFESTATION OF TECHNICAL CHANGE

We will now look at some of the implications of this development in data technology, i.e., increasing tendencies of oligopolistic concentration, conglomeration and integration between sectors. We will deal with each of these aspects below.

1.13 As we have mentioned earlier, the initial costs of setting up these technologies is very high. Also, in order to reap the advantages of the new techno-institutional package the corporations must have a large and diverse client base. Thus inherent in these changes is a bias towards larger corporations which can reap the benefits to the full extent, and consequently the profits tend to be concentrated with big corporations. We can illustrate this from the experience of the US banking sector. The total profits of the 14,000 banks in the US was $25 billion in 1988. Of this two-thirds were made by the largest thirty five banks. If we compare this share with that in 1979, when automation of the kind discussed above was not yet such a widespread phenomenon, we find that it was only one third. So in the last ten years, the big banks have doubled their profit shares and the small ones have lost out, in relative though not in absolute terms. A similar trend is visible in the profitability figures also. Between 1983 and 1988, average return on assets for the largest 35 banks has risen from 0.6 to 0.9%, whereas for the small banks this shows a decline from 0.7 to 0.5%.[5]

1.14 With the development of sophisticated data technologies, electronic devices can communicate with each other, linking up different corporations or their branches

5. The Economist, op.cit.

within a country and across countries. However, in order that such coordination exists between different affiliates of a corporation or between corporations and their suppliers and dealers, it is necessary that users protocols be reestablished to permit communication among electronic devices. Without such standardization most of the electronic devices are not capable of communicating with each other, because they have different specifications allowing communication only within their own specifications. We can take the example of General Motors (GM) to dwell a little more deeply into this problem. In 1984, GM was using 40,000 programmable devices of which only 15 percent could communicate with each other. To prevent such inefficiency a task force set up by GM developed a "manufacturing automation protocol" (MAP) i.e., a standard set of communication specifications to interconnect its automated facilities. Further, GM wanted its suppliers to adopt their standard as well so that a higher level of efficiency to be achieved. Moreover, GM had an interest in seeing that larger number of firms adopt this protocol because this will then put pressure on suppliers of automated requirements to produce products with such specifications. For this GM in 1984 initiated a "MAP Users Group" and by December that year 50 firms including IBM, Digital Equipment, Ford, Boeing, GEC and Intel had endorsed the protocol. A similar group was formed in Europe the next year under the leadership of Unilever.

This is an interesting example of the ownership advantage discussed in the earlier section and the use of this advantage in conjunction with the position of a firm as a market leader. Once GM had developed MAP it successfully used its position as a market leader to see that this protocol was widely accepted both by customers and suppliers, thus enhancing its position as market leader, as well as reaping monopoly rents from the acquisition of new knowledge. What this example also hints at is the necessity to be in monopolistic or oligopolistic environments to be able to reap the full benefits of any new knowledge that may be acquired. And last but not the least, the example also points to the fact that technology may act us an effective entry barrier to the smaller firms and to the potential late comers to the industry.

We have already discussed how the use of data technology enables corporations to diversify into horizontally and vertically integrated activities. Specifically, we have seen that in the finance sector the banks have diversified into other areas. We have also discussed how there exists competition between banks and non-bank financial corporations as a result of diversification in finance related services. The competition is, however manifested not always in the form of antagonistic moves but also by mutual collaborative arrangements. This is not only because the leading corporations in each field realize the costs of competition and resort to collusive oligopolistic practices but also because the corporations are moving into new areas. The experience and familiarity of corporations in specific fields can be profitably pooled together in collusive and collaborative arrangements.

Whereas it may be possible for a firm to go in for collaborative arrangements across and along the value added chain, the full advantages of vertical and horizontal integration may not be reaped through such arrangements and hence the necessity to internalise markets, as we have already discussed in the preceding section. This is all the more important keeping in mind the fact that internalization of markets allows the firm a much greater degree of control over the production and distribution process. And it is this control which is acquired by acquisitions of and mergers between corporations. The above therefore leads to the phenomenon of widespread mergers and conglomeration.

This process of mergers and conglomeration is however not limited to the finance sector. Two distinct trends in conglomeration are visible - that between service TNCs themselves and that between service TNCs and goods TNCs. Of the mergers between service corporations, the finance related services have accounted for large number of mergers.6 This phenomenon has culminated in the formation of integrated financial conglomerates, e.g. American Express(AMEX). The main activities of this conglomerate cover a wide and diverse range of activities - banking, investment banking, brokerage, tax consultancies, portfolio management, insurance and travel services and issuance of credit cards and travellers' cheques. AMEX is the largest integrated financial conglomerate in the world, with total assets of over $100 million and total revenue of $15 million, accounting for about 40% of total assets and revenue of all financial conglomerates.7 The other major conglomerates are Merril.Lynch Corporation Incorporated and Salmon Inc.

Of the other kinds of conglomeration within services, distinct patterns can be observed, between different business service corporations, between business and financial corporation, between retail trading corporations and between retail trading corporations and financial corporations. Other examples are conglomerates within consumer services - between travel, tourism on the one hand and between these services and the banking services on the

---

6. Clairmonte and Cavanagh(1985) mentions some of the recent mergers in their work quoted here.
7. UNCTC (1988)

other. The essential motivating point for conglomeration between consumer service corporations is that these services are all related from the consumer's point of view. Provisions of many consumer services under the same roof reduces the transaction cost for consumers and hence provide a major attraction for him. The obvious example of such consumer service conglomerates are the retail trade chains where the larger the number of goods traded, the more advantageous it is to the consumer. Further, corporations like Sears-Roebuck have gone into issuing credit cards which, while allowing the benefits of using credit cards to the consumers also ties him to the particular corporation. Similarly, among business services, some conglomerates provide market research, legal services, investment banking and accounting services under the same corporation. In cases where the customer is a firm or corporation, provisions of these services requires detailed knowledge of the structure of the corporation. Since a level of secrecy and confidentiality needs to be maintained, it becomes advantageous for the consumer if all these facilities are available at the same place.

The process of integration and conglomeration is in no way limited to the services sector. Acquisitions, mergers and other forms of integration have become widespread between various services and manufacturing corporations.

There are very distinct patterns of integration and conglomerations visible here also.. There are many examples of non-service corporations which acquire service firms in order to achieve greater vertical and horizontal integration. A corporation which deals with the production of goods may find it necessary to avail of services that are necessary and complementary for goods production and marketing, like transportation, advertising, etc. A firm can produce some of these services, thus internalizing the market, instead of buying these services on the market, thus resulting in cost-decreasing vertical integration. Services like consumer credit given to enable the purchase of items like consumer durables are complementary to the consumption of the final output of non-service TNCs. What starts as a process of internalization of markets could progress to a situation where, the interest of the acquired service firm shifts from mainly serving the parent firm to serving the entire service market in question, in its own right.

