

February 2006  
Version 2 (Draft)

## MULTINATIONALS AND THE NEW REGIONALISM IN THE AMERICAS

**LORRAINE EDEN**

Professor of Management  
Mays Business School  
4221 TAMU, 423B Wehner Building  
Texas A&M University  
College Station, Texas 77843-4221 USA  
Phone: 979-862-4053 Fax: 979-845-9641  
E-mail: [leden@tamu.edu](mailto:leden@tamu.edu) WWW: <http://www.voxprof.com>

**Abstract:** Regional integration agreements (RTAs) involving countries in the Americas have multiplied over the past 15 years. As a result, multinational enterprises (MNEs) now face a complex network of overlapping agreements with different rates, rules and dispute settlement procedures. How have MNEs responded to the spread of regionalism throughout the Americas? In this paper, we examine foreign direct investment patterns and the strategies of multinational enterprises as the Americas have become more closely linked through a “spaghetti bowl” of RTAs.

**For presentation at the Third IDB/CEPII Conference,  
“The New Regionalism” Progress, Setbacks and Challenges”,  
Inter-American Development Bank, Washington, DC, February 9-10, 2006**

## MULTINATIONALS AND THE NEW REGIONALISM IN THE AMERICAS

LORRAINE EDEN, TEXAS A&M UNIVERSITY

### INTRODUCTION

Twelve years have passed since the North American Free Trade Agreement (NAFTA) came into force on January 1, 1994. It has been 15 years the Southern Cone Common Market (Mercosur) liberalized trade among Argentina, Brazil, Paraguay and Uruguay in 1991. Across the Americas, governments have cut trade barriers, privatized state-owned enterprises and opened previously closed sectors to foreign direct investment (FDI). Multinational enterprises (MNEs) now move more freely throughout the Western Hemisphere than in any time since perhaps the late 1800s. Tariff barriers are at historic lows in most products and countries. Governments compete for FDI in “beauty pageants”, using locational subsidies to attract inward, particularly knowledge-intensive, investments. The 1990s may have been a “golden era” for the MNE in terms of its ability to access host-country markets and resources.

Is the golden era over? There are some signs the pendulum is beginning to swing, and that MNE-state relations may be less cooperative over the next 10 years than they have been over the past 15 years. Raymond Vernon (1998) argued that economic, political and sociological forces would make MNE-state relations in the early years of the 21<sup>st</sup> century more confrontational than in the 1990s. He saw the late 1990s as the “eye of the hurricane”; he may have been prescient. Political roadblocks to FDI flows are starting to appear. The tightening of US border controls in response to terrorist attacks, illegal migration, and drugs trafficking is one sign. The election of socialist, anti-FDI governments in some South American countries, together with the slowdown in privatization of state-owned enterprises, is another. The paralysis of the Free Trade Area of the Americas (FTAA) and WTO Doha Round negotiations may be a third trend. On the other hand, the notification of regional trade agreements (RTAs) to the World Trade Organization continues unabated. Over 180 agreements are now in force, with many others under negotiation (Crawford and Florentino, 2005). See Figure 1.

[Figure 1 goes about here]

Because RTAs have multiplied over the past 15 years, MNEs now face a complex network of overlapping agreements with different rates, rules and dispute settlement procedures. How have MNEs responded to the spread of regionalism throughout the Americas? In this paper, we examine foreign direct investment patterns and the strategies of multinational enterprises as the Americas have become more closely linked through a “spaghetti bowl” of regional trade agreements.

We argue that MNE responses to regional integration in the Americas must be differentiated into two groups because regional integration is less advanced in Latin America than in North America. First, North American multinationals have engaged in locational reshufflings, designed to bring Mexico into a rationalized regional production pattern for the continental market post-NAFTA. That process is now mainly complete, especially for manufacturing firms. Future reshufflings will depend on subsequent deepening of NAFTA provisions (e.g., the removal of grandfathered sectors, disciplines over state/provincial subsidies, and harmonized tax treatment). Second, in South America and the Caribbean, the regional integration process is much less advanced. As a result, MNEs are still engaged in market-seeking investments, with some rationalization underway in the larger RTAs such as Mercosur. The largest Latin American MNEs are now reaching out beyond Latin America and establishing foreign affiliates in North America. As a result, a new group of regional MNEs are being created (Rugman 2005).

The type of FDI in the Americas is also changing. Historically, business service sectors such as finance, insurance and banking, and public utilities such as telecommunications, hydro and electricity were closed to foreign investors. With the wave of privatizations in Latin America over the 1990s, and the inclusion of service sector provisions in RTAs and the Uruguay Round, these sectors have seen massive inflows of FDI over the past 15 years. At the same time, the information technology revolution (e.g., the Internet) has increased the mobility of services. Services are now being outsourced and offshored in ways

that were not possible 15 years ago. As a result, FDI in services now exceeds FDI in manufacturing (UNCTAD 2005). We now see locational shufflings designed to rationalize the provision of business services within the MNE network, repeating the earlier pattern of rationalization of manufacturing plants. Economies of scale and scope, together with agglomeration economies, support the creation of regional headquarters, to direct and monitor the MNE's regional production network.

