Chapter 3
The International Competition for Investment

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Introduction

Since the industrial revolution, countries have been in an international competition for investment, whether or not they know it or consciously adopt the policies that have such large influence on the competition’s outcome. Part of this competition is for domestic investment and part for foreign investment; in the present world of high and growing interdependence and integration among industrialized countries, the two types of investment often go together. Policies favorable for domestic investment very often attract foreign direct investment (FDI); similarly, policies that make domestic investment unattractive often discourage inward FDI and encourage outward FDI as home companies and residents look abroad for better uses of capital.

Political changes currently being made will have major effects on this international competition for investment. Some of the political decisions are at the level of individual countries; some of the most important decisions are at the level of trading blocks. This paper often uses the European Community and Sweden as examples; Sweden is often said to be the most multinational country in the world, had the world’s highest outward FDI in 1991 (in substantial part to the EC), has applied for EC membership and will almost certainly enter, perhaps by late 1995. More important, current EC policies and the outlines of future policies are substantially clearer than those of other trading blocks that are more potential than actual now. Policies adopted by the EC as a whole and by EC members will surely be important determinants of the international competition for investment, as will reactions by the rest of the world. EC policies may, for example, facilitate formation of rival trading blocks in the Americas and the Far East. Though a variety of economic and political motives were behind negotiations among Canada, Mexico and the U.S. for a North American Free Trade Area, and still are behind the growing integration of the economies of Japan and some of the Asian "tigers," there is no doubt that these moves are partly in response to current and anticipated EC
policies. Similarly, these moves in the Americas and the Far East present the EC with important issues. Many observers fear, and some predict, the emergence of hostile, protectionistic trading blocks centered on the EC, NAFTA and Japan and the tigers; other observers suggest that trading blocks with low internal barriers might negotiate for low protection across the blocks, leading to a more liberal economic order.

Analysis of the policies of any one block is complicated. For example, analysis of EC policies and their effects on investment requires both discussion of EC and its members’ policies and thus is more complicated than if the EC’s policies or a single member’s policies could be considered in isolation. Further, many of the policies that have major effects on investment are aimed at other issues, with the effect on investment sometimes overlooked or considered of secondary importance. In addition, there is substantial diversity among both the EC’s current and prospective members. For example, some of Sweden’s interests are aligned with those of rich EC members and also smaller members; though some of the issues facing Sweden are also faced by all EC members, some important Swedish issues are less relevant to larger EC members and also to poorer members.

Block-Wide Policies and Foreign Direct Investment

Think of two stages in the decision to invest in a country in a trading block. First is the decision to invest in the block. Given this decision, the second stage is to choose one country from possible block locations. In the first stage block-wide policies play an important role, and block-member policies in the second. This section discusses the effect on investment of block-wide policies, taking EC policies as a concrete example, but also referring to NAFTA and a possible Far East trading block. The following section discusses the effects of block-member policies: in some places it takes as an example some Swedish policies relative to EC policies, in other places it uses EC members’ policies or focuses on countries in the Americas and the Far East.

It is hard to assess the net effect of EC policies on investment, particularly because some policies are still being negotiated; difficulties are greater and conclusions more speculative when considering outcomes for NAFTA and a possible Far East block. Nevertheless, the direction of influence of some EC policies is clear.