We have already discussed the increasing service intensity of goods production in the earlier chapter. There are many examples of integration, both vertical and horizontal in the facilities mentioned above. Manufacturing TNCs often acquire insurance companies in order to avoid taxes because insurance premiums are tax free. All these are, however, examples of integration and not conglomeration. There are many examples of service TNCs going in for acquiring manufacturing firms and forming integrated conglomerates. The tendency is most pronounced in the wholesale sale trading sector.

The sogo shoshas of Japan, the integrated conglomerates which started as wholesale trading firms, best exemplify this. They have gone into widespread vertical and horizontal integration, developing very close links with banks and financial houses on the one hand and the industrial houses on the other. Apart from industrial production and financial activities they also carry out purchasing, marketing, inventory and market research. Mitsui and Co. is an excellent example of this sort of a TNC.

The importance of advanced information and communication systems for Mitsui's global market power, reach and activities in various markets is brought out in the following quote from UNCTC 1988. "The information and communication system is the heart of the company's operations. It links foreign affiliates and offices with a number of regional centres outside Japan. In 1986, its communication expenditures amounted to 8% of its total expenditures...Mitsui's communication expenditure to sales ratio surpasses easily that for R&D to sales for most manufacturing firms. For trading companies, the establishment and maintainance of a communication system is an investment, just as R&D is an investment for industrial firms...Capitalising on its worldwide network and experience in transportation and distribution it invested in the establishment of a non-vessel operating common carrier. The system operates no vessels, rather provides information and information arrangements on a fully integrated set of sea, air and land transport services and arranges services where they are required. This information system is complemented by an aircraft transportation company, an international parcel delivery service and a network of overland distribution and warehousing companies...Mitsui has also diversified into a growing range of financial services and through the Tokyo Executive Centre Inc. it rents office space and consultation and secretarial services to foreign business persons staying in Japan."8

However, the phenomenon of integration between goods and services is more pronounced in the case of telecommunications and the data industry itself. Telecommunication, data goods and data services were earlier distinct products with separate corporations dealing in them. With development in telematics, such divisions are breaking down.

The TNC in these sectors are now breaking out of such segmentation and are getting involved in wide range of mergers and collaborative arrangements. These range from

---

8. ibid.

complete acquisitions and equity holdings to various kinds of joint ventures and agreements dealing with technology, manufacture and marketing. The process has led to formation of conglomerates by the major TNCs in the field data and communication industries. Further TNCs in data services are also colluding with major manufacturing TNCs.

The examples of two leading giants[9] in these sectors IBM and AT&T will help us understand the process better. Traditionally, IBM built computers and AT&T carried messages. Today, both computers and telephones operate on the basis of data technologies. Thus, while AT&T sells computers to be used on its communication networks, IBM markets networks to accompany its computers.

In June 1985, IBM acquired thirty percent of share in MCI Communication, the second largest long distance telephone company in US and thus entered the telecommunications market. Further it acquired Rolm Corporation (complete ownership) which produces private branch exchanges (effective in inter office and local area communications).

With these developments it brought itself in direct competition with AT&T. However, IBM's endeavour to diversify does not stop at that. In 1984, IBM established a

9. Sauvant(1986)

joint venture with Merril Lynch, the largest US brokerage house, to develop a computerised information and order execution system for brokers. Subsequently it set up with C.B.S. and Sears Roebuck and Co. (the largest retail chain) TRINTEX, a nationwide commercial videotex service for home shopping, banking and information services.

AT&T in order to retaliate entered similar wide ranging collaborative arrangements. In 1984, it divested itself of about $120 billion in assets to form seven independent regional telephone companies and thus obtained permission to enter the data processing market. Within four months it entered the computer market with a range of computers. To establish itself in office equipment and desk-top computer systems it acquired a twenty five percent of Olivetti's equity stock. In June 1985 it entered into a joint venture with Chemical Banks Time Corporation and Bank America to provide videotex services such as home banking, home shopping, news and ticket reservation services based on Chemical Banks Pronto home banking service. This move was to counter Trintex, similar to the move by IBM discussed above. Further AT&T and Quotron entered a joint venture to develop a sophisticated computer based financial information system, through which stock transactions and other brokerage functions can be executed. The main customer of this system will be Shearson Lehman Brothers (a subsidiary of American Express) which will link facilities with its 5,500 brokerage branches in the United States. With this venture AT&T now competes directly with the IBM-Merril Lynch venture mentioned above.

The TNCs in data services are also in a process of collaboration acquisition or merger with major TNCs in manufacturing. The blurring of boundaries between data resources and other goods or services can be best exemplified by the recent moves by the major automobile corporation. Since the mid eighties there has been series of takeovers of and agreement with firms in electronics, aerospace and other high technology areas by the major automobile corporations. A central reason for these drives apart from diversification is to gain the technology necessary for an automated production process and an effective control system. In 1984, General Motors acquired the then largest independent data processing corporation, Electronic Data Systems for $2.5 billion. In 1985, GM bought Hughes Aircraft for $5 billion. These will enable GM to progress towards the aim of having an integrated information and communication system to link the "factory floor to the Chairman's office". "The system would include the design and production of models, the provision of supplies by any of GM's 30,000 US suppliers and the ordering of products by customers from any of GM's 16,000 domestic dealers."

In similar moves, Chrysler bought Gulfstream Aerospace for $640 million and Daimler Benz bought Dornier, an aerospace company and AEG, a telecommunication company. Ford Motors entered a joint venture with General Electric Company and in the process acquired equity stocks in American Robot Corporations, to produce electric motors in highly automated and computerised factories.

The growing interests of such industrial giants to acquire telematics and such other high technology, exemplified by the above mentioned acquisitions and collaborations, are reflections of a desire to have more control over production and in managerial functions.

It might be useful to try and summarize the argument which has been put forward in this chapter. First, the service sector has seen a kind of technological change which has aided the process of transnationalisation. The reason for this is to be found in what Dunning calls the ownership and internalization advantages as explanations of the transnationalisation phenomena. The ownership advantage ycomes into play because the new technology has made it possible for certain firms to own processes with which to distinguish themselves from the rest of the field and thereby collect monopoly rents. To be more specific, what we are indicating is that the nature of the technology has meant the possession of "knowledge" which allows firms to be monopolists, at least for some period of time. The technology also makes it possible to go in for horizontal and vertical integration and therefore internalize markets. Second, this technology has also meant a certain concentration of capital where the traditional boundaries between the service and goods producing sectors is slowly breaking down.