### **THE FDI POLICY ENVIRONMENT IN THE AMERICAS, 1990-2005**

The policy environment for multinationals has liberalized significantly over the past 15 years, at all levels – national, bilateral and regional. In 1994, I compared the formation of NAFTA to the removal of blocks scattered across a chessboard (Eden, 1994: 193):

*Imagine a chessboard where, in addition to the chess pieces, there are immovable blocks scattered across the board. The impediments are more numerous in the middle of the board. Two players can maneuver the chess pieces around the blocks but clearly the game is less efficient than one without such barriers. Individuals who play regularly become skilled at taking the barriers into account in their game strategies. Some will hide behind them, others develop methods of avoiding the blocks, others use them to obstruct their opponents. Now suppose the rules of the game are changed and most of the blocks are removed. Several things happen. In the short run, some old strategies no longer work and individuals may lose games that they usually won. Costs are incurred in learning new strategies. It is possible that people who played the old game regularly may adapt more quickly to the new board, or perhaps new players without the handicap of history adapt more quickly. It is probable that flexibility and scanning ability will be key factors affecting success. In the long run, the game should be faster and the players more efficient. The question is: are we better off after removing the blocks?*

The analogy holds now, more than 10 years later, throughout the Americas due to the spread of regional integration schemes, the reduction in trade barriers, and the liberalization of FDI regulations. MNEs move more freely throughout the Americas than in any time in memory. These changes have taken place at the regional, bilateral and national levels.

#### **The New Regionalism**

The new RTAs are so different that policy makers now distinguish between “old regionalism” and “new regionalism” (Devlin & Estevadeordal, 2001; IDB, 2002; Iglesias, 2002). In North America, the old regionalism was mostly about one event: sectoral free trade for U.S. and Canadian producers under the 1965 Auto Pact, which removed cross-border trade barriers in autos and auto parts. The new regionalism started with the 1989 Canada-U.S. Free Trade Agreement (CUSFTA), which extended the integration process to goods, business services and investments in almost all sectors of both economies. In 1990, President Salinas de Gortari of Mexico approached the US President George Bush about a bilateral free trade accord, which subsequently became the 1994 NAFTA. Whereas the CUSFTA was a north-north agreement, adding Mexico created the first north-south RTA in the hemisphere.

In Latin America, the old regionalism was a complement to import substitution industrialization (ISI) strategies, enabling Latin American countries to lessen trade and FDI barriers among themselves while keeping (or raising) them against outsiders. Thus, the old regionalism was a substitute for taking part in the multilateral trading system (Ethier, 2001). Because of the protectionist, inward-looking motivations behind the old regionalism, the results of early RTAs in Latin America, such as the Central American Common Market (CACM), the Latin American Free Trade Area (LAFTA), the Andean Group and CARICOM, were limited. The underlying policies of protectionism, state intervention, and bureaucratic authoritarianism meant that governments only halfheartedly engaged in region building. Tariffs were lowered only where domestic firms were weak or nonexistent, while nontariff barriers such

as licenses and quotas exploded.

The new regionalism in Latin America began with the signing of Mercosur in 1991. In Latin America, MERCOSUR dominates the field of RTAs. It is quite different from NAFTA. NAFTA is a free trade agreement (FTA) using rules of origin to control duty-free access to national markets. MERCOSUR, on the other hand, is a customs union with a common external tariff. NAFTA has wide-ranging commitments to free trade in goods, business services, intellectual property and capital; whereas MERCOSUR is much weaker and remains primarily about trade in goods.

When the U.S. Congress failed to extend fast track authority to President Clinton in 1995, leaving Chile out in the cold, the U.S. withdrawal left the regional integration field wide open to other countries. Chile and other small Latin American countries responded by signing multiple RTAs. Mexico, for example, has signed bilateral RTAs with Chile, Bolivia, Costa Rica, the European Union, Nicaragua, Israel, among others. Chile has bilateral RTAs with Canada, Mexico, the United States, Colombia, Ecuador, and associate member status within MERCOSUR. While most of these agreements have been within the region, others have not (e.g., with the European Union).

Finally, after many years of sitting on the sidelines watching other countries negotiate RTAs, the US government switched its course and began negotiating with multiple countries after the enactment of the Trade Promotion Authority (TPA) in August 2003 (Cooper, 2005). The most important set of negotiations have been the 34-country Free Trade Area of the Americas (FTAA) agreement, which was supposed to conclude by 2005 and now appears to be in limbo. In terms of smaller agreements, in January 2004, US free trade agreements with Chile and Singapore entered into force. Agreements with Australia and Morocco were signed and approved by Congress in 2004; the Australian agreement went into force in January 2005, while the Bahrain agreement has not yet been implemented. Trade agreements with the Central American countries and the Dominican Republic were combined into one agreement: DR-CAFTA that went into force in August 2005. The United States is currently negotiating RTAs with Thailand, Panama, the Andean countries, and members of the South African Customs Union (SACU).

One of the features of the new regionalism is the proliferation of regional accords. Figure 1 shows the rapid build-up in regional trade agreements. Currently, over 180 RTAs are in force, with dozens of others either notified to the World Trade Organization or under negotiation.