CHAPTER FOUR

FORMS OF CROSS-BORDER ORGANIZATION OF PRODUCTION AND DISTRIBUTION OF SERVICES, CERTAIN INHERENT COMPLEMENTARITIES AND ITS RELEVANCE TO THE TRANSNATIONAL CORPORATIONS

We have already discussed in the last chapter how TNCs are increasingly going in for various collusive and collaborative arrangements. We have seen that certain features like ownership and internalization advantage affect the pattern of cross-border organizational forms of the TNCs. Technological change by enhancing the scope of reaping these advantages has increased the choices available to the TNCs while deciding on their appropriate organizational form. Another ramification of technical change has been the increased possibility of cross-border trade in services. This chapter, first examines the variations in organizational forms within the service sector and attempts to explain them in terms of variations in the nature of sector specific advantages a TNC enjoys over its competitors(section 4.1). Then, it analyses the complementarity between trade and FDI in the service sector and their effect on TNC behavioral patterns(section 4.2). Finally, it examines the ramification of these complementarities for a multilateral framework for trade in services(section 4.3)

4.1 : ORGANIZATIONAL FORMS WITHIN THE SERVICE SECTOR - SOME EXPLANATIONS

4.1.1 : LOCATION SPECIFICITY

Before entering into the discussion we may note that apart from "ownership" and "internalization" advantages, the organizational form chosen is also affected by "location specificity". What we mean by this term is something close to what Dunning1 called "location advantage" but with a major qualification. Dunning noted certain advantages which the location of a foreign country can offer, when he looked into the question of why TNCs invest abroad at all. These advantages were mainly in the form of cheap labour, proximity to raw materials and the nature of government regulations. As we have mentioned earlier, we are not interested in the question of why TNCs invest abroad(a question which in a sense boils down to why TNCs are what they are). and we do not think a theory of transnationalization can be constructed merely on the basis of identifying some such "advantages". However, we do believe that specificities of a location are very important in choosing between alternative locations and more than that, in choosing the form of investment (in our context, the choice of alternatives from various cross-border organizational forms.)

1. Dunning(1974).

Of the major location specific factors discussed in the literature2 on TNCs, ie, cheap labour, proximity to raw materials, the possibility of jumping tariff barriers and government regulations, the first three are not so important in the case of services. Whereas the question of raw materials is not important for services, the low tradeability of services because of their physical nature makes the question of jumping tariff barriers also inconsequential. The advantage of cheap labour benefits TNCs in transactions involving goods, where they can separate stages of production and locate the unskilled or semi-skilled stages of production where labour in cheap (mainly LDCs). However, the instantaneous nature of service production and consumption makes it impossible to separate stages of service production and thus this advantage also is irrelevant for services.

The most important location factor which affects the determination of cross border organizational form is the state of government regulations. The service sector confronts the most stringent government regulations both in trade and FDI so that TNCs do have to take this into account while determining their organizational form abroad.

2. Casson(1987)

In what follows, we have discussed the pattern of organizational forms visible in some specific service industries. Absence of systematic and comparable quantitative evidence dos not allow us to examine in any substantive manner the cross-sectional pattern of organizational forms in various service sectors. However, we can get a broad picture from some qualitative evidence provided by the UNCTC study. In what follows we will also try to identify the reasons for the existence of various organizational forms in the light of our discussion in this and the previous chapter.

4.1.2 : EXPLAINING ORGANIZATIONAL FORMS

A wide range of organizational arrangements are visible in the service sector, which includes majority owned subsidiaries, agencies and branches, representative offices, joint ventures, subcontracting, licencing, management contracting and franchising. In what follows we have attempted to identify the dominant form of organisation in specific service sectors. This however has to be read with a caveat. Not only are there sectors where such a dominant form may not exist, even in the sectors where such a dominant form exists, the presence of other forms may not be insignificant. This is particularly so, given the changes going on in the service sector, where newer forms of arrangement and investments are coming into play.

The UNCTC study3 identifies certain service where FDI, (in the form of subsidiaries, majority owned affiliates, branches, and representative office) is the major organisational form. These service are banking and finance related services, management and consultancy services, brokerage (investment banking), advertising, transportation (mainly, shipping and airlines) and wholesale trading .

These are typically, the services where gains from internalization are very significant (because the nature of ownership advantage may justify internalization or there may be scope for vertical and horizontal integration) or there are strong economies of scale.

In banking for example the gains from internalization are obvious. Banking, being a high value activity, with significant involvement in international financial and capital markets, centralised control becomes essential for coordinating various activities world wide. Not only does centralised control allow co-ordination of cross country capital flow, in the age of fluctuating exchange rates it also allows better possibilities of international arbitrage. A large part of transnational banks operation involve inter-branch transactions. Further many of these operations need considerable secrecy. The major clients of those banks are the TNCs, whose activities often demand confidentiality.

3. UNCTC(1988)

transnational banking, since both flexibility and secrecy are important characteristics its operation. As the banks diversify into other activities like investment banking or financial consultancies the need for confidentiality increases even more. Further with changing nature of international banking, having access to exclusive information and expertise becomes more central for a TNBs operation. "Possession of Knowledge"4 (information, skill, expertise) therefore becomes the central ownership advantage. As discussed earlier, to reap the full monopoly rents from an advantage such as "Knowledge", internalisation is necessary, as the cost of producing such "Knowledge" is high but its replication and reproduction may be easy. Further, with diversification in operations, i.e. with increase in economics of scope, the goodwill of the banks become an important issue. The banks therefore may have apprehensions that any licence may not be able to maintain the quality of operation, specially when the operation that the TNBs are involved in can hardly be standardised and are complex, and idiosyncratic in nature.

For all these reasons, the banks prefer FDI to other forms for organising activities abroad. However, there are notable exceptions. In many underdeveloped countries. TNBs

4. For a discussion on the possession of knowledge as an ownership advantage refer Casson(1987).

have entered into joint ventures, mostly with government sponsored banks. The location factor plays a role in these cases. In many LDCs, banking laws are very strict and foreign banks are not allowed to operate independently (or they are not allowed to hold majority share). Further familiarity with local customs and more than that contacts with local industrialists and bureaucrats and politicians may be important considerations to collaborate with a local bank. These considerations are important because the major clients of these banks the TNCs often need these contacts to facilitate their activities in these countries. In a drive to diversify activities some TNBs have chosen to enter various forms of collaborative arrangements with other financial service firms but even in most of these cases, for reasons described above the banks to attempt to maintain control over the firms. Therefore, mergers and acquisitions are more common than single collaborative arrangements.

Reasons, similar to that in the case of banks, can be forwarded to explain the dominance of FDI to other forms in management and financial consultancies and investment backing. "Knowledge" being the main ownership advantage and the goodwill of the corporation being a very important factor FDI is the most suitable form of organisation. We have however discussed about those while discussing the need of internalization in the wake of diversification in banking activities.

Once again similar reasons can be forwarded for explaining the dominance of FDI in advertising TNCs. The goodwill of the corporation is very crucial factor in this case. The customer must have the confidence that the advertising corporation will be able to market its product. This is all the more so, because present day advertisement corporations no longer limit their activities to media advertisement. They programme marketing strategies for their clients and are even involved in sales promotion, sales training and after sales services. The goodwill of the advertising corporation once again be in superior "Knowledge". In particular, apart form the need to have highly skilled personnel, they need to have thorough information about consumer psyche and the nature of market segmentation. It needs costly and painstaking study to gather these informations. It is necessary that these informations once generated are easy to make use of and therefore confidentiality is a central element in the organisational structure of these corporations. FDI therefore seems to be the best option for such kind of operations. Diversification and integration of activities, a trend visible in this sector, is accompanied by a spate of mergers and acquisitions. The gains from diversification and integration of activities can thus be internalised more effectively when corporations merge (or are annexed) rather than by forming collaborative arrangements such as joint ventures. For example one of the most important development in the recent advertisement world was the amalgamation of McCann Erickson, Marschalk, Campbell Ewald, SSC & B and Lintas into a single management agency called the Interpublic Group,5 delivering a vast range of services.

However, formation of joint ventures specially between the U.S. and Japanese firms have been no less significant development. Dentsu and Young & Rubican, two of the largest TNCs in advertisements established a joint venture in Japan and elsewhere early in this decade.6 United States and Japan form world's two largest advertisement markets, with significant involvement of both the country's TNCs in each other market. However, both these countries have very different cultural specificities with very different nature of consumer psyche. Advertisement, being a culture sensitive activity, the location specific factor is important here and this may put a domestic firm in an advantageous position. Formation of the joint venture, mentioned above, was thus a collusive practice to curve out a greater market share in the world advertisement market. However this move by Dentsu and Young & Rubicam to emerge as market leaders was

5. Clairmonte and Cavanagh(1985).
6. ibid.

countered by a spate of similar collusions between U.S and Japanese firms. Notable examples are collusions between Leo Burnett and Kyodo and between Doyle Dane Bernbach and Dai-Ichi Kikaku.

These examples demonstrate that, in advertising, though FDI is the dominant organisational form because of significant gains from internalization, location and sector specificities such cultural specificity can be important reasons for the existence of collaborative forms.

Two other sectors where FDI is the dominant form of organisation are transportation (shipping and airlines) and wholesale trading.

Both shipping and airlines have significant scope for vertical integration of activities and have tendencies towards formation of service conglomerates. Shipping has strong linkages with bulk goods producers and wholesale trading firms and retailers. The core service shipping itself is capital intensive with high fixed costs and scale economies an crucial to its operation. There is considerable scope for co-ordination of activities and inefficient management can prove to be very costly. The possibilities of vertical integration, the need for centralised control of activities and the need for very efficient management, makes FDi the most suitable form in this activity. However shipping companies often go into various collaborative ventures in their subordinate activities (ship repairing, stevedoreship, etc).

Airlines share most of the central features of shipping. However their linkage are not obviously with bulk traders or retailers. The conglomeration here involves travel agents, tour operators, hotel chains, car rentals and such other activities. The need for co-ordination and control is central to the activities and most airlines have their own ticket booking offices and business outlets spread around the world. However, competition often make these corporations to go into collusive arrangements with each other to protect market shares. Though many airlines have also gone into vertical integration by owning travel agencies and hotel chains, many others have gone into collaborative arrangements with established travel agents, tour operators, hotel chains and car rental firms.7 Being consumer services, a corporation involved in these often need to have a strong goodwill. The airlines may thus find it profitable to go into collaboration with an already established corporation in these services rather than attempting to produce them on their own. Wholesale trading is another activity where FDI is overwhelmingly dominant. Integration, both vertical and horizontal is central to

7. UNCTC(1988).

wholesale trading. The subsidiaries need to obtain inputs for the parent company at the best possible terms, and develop and serve the markets for goods and service produced and exported by the parent firm. Internalization is therefore necessary as it may not be an efficient to leave these operations to independent agencies. Further corporations, because the wholesale trading corporations are getting involved in a vast range of activities. The world market for wholesale trading is dominated by the Japanese conglomerate, the sogo shoshas, about whose activities, we had already occasion to discuss in chapter 3.

The UNCTC study identifies certain other services where minority joint ventures or non equity a agreements are preferred forms of foreign participation. These services are mostly consumer services like hotels, restaurants, fast food outlets and car rental firms; and some business services like accountancy, legal services and engineering, architectural and such technical services.

In the consumer services, management contracts and franchising are common forms of organisation. The "Knowledge" involved is often simple and low cost and easily reproducible. However, the reproducability feature of "Knowledge" does not necessitate internalization primarily because of two reasons. First, the ownership advantage of the firm does not lie in superior "Knowledge" because the quality of "Knowledge" is neither complex nor particularly exclusive. Second, the advantage of the firm is however in the goodwill, it has already managed to generate. This goodwill is generated because of the particular quality of the service which, however, can most often be standardised and satisfactorily codified in the management contract or franchising agreement. There is not much scope for apprehension about under performance.

Franchising is a type of contractual arrangement to distribute brand name services under licence. The franchiser provides the business system and trade mark and the franchisee operates the business under the franchisor's name. Though the franchiser and franchisee can have independent relationship the more significant form of franchising in the consumer services is characterised by a fully integrated, ongoing business relationship between the two. Thus apart from the trademark, the entire business format itself - the marketing strategy, operating manuals and standards and quality control is dictated by the franchiser. This is best exemplified by the following quote about the largest fast food corporation - McDonalds interaction with its franchisees.

"Each franchisee obtains an operating manual which deals with everything - from the temperature of the shortening used to prepare French fried potatoes, to the way in which the bag containing the hamburger has to be given to the customer, to the number of time the bathrooms have to be cleaned daily. Each job is broken down into smallest steps; the cooking and bagging of fries, for instance consists of 19 separate steps. To ensure that these procedures are understood properly, each foreign operator has to attend one of Mc Donald's four Hamburger Universities and consultants regularly visit franchisees to offer advice on such issue as promotional campaign and employee training".8

Such types of franchising called "business format franchising" is the predominant form of foreign participation in sectors like hotels, restaurants and fast food centres. Thus in 1986, 94 percent of all hotels belonging to the 10 largest United States transnational chains and 66 percent of U.S. fast food transnationals were franchised. However, in some of these cases the franchisor also has some equity participation in the franchisee's firm.

In car rental and various other consumer services like health and education related services other forms of non equity arrangements and particularly management contracts are more prevalent.

---

8. ibid.

In accountancy, legal services and even in engineering and technical services, partnership and licencing are common. Minority joint ventures are also quite common in engineering services and construction. These services being specific to the local law, customs and tastes, the location specific factors are very important in determining the form of foreign participation. In both accountancy and legal services, a thorough knowledge about the local accounting practices and legal framework is necessary. There is not much scope for internalisation and even the ownership advantage of the TNCs in these two fields lies in goodwill, professional expertise and their favoured access to transnational clients. The international activities of the transnational accounting corporations are loosely organised.