[Figure 1 goes about here]

This ad hoc proliferation of RTAs has been likened to a “spaghetti bowl” mixture of bilateral, trilateral and multilateral RTAs, by the Inter-American Development Bank (see Figures 2 and 3).

[Figures 2 and 3 go about here]

The rapid proliferation of RTAs considerably complicates the analysis of their economic effects. A key problem is the creation of hub-and-spoke arrangements. In the simplest hub-and-spoke pattern, one country (the hub) has bilateral RTAs with two other countries (the spokes). Trade barriers are eliminated within each RTA but not between RTAs. Comparisons between two hub-and-spoke RTAs and one trilateral RTA demonstrate that potential static and dynamic benefits are higher under the trilateral RTA. Two bilaterals leave trade barriers in place between the spokes, whereas one trilateral eliminates these barriers

At the same time, administrative and transport costs are higher in a hub-and-spoke system because of its greater complexity, potential for rent-seeking behavior, and inconsistencies. Instead of one tariff rate for imports, tariff schedules vary depending on which RTA applies. Different rules of origin for the same product encourage “forum shopping” for the lowest rates, raising the cost of administering these agreements. To the extent that rules of origin are seen as transaction costs for firms, they can influence not only trade flows but also investment decisions.

Hub-and-spoke arrangements that create “who is whose” problems that increase protectionism and reduce the overall welfare gains from RTAs (Bhagwati et al., 1998; IDB, 2002; Wonnacott, 1996). The distribution of (albeit smaller) gains differs also, with the gains being distributed more unevenly in a hub-and-spoke system. The hub gains at the expense of the spokes because the hub benefits from preferences in both spoke markets and only firms in the hub can buy duty-free inputs from each spoke. The spokes, on the other hand, lose because they do not have duty-free access to the other spokes, face

more competition in the hub market from the spokes, and are less competitive relative to hub firms because their input costs are higher.

### **Bilateral Liberalization**

The new regionalism is not the only widespread policy change liberalizing trade and FDI flows. Since the late-1980s, there has been enormous growth in bilateral arrangements linking countries: bilateral investment treaties (BITs), bilateral tax treaties (BTTs) and transnational arbitration treaties (TATs). Besides signaling an “open door” policy for FDI, these two-way FDI accords are helping to create an international investment regime that extends the GATT norm of national treatment (foreign activities performed within a country's borders receive the same treatment as activities of nationals) to foreign investment, services and intellectual property (Eden, 1996a, 1996b). Thus, RTAs are occurring along with multilateral commitments, helping to solidify (and acting as a backstop to) domestic policy reforms in Latin America. The key impact of these BITs, BTTs, TATs and RTAs is not just an explosion of acronyms, but also an explosion of multiple overlapping trade and investment agreements of differing degrees of breadth and depth throughout the Americas.

[TO DO: ADD TABLE ON BITS AND DTTS IN THE AMERICAS HERE]

### **National Liberalization**

At the national level, regulatory changes affecting FDI have also been proliferating in the Americas. UNCTAD's Division of Investment, Technology and Enterprise Development (DITE) has been tracking regulatory changes affecting foreign direct investment since 1992. Eight types of regulations are tracked: Foreign ownership, Sectoral restrictions, Approval procedures, Operational conditions, Foreign exchange, Promotion (including Incentives), Guarantees and Corporate regulations. In each case, DITE determines whether the regulatory change is more or less favorable to FDI. Table 1 provides statistics on regulatory changes in the Americas between 1992 and 2002. Not surprisingly, given that most national governments have been engaged in substantial liberalization since the late 1980s, the same pattern is evident in the Americas. I separate the data into three regions (the Caribbean, Latin America and North America) and their totals.<sup>1</sup>

By far the bulk of regulatory changes, by number, were Latin American. DITE recorded 234 policy changes over the 1992-2002 period and 178 of these (76%) occurred in Latin America, followed by the Caribbean (14%) and North America (10%). In the Caribbean, all but two of the 32 FDI regulatory changes were positive; the two less favorable were by Bahamas in terms of approval procedures. In Latin America, 14 of the 178 regulatory changes (8%) were anti-FDI. These were primarily actions by Brazil, Argentina and Ecuador in the areas of foreign exchange, and FDI promotion. All 24 regulatory changes in North America were pro-FDI. Of the 234 FDI policy changes in the Americas identified by DITE for 1992-2002, fully 93 percent were pro-FDI.

[Table 1 goes about here]

Statistics on regulatory changes at the individual country level are presented in Table 2. The table provides a count measure of the number of regulatory changes affecting FDI in the Americas in 1992-2002. For all three regions, more than 90% of the changes were categorized by UNCTAD as favorable to FDI. The countries with the highest percent of less favorable changes were Bahamas (40%), Chile (25%), Venezuela (22%) and Brazil (19%). Percentages can be misleading, however, where the numbers of regulatory changes are small. Some countries made large numbers of changes, including Ecuador with 19 regulatory changes (#1), Canada and Venezuela (tied as #2), and Brazil, Colombia and Peru (tied for #3).