They represent a collection of loosely organised autonomous partnerships. In some case the profits are shared by the parent corporation, but in most cases they merely receive fees for services rendered. Autonomous national firms, mostly owned and managed by the citizens of the country of location, sometimes are linked to the TNC. In most cases they share the name of the TNC and other significant transnational activities include setting operating standards, offering training, and most importantly providing a common data service infrastructure, specially regarding the application of software. In spite of loose structure eight U.S.firms dominate the field.9

In services like engineering consultancies and construction often locational factors play very important role. The nature of activity here is somewhat complex and there is ownership advantage in possession of superior "Knowledge". However, customization to local tastes, needs and contact with local government machinery are very crucial to the operation of the TNC. A common form in these services therefore is joint venture (with both minority and majority share). However in cases where the technology is standardised, the firm also licences out technology, without any equity participation (or with very minimal equity participation). The latter case is specially common in LDCs, where though standardisation of the technology does not necessitate internalisation, but the technology being beyond the LDC's technological frontier, the firm can still manage to earn monopoly rent.

There are some services where no clear dominant organisation form is visible. The most notable of these, which the UNCTC report mention are insurance and telecommunication.

---

9. Clairmonte and Cavanagh(1985).

Various forms of foreign participation are visible in insurance ranging from majority owned subsidiaries, joint ventures and licensing. Insurance has certain features of financial services and involves possession of tacit "Knowledge" and goodwill. Further there is lot of scope for economics of scale and scope and in co-ordination of activities worldwide. These are factors which tends to favour FDI as the suitable form of foreign participation. However, location specific factors may be significant enough to demand collaboration with local agencies. One such important location specific factor in the presence of strict government regulations prohibiting majority participation (or sometime even prohibiting holding any equity share at all) by foreign insurance firms. Strict government regulation in this sector is not only common in the LDCs, they are found in many DMEs also. The other reason why these corporations often go for joint ventures is because of risk sharing. Insurance involves, large scale risks and joint ventures with other insurance firms and sometimes with reinsurance companies are therefore commonly found. Many Insurance corporations have also gone into collaboration with financial service corporations and travel agencies for reaping the benefits of horizontal and vertical integration. Many insurance firms are however not independent, but are part of financial conglomerates (like AMEX) or are wholly owned subsidiaries of industrial TNCs (the captive insurance firms are an example of this because they are set up essentially to allow financial flexibility to the parent firm).

Telecommunication is a perfect example of the phenomenon of blurring of boundaries between goods and service sectors. As we have discussed in Chapter 3, producers of goods and services relating to the data industry are forming various arrangements from merger, collaborations to collusions and thus a wide range of organisational forms are visible in this sector. Being a knowledge intensive operation, with possibilities of reaping significant economies of scale, FDI as an organisational form may be suitable as it allows more control. However, the high cost structure and complexities of the goods service continue often necessitate collaboration and formation of a consortia of firms. However, the service per se can be traded very easily and therefore may not need direct foreign participation in many cases. But telecommunication being a sensitive service to a country's defence, politics and culture, often face government restrictions in this area which modifies the scope and form of operations of the TNCs. Thus arrangements with local bodies or government agencies are often necessary. These arrangements can range from joint ventures, market presence to technology leasing.

4.2 : ISSUES RELATING TO COMPLEMENTARITY BETWEEN TRADE AND FDI IN SERVICES

Trade and FDI are two distinct sets of activities. Whereas trade is defined as activities involving transactions between residents and non-resident of a given country, FDI involves the acquisition of a lasting interest and of an effective voice in the management of an enterprise in a foreign country(foreign affiliates of a corporation are thus treated as the residents of the host country).

Trade can be cross-border trade, where traded commodities cross the border from the producer's country to the consumer's country. Most of the trade in goods is cross border trade and our normal notion of the term trade is also a cross border one. Mainstream economic theory too models the case of cross border trade where commodities move from one country to another but factors do not cross national boundaries. Inherent in such a concept of cross-border trade is the fact that production and consumption take place in different territories where the commodity is transported from the producer's to the consumer's country.

However, it is not necessary that commodities cross border in trade. There can be "within-border" trade as mentioned earlier. Here, either the producer moves to the consumer's country or the consumer moves to the producer's country. For trade in goods, this form of trade does not have much importance, but since services have to be produced and consumed simultaneously, the proximity of the producer and consumer often becomes a necessity and within-border trade acquires significance. In such cases, where the producer moves to the consumer's country, a structural similarity with FDI is found. The case involves mobility of capital and labour to a foreign country, contrary to the normal notion that in trade, where commodity flows substitute factor movements across countries, in services factor movements are complementary to trade. The fact that whether transactions of this kind should be designated as trade or FDI now depends on whether the producer is going to acquire any lasting interests in the consumer's country.

The normal notion about trade in services refers to within border trade discussed above with its consequent complementarity between factor movements and trade. However, as we have discussed in chapter three, technological progress has opened new horizons for cross-border trade in services, by enabling instant communication between different parts of the globe. Being a case of cross-border trade, where factors do not have to cross borders, one may expect that the complementarity between FDI and trade will break down in this case. But, quite to the contrary as the following discussion will show, even in this case, complementarities of different types are established between the two.

One type of complementarity is established because a large volume of this trade in data and information is intra-firm trade (i.e., it takes places between two branches or between a branch and the headquarter of a TNC). In this case FDI facilitates the trade and hence the complementarity. However, intra-firm trade is a feature of transnational operations itself and is not particular to service trade. In the within-border trade case, while the complementarity was structural in nature, in this case the complementarity arises at the operational level specially in the operations of the TNCs which are involved in such services trade.

The other type of complementarity comes because of the nature of cross-border trade itself. In the case of cross-border goods trade, there need be no direct contact between the exporter and the importer. Once the good is transported it is separated from the producer and after it crosses the border of the importing country it is the importer who has control over the commodity. But in services, the production and consumption of the service being one and the same act, the exporter of the service may need to establish direct links with the importer.

In case of goods trade, the practice is to grant the right of national treatment, where a good which legitimately crosses a border enjoys the same right as any domestic good with regard to its access to the domestic distribution system. In the case of services trade granting national treatment would mean that the exporter can now legitimately establish direct links with the importer and more importantly, can gain access to the importing country domestic distribution system and can even regulate the flow of services in the importers country. In the following, we elaborate the dimensions of the problem.

It may be in the exporting corporation's interest to claim access to the importing country's domestic distribution system or even more than that to set up a liaison office in the importing country to maintain contact with the consumers. The consumers may want instantaneous information or data about various things for which it has to depend upon the exporting corporations central data base. If the consumer is a corporation and has continuous need for the exporting corporation's service it may set up the communication link with exporting corporation by itself. On the other hand, if the market is such that many small consumers want instantaneous information but do not want to have any continuous relationship with the exporter, the exporting corporation might have to set up a liaison office in the importing country to have instant delivery of such services.

A good example of the first kind is of managerial or engineering services, where the importer may need to establish continuous contact with the exporting corporation's central information base. An example of the second kind is provided by the tourism sector where spot information on latest tourism positions may be required by a large number of consumers who, however, do not need to maintain a prolonged contact. While the first example brings in the concept of "market presence" which seeks the right of having access to national distribution system for services, without which they cannot be effectively traded. The second example illustrates the concept of "right of establishment" or the right to have an establishment or some arrangement locally to export the service. Encompassing all the various aspects of within-border trade, which necessitate various rights like those outlined above, is the concept of "right of presence"10 which can be introduced here. This "right of presence" would mean the right to have some form of presence in another country in order to effect the trade of services in whatever form or time-frame that may be apprpriate for it. The above should be viewed in the context that the conventional understanding of trade involves a mere access

10. Sauvant (1986).

to the other country's market and does not require any form of presence.