[Table 2 goes about here]

### **The Special Case of Tax Havens**

Discussing FDI regulatory changes in the Americas would not be complete without at least a brief mention of the unique changes currently affecting tax havens in Latin America (Eden and Kudrle, 2005). Even before the radically transformed international environment after September 11, 2001, focused international attention on secret financial transactions and the role played by tax havens, the OECD

released a 1998 report, which argued that harmful tax practices had diverted FDI and taxable income away from its member countries. In 2000, the OECD issued a second report that put 35 countries on a blacklist as “noncooperating tax havens”. Tax haven governments were encouraged to sign a Collective Memorandum of Understanding with various commitments, including transparency and information exchange. By June 2004, all the Caribbean and Latin American tax havens on the OECD blacklist had signed OECD Memorandum letters, committing their governments to eliminating harmful tax practices. While this does not mean they must raise corporate income tax rates, the benefits to offshore banking and other financial activities will be curtailed. MNEs and wealthy elite families, the primary users of and beneficiaries from tax havens, should, as a result, find it more difficult to engage in income shifting. A short-term critical issue for the tax havens, particularly for the smaller island economies, is the administrative costs of implementing the OECD letters. Here, the OECD has promised financial and technical aid. A critical long-term issue for these governments is the development of other sources of long-term competitive advantage. For many of the smaller islands, tourism and some agricultural exports (e.g., bananas) are the only other competitive sectors in addition to the offshore sector. These countries face difficult choices ahead in terms of attracting FDI. Table 3 below provides information on which countries in the Americas have been affected by the harmful tax practices initiative.

[Table 3 goes about here]

### **FDI PATTERNS IN THE AMERICAS, 1988-2004**

#### **FDI Statistics**

The effects of liberalization of trade and FDI regulations throughout the Americas is clearly tied to the explosion of FDI that occurred over the same time period. Table 4 provides data on the growth in FDI stocks in the Americas. Since FDI inflows are notoriously variable, and for small countries one investment can make a huge difference in its numbers, FDI stock data from UNCTAD are reported, for selected years. The last two columns in the table show the percentage share for individual countries of the total non-US FDI stock in the Americas in 1988 and 2004.

[Table 4 goes about here]

A few key points emerge from this table. First, is the astonishing growth in FDI inflows over the period. Second, is the relative stability of country shares in total inward FDI stock. The four largest countries in terms of inward FDI stock are the United States, Canada, Brazil and Mexico, in that order. While the order has not changed over the period, Canada’s share has fallen significantly from 19% in 1988 to 11% in 2004 of the Americas FDI stock. Looking at country shares of the total non-US FDI stock in the Americas even more clearly accentuates the Canadian loss: its share falls from 50.32% in 1988 to 29.6% in 2004. The third NAFTA partner, Mexico, on the other hand, has seen its share of the non-US total rise from 8.7% to 17.8%. Another country that has seen its share of the non-US total fall by more than two percentage points between 1988 and 2004 is Brazil (16.9% to 14.7%). While its share of all FDI in the Americas is up slightly, its share of the non-US FDI has fallen, suggesting that Brazil is not keeping pace with the rest of the non-US Americas. On the other hand, six countries have significantly raised their share of non-US FDI in the Americas: Argentina (3.6% to 5.2%), Chile (2.1% to 5.3%) and Venezuela (1.3% to 4.2%) and three tax havens (Aruba, BVI, and the Cayman Islands).

#### **FDI Performance versus Potential**

Simple statistics on FDI stocks and flows may mask underlying patterns. For example, small countries may have small stocks of FDI but the stocks may be large relative to the size of the economy. For this reason, DITE has been calculating FDI potential and performance indices for countries since 1988. We examine the DITE indexes for the Americas over this period.

Table 5 reports on FDI potential indexes for the Americas, as measured by UNCTAD. These indexes proxy country attractiveness for inward FDI. UNCTAD calculates an average of 12 measures (see <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2470&lang=1> for details), which have been shown to be related to FDI, including GDP per capita, the rate of GDP growth, exports/GDP, telephones

per capita, energy use per capita, R&D/GDP, tertiary education, country risk, and share of world inward FDI stock. I report data for 1988-90 (15 years ago) and the two most recent available periods (1999-2001 and 2001-2003). Raw scores, ranking out of 140 countries and rankings within the Americas are reported. The United States and Canada rank #1 and #2, respectively, followed by the Bahamas and Chile. At the bottom of the list in terms of FDI potential is Haiti, followed by Nicaragua.

[Table 5 goes about here]

DITE calculates inward FDI performance indexes on a rolling three-year average. The index ranks countries by the FDI they receive relative to their economic size, as the ratio of a country's share in global FDI inflows to its share in global GDP.<sup>2</sup> A ratio greater (less) than one indicates that a country receives more (less) FDI than its relative economic size. A negative score means that foreign investors have disinvested in that period.

Table 6 shows the raw score, the country ranking out of all 140 countries, and the country ranking within the Americas for three periods: 1988-1990 (for a 15-year comparison) and the two most recent periods available 1999-2001 and 2002-2004. The big performers in terms of consistently attracting high levels of inward FDI relative to their economic size (indexes over 2) since 1999 have been Bolivia, Chile, Guyana, Jamaica, and Nicaragua. The countries least attractive to FDI relative to their size, since 1999, have been Suriname (#26 out of 26 in all three periods), Haiti (#25 out of 25 in all three periods), Guatemala and Paraguay.

[Table 6 goes about here]

With this material as background, we turn now to examining MNE responses to regional integration in the Americas.

## **FDI RESPONSES TO REGIONAL INTEGRATION**

International trade economists have long studied the welfare impacts of RTAs, generally focusing on the customs union case, where the member countries reduce internal tariffs to zero and erect a common external tariff (Baldwin & Wyplosz, 2003; Bhagwati, Greenaway, & Panagariya, 1998; Bhagwati & Panagariya, 1996; Lipsey, 1960). The literature on the effects of regional integration on FDI patterns is considerably smaller than that on the trade effects.

### **Investment Creation and Diversion**

When analyzing the economic effects of RTAs, it is important to distinguish between *de jure* and *de facto* liberalization. RTA negotiations often take several years. Some firms will react to the RTA in advance of the start date, seeking first-mover advantages from pre-empting the competition. On the other hand, when a new RTA is announced, gains are expected quickly. However, reductions in trade barriers tend to be phased in over a transition period to give local firms time to adjust (e.g., the NAFTA was phased in over 10 years), many nontariff barriers are grandfathered, and some sectors (usually the most controversial, like agriculture) are excluded. In addition, RTAs sometimes resort to positive lists of products to be liberalized rather than negative lists of exceptions; negative lists are more trade promoting since they eliminate tariffs on non-listed products. Thus, the effects can be complicated.

At the same time, confounding factors make it difficult to separate out the impacts of regional integration from other macroeconomic and policy changes. For example, the 1994 peso shock and Mexico's 1993 liberalizing FDI law are difficult to disentangle from the adoption of NAFTA. However, most scholars agree that NAFTA did encourage FDI in Mexico (Globerman, 2002; Krueger, 2000; Yeyati et al., 2002). More recently, the exchange rate depreciations in Brazil in 1999 and Argentina in 2002 have strained economic relationships within MERCOSUR. Currency devaluations lower export prices and raise import prices, causing large trade adjustments that can induce FDI reshufflings within the region. Devaluations can also provoke more direct forms of protectionism; for example, Mexico reacted to its peso devaluation by raising tariffs against non-NAFTA countries, while Argentina responded to its own peso crisis by raising tariffs against Brazil. Since exchange rate swings can often be several magnitudes larger than tariff reductions, the increased trade and investment interdependencies encouraged by RTAs

leave the member countries more exposed to each other's poor monetary and fiscal policies.

Figure 3 outlines the theoretical framework used by most researchers (Buckley et al., 2004; Eden, 1994, 2002; Vernon, 1994; Yeyati et al., 2002). Two or more countries are assumed to form a preferential trading agreement, whereby they eliminate tariffs between themselves, but leave tariffs against non-member countries. The key issue is how trade and FDI patterns are affected inside and outside the RTA. There are typically two approaches to answering this question: macroeconomic and microeconomic. We look at each briefly below.

[Figure 3 goes about here]

The macroeconomic effects of regional integration on FDI can be analyzed from two angles – investment creation and investment diversion. *Investment creation* occurs when the fall in trade barriers within the RTA causes a shift from lower-profitability investments to higher-profitability investments within the region. (This is the investment equivalent of trade creation; similarly, investment diversion is the equivalent of trade diversion.) In addition, investment creation occurs when the now-larger regional market attracts more FDI from outside the region as firms that had previously exported to individual countries within the region shift from exports to FDI.

*Investment diversion* occurs when the RTA causes a shift away from higher-profitability external investments to lower profitability internal investments because the investments outside the region have become uncompetitive in the internal market. In other words, if investments divert into the region that would have been made or were previously made in a nonmember country, because of creating the RTA, this is investment diversion. An example is the movement of “cut-and-sew” garment firms from the Caribbean to Mexico after NAFTA was formed because Mexico would have preferential access to the U.S. market.

Taking micro-level considerations into account, the effects of an RTA on FDI become more complicated and uncertain. Transport costs and plant-level economies of scale are two major concerns. Where transport costs are low and economies of scale large, insider firms are likely to concentrate production and supply the entire North American market from one location, reducing intra-RTA FDI. On the other hand, segmenting production stages and setting up vertically integrated plants to take advantage of factor price differences across member countries can lead to the increase in intra-RTA FDI. Thus, the production-location decisions of MNEs involve a tradeoff between the advantages of being close to the customer (which encourages market-seeking FDI) and the advantage of concentrating production to take advantage of scale economies (which encourages exports).

To the extent that investments by firms in one member country were originally made in another member country for tariff-jumping reasons, their reason for existence disappears once a RTA is introduced. As a result, disinvestments can occur. However, there are significant nonlinearities in the impact of declining tariff rates on FDI flows. Unless other locational attractions are more important than avoiding tariffs, the combination of big tariff cuts with large plant-level economies of scale can lead to lower FDI and higher trade flows within the region (Eaton et al., 1994). For instance, Feinberg and her colleagues (1998) found that as Canadian tariff rates fell, U.S. MNEs increased their capital and employment in Canada, contradicting the view that tariff liberalization would lead to an exit of U.S. firms from Canada.