In the two cases reffered to above, effectively this will mean that the exporting company can sign contracts with local bodies in order to deliver the services or can open a branch of the company itself in the importer's country. Though in the former case it can be argued that the contract is delinked from ownership rights and the actual ownership of the company would be in local hands, in the latter case the issue becomes more complex because the exporting corporation must own assets in a foreign country. While the former case does involve an FDI question, in the latter case, it structurally becomes an FDI issue.

However, the apprehensions of the parties opposed to this move lie in the fact that whether or not the exporting corporation holds substantial assets in the importing nation, it it maintains regular contacts with an agency, even if the latter is local, and thus allows itself enough indirect means by which substantial control over these agencies can be exercised. We had noted that because the TNCs have monopoly over some non-physical assets, it may be in the interests of the local firm to accept the leadership or hegemony of the TNC in spite of the TNC having no formal equity control. Further, in an age where the formation of transnational conglomerates is the order of the day, banking and industrial interests have merged and international financial transactions have become extremely sophisticated, TNCs may move and manouevre in order to establish control over a local firm. For example, a local company may be floated with loans from the local branch of a TNB and the TNC may not have any formal control over the company, only a leasing contract to carry out trade in data or data and information based services. The company may, in this situation, be actually under the complete control of the TNC. This kind of situation becomes even more plausible in the field of services because in information and data-based services, it is difficult to record how much of "production" a local company does, or how much of transaction has taken place with its foreign trading partner, or what is the actual price at which the transaction has taken place as most TNCs use transfer pricing, a fact well recognised in the literature. In the case of services a, however, it goes a step beyond transfer pricing because the nature and volume of transactions itself need not be known.

In the case of trade with the right of establishment, these problems are qualitatively of a similar nature, the only difference being that the corporation now can have a formal establishment in the importer's country and can still claim that it is a form of trade and not FDI.

Thus, merely the fact that a TNC does not have ownership right in a local company does not mean the issue is to be treated as a trade issue. Further, a number of contractual, informal and disguised relationships may have the effect of granting to the corporation an effective voice in management of the enterprise with 'lasting interest'. It is thus possible that an apparent trade issue may effectively be an FDI issue.

The distinction, therefore, between trade and FDI in services is not clear and the boundaries between the two concepts are blurred. This arises either because of the structure of within border service trade itself, where factor movements across countries are necessary for trade, or because of the operational structure and operational necessities of across border trade in services. This ambiguity, however, is not merely a definitional problem, but has very deep implications. Whereas every country, in practice, has the sovereign right to admit or reject FDI, under a free trade regime, it (i.e. FDI) may bypass importing country laws and enter the country under the guise of trade.

To the TNCs, these complementarities mean that trade, FDI and various other organizational forms represent a continuum from which they can choose, depending on the specificities of the sector and country.

4.3 : TRANSNATIONAL CORPORATIONS AND A MULTILATERAL FRAMEWORK FOR TRADE IN SERVICES

In the preceding sections of this chapter and earlier we have put forward the view that sectoral boundaries between goods and services are getting blurred. In the light of such a phenomenon, the TNCs,initiated a move towards a liberalized regime for both trade and FDI in services. The fact that most of these TNCs originate in the DMEs, especially in the US, and that these DMEs as a whole have a surplus in their service bop accounts with respect to the LDCs forms a strong enough case for these countries to champion the cause of liberalization of trade in services.

The case for the liberalization of trade in services has been put forward, among others, by the International Service Industry Committee of the US chamber of commerce, the Service Policy Advisory Committee and the Industry Sector Advisory Committee, which are bodies dominated by US TNCs and are effective forums of the US private sector to voice their views to the US administration.[11] These bodies demanded that the US should argue for adopting a multilateral framework, leaving enough scope for bilateral agreements at the sectoral level. They demanded that the US should argue for a trading system which, among other considerations, allows for national treatment and the rights

11.ibid.

to establishment, and some, special emphasis on removing barriers on telecommunications and related services.

The most concerted move in the liberalization of service trade has so for been made by the US government, with the views mentioned above having found concrete expression in the US Trade and Tariff Act of 1984.12 The act defines international trade to include both trade in goods and trade in services. However, it also subsumes certain aspects of FDI which has any implications for service trade under this trade act. The act provides the "mandate, objective, instruments and resources for the government services policy and, while advocating bilaterally and multilaterally negotiated solutions, it also provides the administration with several instruments to make its trading partners more amenable to US objectives. In particular, the act gives authority to the administration to retaliate against what it considers unfair trade practices and investment restrictions. The significant features of this act are as follows. For the first time, equal treatment to trade in goods, trade in services and certain forms of FDI (linked with services trade.) Second, as most forms of FDI can have direct on indirect Links with services trade, FDI US trade law; This is of particular importance to our discussion because transfer of information and data are now

12.For a summary discussion on the US Trade and Tarrif Act 1984 and its importance for TNCs see Sauvant(1987).

clearly included in services trade and such concepts as market presence or right of establishment clearly become trade issues under this act. Third, the remedial measures have now been expanded to cover trade in services and this the US government can retaliate by even imposing protection in goods trade if it faces barriers in services trade. Fourth, the act amends section 301 of the 1974 act and gives the administration broad discriminatory power to negotiate for the reduction and elimination of barriers to US service exports, FDI flows, and also to take positive action against countries that do not reduce or remove such barriers.

This act is therefore a clear expression of what has been discussed in the earlier section - first, whereas trade in goods is a substitute for factor movements, trade in services, on the other hand, may be accompanied by them, second, this fact leads to a blurring of lines between trade and direct investment. Given the first two propositions the TNCs tend to view services trade, FDI and indirect investment in a continuum and would therefore, prefer to have service trade and service FDI as unencumbered by regulation as possible. In the world of international business lead by the TNCs the barriers between goods and services and between trade and investment are fast breaking down. The following passages from the act make this amply clear, "it aims to reduce or to eliminate barriers or other distortions of international trade in services including barriers that deny national treatment and restriction on establishment or operation in such markets" and further, also to "reduce or to eliminate artificial or trade distorting barriers to FDI to expand the principle of national treatment and to reduce unreasonable barriers to establishment".

However, the ultimate aim of the US and other major service exporting DMEs is to finds a framework for service trade similar to that of goods as under the GATT multilateral framework and to include trade in services under the framework of the General Agreement on Tariff and Trade (GATT) in order to make this trade subject to multilateral agreements which defines rules for it and matters pertaining to it. The GATT in its present form does not cover services and was set up to provide a set of rules for goods trade and to provide a forum for negotiations to liberalize goods trade. The major DMEs led by the US are of the view that when GATT was conceived trade in services was insignificant. Now that this trade, has taken on significant proportions and has become integrated with goods production and trade, a "free trade" atmosphere should prevail in this area as well. These countries agree that liberalization of this trade will increase global welfare and that, since high technology services have become the nerve centre for industrial progress, unless a liberal exchanged of services takes place there will be severe inefficiencies in the global allocation of resources.