### Gravity Model Estimates

The typical model of the economic impacts of forming an RTA is based on a gravity model equation originally developed to explain bilateral trade patterns.<sup>3</sup> The gravity model explicitly includes income and distance measures, as below:

$$\text{TRADE}_{IJ} = \text{GDP}_I + \text{GDP}_J + \text{DISTANCE}_{IJ} + \text{TRADE}_{IJ} + \text{RTA} + Z \quad (1)$$

The embedded assumption is that trade between countries I and J should be positively related to their GDPs (and/or their per capita GDPs) and negatively to the distance between them (DISTANCE). FDI is assumed to be either a substitute or complement to trade patterns (TRADE). The impact of the formation of the regional trade agreement is tested by adding a dummy variable (RTA). Z is a vector of control variables that could also potentially explain FDI patterns, such as industry mix, exchange rates

and real interest rates. The gravity model can be seen in many FDI studies, such as Krueger (2000), Levy Yeyati (2001), Levy Yeyati, Stein, and Daude (2002b), Stein and Daude (2001), Mauro (2000), Harrigan (2001) and Frankel & Rose (2000).

It is well documented in the literature that FDI is strongly attracted to countries characterized by relatively large domestic economies and by increasing levels of real per-capita income (Globerman & Shapiro, 2002). Levy Yeyati et al. (2002a) also indicate that the gains may be smaller for countries that are less developed, closed to international trade, and altogether unattractive for foreign investors. Virtually overall studies of FDI flows stress the dominating importance of the size and income level of the host country (Graham, 1999). Implementing regional integration creates a common boundary for member countries (as shown in Figure 3). The new regional economy competes with nonmember countries, and an increase in FDI into the region is expected once the RTA is launched. MacDermott (2002), for example, applies both the traditional gravity model and the knowledge-capital model to analyze the bilateral OECD FDI data from 1980-1997, and finds that implementing NAFTA led to an increase in FDI into member countries. This is particularly evident for Mexico, which is not surprising since NAFTA was mainly about adding Mexico to the preexisting Canada-U.S. FTA.

One difficulty in assessing the role of RTAs on FDI – particularly for a specific country's FDI – is there are many channels through which RTAs could potentially have impacts on FDI flows (Levy Yeyati et al., 2002a). The impact of RTAs will depend on characteristics of the host countries that make them more or less attractive than their RTA partners as a potential location of foreign investment (IDB, 2002). It is therefore critical to take other potential explanations into account by including them as control variables in the gravity model in order to isolate the impact of the RTA on FDI patterns.

For example, *domestic economic reforms* can confound the analysis. Graham and Wada (2000) find that investment into Mexico began to speed up following the onset of policy reform in Mexico in the later 1980s, which was well before NAFTA. They cite two possible causes: bilateral trade agreements between the United States and Mexico during the period 1985-89, and policy reforms implemented unilaterally by Mexico. They infer the first explanation is not consistent with U.S. FDI patterns, while the second explanation does fit the facts. Therefore, Graham and argue it is probable, even if not provable, that NAFTA kept FDI flows into Mexico from falling after domestic reforms had been fully implemented.

Globerman and Shapiro (2001) provide another example of the importance of domestic policies. They identify two domestic explanations for Canada's declining share of inward FDI in North America: (1) higher taxes in Canada discouraged investment by domestic and foreign investors; and (2) Canada's declining capacity to innovate and support "new economy" activities discouraged FDI inflows. Further, Blomstrom and Kokko (1997) claim both economic reforms and macroeconomic factors affect FDI. Their paper shows that the most positive impacts on FDI when regional integration coincides with domestic liberalization and macroeconomic stabilization.

Another factor that can influence FDI patterns is *factor costs and availability*. Love & Lage-Hidalgo (1999) conclude that U.S. FDI into Mexico is systematically influenced by relative Canadian-Mexican wage rates and demand differentials in both the short and long runs. However, there is no evidence of similar influences at work on U.S. investment into Canada. The U.S. FDI pattern in Mexico and Canada is due to the different industrial composition of U.S. FDI in these two partners. They conclude that Canadian concerns about the extent to which Canada competes with Mexico may be overstated. Also, market size serves as an important consideration of investment location (for example, Bertrand & Madariaga, 2002)

Finally, *exchange rate changes* can also influence FDI patterns. Buckley, Clegg, Forsans and Reilly (Forthcoming) find the acceleration of changes in the exchange rate fostered U.S. FDI into Canada. In contrast, Mauro's (2000) empirical study of world-wide FDI patterns shows that exchange rate variability does not appear to have affected firms' decisions to invest abroad, except during the turbulent 1980s when FDI represented a means of reducing exchange rate risk.

### **Horizontal versus Vertical Integration**

One of the major advantages of regional integration is the economies of scale gains that come

from replacing small, national markets with a larger, regional market; this suggests that horizontal FDI (locational shufflings for efficiency reasons) should be the primary response to RTAs. Empirical analysis of FDI patterns worldwide suggests that horizontal FDI is the primary explanation (Markusen & Maskus, 1999). Mauro (2000), in analyzing the impacts of tariff and nontariff barrier reductions on bilateral FDI patterns in 1988, 1993 and 1996, finds that FDI is primarily market seeking.

However, Levy Yeyati, Stein, and Daude (2002b), examine bilateral FDI patterns between 20 OECD countries and 60 host countries from 1982 through 1998, finding that RTAs tend to promote vertical over horizontal FDI. They find that vertical FDI for differentiated products does not substitute for trade, while the conclusion on horizontal FDI is not definitive. Waldkirch (2001) also finds that vertical integration is the likely explanation for the large increase in Mexico's FDI from Canada and the United States after NAFTA. Similar results are reported by other studies (for example, Aizenman & Marion, 2001; Hanson, Mataloni, & Slaughter, 2001).

Moreover, MNCs display strategy preference patterns according to their origins, which affects the linkages between RTAs and FDI. For instance, Makhija and Williamson (2000) argue that U.S. industries are mostly multidomestic in comparison to other nations. That is, U.S. firms tend to duplicate production activities across the different countries in which they operate and to be less vertically specialized than MNCs from other OECD countries. This, according to Makhija and Williamson, implies the NAFTA experience might differ from that of the European Union.

When interpreting intraregional FDI data, differences in sectoral performance should also be taken into account (Rugman & Brain, 2003). However, there are few econometric studies focusing on individual sectors and regional integration, probably because of FDI data limitations. The most important sector in terms of bilateral trade flows within NAFTA is autos and auto parts, which represents between one-third and one-half of NAFTA trade depending on how broadly the sector is defined (Eden & Molot, 1992, 1993; Hunter, Markusen & Rutherford, 1995a,b; Molot, 1993). The Canadian and U.S. auto industries were not expected to see major MNE location shifts after CUSFTA and NAFTA because of bilateral producer free trade since the 1965 Auto Pact. NAFTA, in terms of autos and auto parts, was primarily about the opening up and integration of the Mexican auto industry into an already deeply integrated North American auto sector (Weintraub & Sands, 1998).<sup>4</sup>

### **Insiders versus Outsiders**

A body of empirical work on the impact of RTAs on FDI inflows finds that RTAs benefit member countries (insiders) and have no impact or negative effects on nonmember countries (outsiders), as the executors of RTAs expected. For instance, Bertrand and Madariaga (2002) use the panel data on U.S. FDI in NAFTA and MERCOSUR from 1989 to 1998 and find that economic integration certainly plays a major role on U.S. firms' location patterns. The U.S. position regarding to the two agreements – an insider in NAFTA, an outsider in Mercosur – seems to matter. Their regression results indicate significant positive relationship between U.S. (insider) FDI and NAFTA dummy variable while no relationship is detected between U.S. (outsider) FDI and MERCOSUR dummy.

Monge-Naranjo (2002) compares the effect of NAFTA on flows of FDI received by Mexico (an insider) and the countries in the region excluded from NAFTA (outsiders). He finds that, with the exception of Costa Rica, all other Central American countries lagged behind Mexico after 1994. The most severe bias occurred in textile and apparel sectors, which represented most of the FDI flows in Honduras, El Salvador and Guatemala, but not Costa Rica. For Costa Rica, what attracts FDI was the production of electronic components, medical equipment, and the like. Unlike other outsiders, Costa Rica, after the launching of NAFTA, still remained its attractiveness for FDI inflows. The “secret” lies in its production of electronic components, medical equipment and the like.

## FIRM-LEVEL RESPONSES TO REGIONAL INTEGRATION

In thinking about how multinational enterprises are responding to the wave of regional integration schemes in the Americas, four trends are evident. The first response is locational, as MNEs shift their activities in response to the removal of crossborder barriers within the region. The second and third responses are partly affected by RTAs, but also by globalization and information technology more generally: the shift from manufacturing to services, and the growth of outsourcing and offshoring. Lastly, true “Americas” multinationals are forming, that stretch across North and Latin America. We look at each of these trends below.

### Changing Plant Location Strategies

Understanding how MNEs are likely to respond to regional integration pressures, in terms of their location decisions is best understood through the concept of the international value chain, which is illustrated in Figure 4.

[Figure 4 goes about here]

Firms engage in two types of value adding activities: primary and support activities. Primary activities are the core functions as a product moves from the upstream raw materials stage downstream to the customer. Support activities are the overhead functions, which can be separated into three categories: strategic management, technology development (both product and process) and business support services (e.g., accounting, marketing, and finance). Firms must decide which activities along the value chain should be done inside the firm and which can be contracted to outside parties. In addition, they must decide where these activities should be located. Typically, one expects the upstream resource allocation stage to be located close to available resources, where the downstream sales and distribution stages are located close to customers. When a firm engages in two or more of these activities in a linked fashion (e.g. parts, assembly and sales) we say the firm is vertically integrated; when a firm has two or more plants at one of these stages (e.g. several assembly plants in different locations) the firm is horizontally integrated.