The free trade pursuasion underlying Gatt's Articles of Agreement suits DME interests perfectly, further, under this forum tradeoffs between good and service trade are possible this has a very serious implication for their dealings with developing countries. Services trade between DMEs and LDC being limited, the LDC are not very vulnerable to retaliatory pressure in this area, but under a unified framework, retaliatory pressures can now be applied on goods trade for any restrictions that the LDCs may put on service trade.

Most of the developing countries were extremely against such a multilateral framework for services, as they see that such a move will harm their interests badly. In any case, any framework on services which has elements of the US trade and tariff act will mean they lose effective control on matters such as regulation of FDI.

The agenda for the Uruguay Round after protracted negotiations took note of these fears of the LDC, and it was agreed that whereas a multilateral framework for trade in services would have to be negotiated, it would be outside the GATT framework. It was also agreed that issues of importance to LDCs such as trade in certain kind of goods like agricultural commodities, textiles, clothing, etc. which are subject to very high non-tariff barriers and are at times even outside the purviews of GATT would be taken up under the Uruguay Round.

A discussion on the issues involved in the formation of a multilateral framework for services lie outside the scope of our dissertation.13 However, given the features and dynamics of the transnationalized service sector, in so far an any such multilateral framework benefits the TNCs certain issues should be worth raising here.

We have discussed time and again in this dissertation, how the TNCs resort to various restrictive business practices such as market sharing, price manipulation including transfer pricing setting up barriers to entry and various other non competitive arrangements, which eliminates arms length transactions. Further the flexibility and control of the TNCs have been heightened by technological innovations in data and communication service. In particular the increased potential for intra firm trade in services strenghthens this flexibility and control and opens more avenues for violation of areas length transactions. The fact that trade and investment in services are complementary and

13.For a discussion on this area see Gibbs(1985), Sampson and Snape(1985), Sapir(1985), Sauvant(1986), Bhagwati(1987) and Nayyar(1986, 1988 and 1988a).

that there lies a continuum in the range of organisational forms may imply that a multilateral framework in trade in services renders sufficient flexibility to the TNCs to choose their most appropriate forms of conducting business abroad and thereby extends their scope of resorting more easily and effectively to various restrictive practices.

These practices have serious implications for the LDCs. Not only do they adversely affect the distribution of gains from trade but more fundamentally they may hinder the growth of the infant services sectors in many of these countries.

Any possible multilateral framework for trade in services should therefore go beyond the realm of government regulations (with which must of the discussion regarding this in preoccupied) and deal with the problems of restrictive business practices adopted by the TNCs.14 In particular a regime for identification, notification, consultation and remedial action to control restrictive business practices must be developed, however difficult it may be to frame or to implement it.

14. Nayyar(1988a)

CHAPTER FIVE

SUMMARY AND SOME CONCLUDING REMARKS

Transnationalisation of services, a phenomenon which gathered momentum in the mid 1970s, has continued at an accelerated pace throughout the 1980s. Transnational capital which was earlier significant in only a few sub sectors within the service sector has how penetrated deep and wide into the sector. The manifestation of this phenomena lies in the fundamental and unprecedented changes which are occurring in the realms of market structure and in the pattern of organisation of production and distribution of activities in this sector.

The main essence of this change lies in the process of diversification and integration of activities leading to diffusion and obiliteration of sectoral boundaries within the services sector. However, the ultimate expression of this change is in the diffusion of boundaries and an integration of the goods and the services sector. The manifestation of these changes are the formation of the transnational service conglomerates and the transnational integral (goods-service) conglomerates

TNCs both in services and in manufacture have been responsible for these changes. In fact, a significant part of service affiliates are parented by TNCs whose main activities are outside the services sector. While this in itself demonstrates the fact that the goods and service sector are getting integrated, perhaps epitomes of such integration are the transnational integral conglomerates. The accompanying factors of this development are the tendencies of concentration of capital and formation of oligopolistic market structures.

Perhaps, the most fundamental factor which is making these changes possible is technological innovation. The possibility of instantaneous flow of data and communication within and across national boundaries, has tremendously enhanced the scope of transnationalization of services.

Technological progress has broadened the scope for the TNCs to reap certain monopoly advantages (ownership advantages) over its competitors. It also makes it more feasible to internalise markets, either to make it possible to garner monopoly rents or to gain greater flexibility both vis a vis the consumers and the potential rivals (internalization advantage). In particular, the possession of this technology in itself is a fundamental "ownership advantage" to the TNCs.

These innovations allow TNCs in general to have greater managerial and financial flexibilities. It makes communication easier between stages of production as also between markets and thus increases the scope of vertical and horizontal integration of activities along and across the value added chain. Further, by making instantaneous communication across national boundaries possible, this technology has made possible cross-border trade in services, specially in services which have a strong data and information component. However data flow being a service in its own right, transborder data flow, in itself is, par excellence, the example of cross border trade in services.

The recent developments in the transnationalized service sector also include the phenomenon of widening the range of forms of organising production and distribution from which the TNCs may chose to deliver service abroad. The organisational forms range from FDI (with majority affiliates or subsidiaries) minority holdings through various forms of collaborations, including joint ventures, leasing, subcontracting, management contracts, franchising to international trade.

However, a strong sector specific preference is observed in the choice of the appropriate organisational from. An explanation of this can be put forward in terms of certain sector specific advantages (Ownership, internalization or location specific advantage).

However, these alternative forms are not watertight and there exist various forms of complementarities between them. This is best exemplified by the nature of complementarities between their two extreme alternative forms - FDI and trade.

Unlike in case of goods, FDI and trade which are generally taken to be substitutable forms, have complementary relationship in case of services. This was initially because, the general form of service trade (except for cross-border transportation) has been a case of "within border" trade (ie either the producer comes to be consumer's country or the consumer moves to the producer's country), which has structural complementarity with foreign direct investment. With the increased scope of cross border trade in services, facilitated by technological progress, this complementarity however, far from being weakened, has actually been reinforced. One reason for this is that much of the services trade of this type is intra firm trade, between two branches, or between a branch and the headquarter of the TNC. But there is another way the complementarity is reinforced. In this case the complementarity is inherent in the structure of services transaction. The communication between the exporter and importer, being instantaneous in nature, may necessitate the exporter of the service to have direct links with the importer and these may necessitate a direct access to the importing country's distribution channel or some form of physical presence in the importing country. One of the effects of this complementarity is that FDI issues may now appear as trade issues. Given the power of TNCs, this only adds to the flexibility of approach that TNCs can take as a response to any situation. Therefore while trying to arrive at a multilateral framework within which service trade can take place, adequate precaution must be taken to see that the TNCs do not use this new power to the detriment of others.

The development of diversification, concentration and amalgamation of capital are not fundamentally new developments in the realm of services. In fact, this is perhaps, inherent in the development of monopoly capitalism. Monopoly capitalism, as Lenin understood it, is a phase of capitalism which is characterised by the supremacy of finance capital the amalgamation of banking capital with industrial capital1. Lenin's observation in the early decades of the century, about the amalgamation of these two forms of capital and the consequent process of concentration and diffusion of capital which takes place stands equally or may be more relevant even today. What has, however, altered is the form which monopoly capitalism has taken. Whereas

1. Lenin, V.I. (1978)

earlier this amalgamation was mainly between banking and industrial sector or within the industrial sector itself, in our times the process has spread across all sectors, where traditional boundaries are slowly getting obliterated. As Clairmonte & Cavanagh put it "The largest corporations now transcend the sectoral categories of primary, secondary, and tertiary. In their production, finance and marketing operations the frontiers of another time, and soon of another age, will have become meaningless."

However, by the above we do not imply that the services sector as a whole is getting transnationalized. What we are implying is that the process of transnationalization is spreading across all the (sub)-sector within the sector. Sectors, which earlier did not witness significant transnationalisation are now experiencing the process. Viewing it from another standpoint, services are becoming very important and integral part of the activities of the TNCs in general.

What we are not implying is that the entire output (or even a very large portion of output) of a country's service sector has got transnationalized.. In fact a large part of the services sector probably still lies under the control of domestic small and medium capital (or, under the control of the state). It is this segment of the services sector which may still retain the features of the "employer of the last resort".

A discussion of all these aspects, however, clearly lies outside the scope of our dissertation. Our task was limited to explore and explain some of the recent developments in the transnationalised service sector. The developments that we record and the explanation that we suggest are in no way exhaustive. In a relatively under-researched area like this, there is a lot of scope for further research. However, unless primary sources are available a researcher may have to face the constraints of non availability of data. Still we can suggest a few areas, where a lot of research need to be done. Very little is known about subjects like capital intensityand labour productivity in the transnationalized service sector. There is a general notion that the transnationalized services sector will be less labour intensive than the domestic service sector. There is some rudimentary evidence in UNCTC(1988) but it is highly inadequate. In fact it is necessary to study the entire labour process in the transnationalized service sector. The work done by Braverman for modern services sector can throw some light on this2. A detailed study is possible of the patterns of mergers, collaborations and conglomeration occurring in this sector, but for that detailed primary data is absolutely necessary.

2. Braverman, H. (1974)

There are also more general issues to be researched on. Activities of TNCs in L.D.Cs has been a fairly well researched topic. However, the activities of service TNCs in L.D.Cs. or more generally the implication of transnationlization of services for L.D.Cs need to be researched. Finally, there is a lot of scope to work in area concerned with trade and investment policies, specially in the area of multilateral framework for trade in service or international framework for FDI and their relevance for the TNCs in services.

Very little to almost no detailed published work is available in all these areas. However a lot of work on these aspects are currently going an. Given the limitation of sources and data and the constraint of the scope and size of this dissertation, we could not venture into all these very interesting and challenging areas. As long as this work manages to throw some light on the recent developments and to provide some explanations to these developments and the related issues, however inadequately it may do so, we will not consider our effort entirely wasted.

BIBLIOGRAPHY

1. Atinc, T; Benham, A; et al (1985). "International Transactons in Services and Economic Development". Trade & Development, An UNCTAD Review No.5.

2. Baran, P.A. and Sweezy, P.M. (1973), Monopoly Capital, Pelican.

3. Bhagwati, J. (1987); "Trade in Services and Multilateral Trade Negotiations". The World Bank Economic Review.

4. Casson (M), 1987. "Firm and the Market: Studies in Multinational Enterprises and The Scope of the Firm".

5. Clairmonte, F. and Cavanagh, J. (1984). "Transnational Corporations and Services: The Final Frontier". Trade & Development, An UNCTAD Review, No.5.

6. Clark, C. (1940) Conditions of Economic Progress, London Macmillan & Company.

7. Economist (1989), "Special Issue on Banks", 24-31 March.

8. Ghamawat, P, Porter, M; Rawlinson, A (1986) "Patterns of International Competitions and Activity". In Porter ed. Competition in Global Industries. Boston, Harvard Business School Press.

9. Gibbs, M. (1985) "Continuing the International Debate on Services" Journal of World Trade Law, May June - 1985.

10. Hymer, S.H (1979), "The Multinational Corporation: A Radical Approach", R.B. Cohen, N. Felton et al. ed. C.U.P., Cambridge.

11. Lenin, V.I. (1978), "Imperialism: The Highest Stage of Capitalism". Progress Publishers, Moscow.

12. Marx, K. (1978). "Theories of Surplus Value Part-I", Progress Publishers, Moscow.

13. Nayyar, D. (1988). "Some Reflections on the Uruguay Round and Trade in Services". Journal of World Trade, Vol. 22, No.5.

14. ----------- (1988a) "The Political Economy of International Trade and Services". Cambridge Journal of Economics, Vol.12.

15. Sampson, G.P. and Snape, R.H. (1985) "Identifying the Issues in Trade and Services" The World Economy, June, 1985.

16. Sapir, A. (1985) "North-South Issues in Trade in Services". The World Economy, March, 1985.

17. Sauvant, K.P. (1986) "International Transactions in Services - The Politics of Transborder Data Flows" The Atwater Series on the World Information Economy, No.1. Westview Press/Boulder & London.

18. UNCTAD "Productiion & Trade in Services: Policies and their underlying factors bearing upon International Service Transactions" Report by UNCTAD secretariat. TD/B/941/Rev.1. United Nations, New York.

19. ------- (1987) "Revitalising Development, Growth and International Trade". Report to UNCTAD VII, United Nations, New York.

20. UNCTC (1979) "Trasnational Corporations in Advertising" New York United Nations.

21. ------- (1980) "Transnational Reinsurance Operations" NY, UN.

22. ------- (1981) "Transnational Banks: Operations Strategies and their effects in developing countries"

23. ------- (1982) "Transnational Corporations and Transborder Data Flows".

24. ------- (1982a) "Transnational Corporations In International Tourism".

25. ------- (1988) "Transnational Corporations in World Development: Trends & Prospects", United Nations, New York.

ERRATA TO BIBLIOGRAPHY

Braverman, H. (1974) "Labour and Monopoly Capital: Degradation of Work in Twentieth Century", N.Y. Monthly Review Press.

Dunning, J. (1974) Economic Analysis and the Multinational Enterprises, George Allen & Unwin, London.

Fischer, G.A. (1935) "The Clash of Progress and Security" McMillan, London.

-------------- (1939) "Production; Primary, Secondary and Tertiary" The Economic Record.

Hill, T.P. (1977) On Goods and Services: Review of Income and Wealth, vol.23, December.

Rowthorn, R.E. and Wells, J.R. (1987) Deindustrialization and Foreign Trade, C.U.P.