When an MNE goes abroad, it sets up a foreign affiliate or subunit in a particular location (a “plant” or “site”). We can use the value chain to explain why firms set up subunits in foreign countries. The reasons may be internally driven (either by product requirements or the nature of overall firm requirements) or externally motivated (by strategic interactions with rival firms or by government regulations) or both. Building on Dunning (1993), we argue that there are three basic motivations behind the establishment of an MNE subunit in a foreign country: resource seeking (the search for raw materials and/or lower cost production locations), market seeking, and support provision (the need to provide support services to other parts of the MNE). There may also be other strategic (e.g., financial, tax, pre-emptive) motivations for offshore locations.<sup>5</sup>

### Resource Seeking Plants

*The Search for Raw Materials:* First, MNEs establish foreign plants in order to access natural resources not available at home. This type of resource seeking international production was typical of MNEs in the early part of the 20th century. The so-called Old International Division of Labour (OIDL) linking developed and developing countries was based on vertically integrated trade in raw materials. In the stereotypical case, natural resource seeking MNEs go into resource rich countries set up a natural resource (e.g. mining, oil) extraction plants. The MNE sends in a package of an inflow of capital goods, engineers, and technology, and uses domestic labour and energy inputs to extract the raw materials. The raw materials are either exported directly to the parent or other affiliates in unprocessed form, or possibly processed in an adjacent plant and then exported in semi-processed form. The latter case provides some upgrading of technology inflows and local capability. Economies of scale relative to the size of downstream demand determine the size of plant; output is usually exported to downstream MNE affiliates. The raw material flows are intrafirm so that transfer prices are used to price the products as they are sold from one plant to another; however, since the products are commodities arm's length market

prices are likely to exist for comparison. Transport and energy costs are important for determining upgrading possibilities; so too are tariff and NTBs in downstream country as these tend to discourage host country upgrading. Typically most developed countries have had a cascading tariff structure (higher tariffs the higher the degree of processing) and cascading tends to discourage upgrading in the host country.

*The Search for Low-Cost Production Sites:* MNEs set up foreign plants in locations where inputs into the production process are cheaper than at home; primarily this is a search for cheaper labour inputs but it could also be for cheaper energy or materials. While the resource seeking stage is tied to the location of natural resources and the market access stage is tied to the location of markets, the cost reducing stages are more footloose and can move from country to country in search of cheaper production costs. Developing countries set up export processing zones to encourage MNEs to assemble and manufacture low technology products for final assembly and sales in the Triad countries. Such worldwide sourcing has been called the New International Division of Labour (NIDL), because it links developing country labour intensive manufacturing to Triadic high tech assembly and sales. Enormous flows of intermediate goods trade in parts and partly assembled products are created.

### Market Seeking Plants

The second motive for setting up a foreign plant is to secure access for one's products in foreign markets. This type of market seeking international production replaces exports to a country with production inside that country. The product may be either a final good (e.g. autos) or an intermediate good (e.g. auto parts) or business services (a financial affiliate). We can think of several motivations for wanting market access:

*Tariff jumping or defensive FDI:* If a country has high tariffs and/or non-tariff barriers designed to keep out foreign goods, exporting firms which perceive this market as important are likely to incur the costs of setting up inside the tariff walls. Such inward FDI is a (for the firm) efficient response to internalizing market imperfections caused by government policy, but inefficient from the viewpoint of world welfare. An additional problem occurs if excessive entry results as MNEs compete strategically to enter new market. The term "miniature replica effect" was coined to describe the high cost production based on excessive numbers of product lines supplying too small a market that occurred in Canadian manufacturing in the 1960s and 1970s as a result of high Canadian trade barriers.

*New or expanded market entry:* When a previously closed market opens up to foreign firms, particularly if the market is of large size or strategic importance, firms will enter to supply that market. One can think of the opening of China and Eastern Europe to foreign investment and the (expected) removal of U.S. prohibitions against U.S. firms doing business in Vietnam as examples. Related to this category is the formation of free trade areas and customs unions which induce entry by new MNEs seeing the possibilities of a larger market with reduced intraregional barriers (and possibly higher barriers against imports so that tariff jumping may also be a factor).

*Following one's customers abroad:* This is a common motivation for firms that provide intermediate goods and services to downstream businesses. When Japanese automotive assembly plants moved into North America in the mid-1980s, a few years later auto parts suppliers from Japan followed. Hotel chains provide similar services to their international customers, regardless of their location. Banks set up branches in foreign countries to supply their manufacturing customers with the same services they have at home.

### Support Services Plants

*Business Services:* Provision of business services to support other parts of the MNE may be shifted to offshore locations. These include the sales, producer service, technology and head office stages. The sales distributor is often the first move a firm makes into a new market, while other producer services follow at a much later date when the MNE has established a more diversified subsidiary base. Services affiliates are the fastest growing category of FDI according to the UNCTC; their purpose is to supply accounting, finance, marketing, and so on in support of the MNE's manufacturing and resource-based

affiliates. In terms of technology development, historically little R&D was decentralized from the parent firm's location; however, with new products and processes being developed throughout the Triad it is now more important that MNEs have access to the latest technology wherever developed. As a result, R&D affiliates are being set up outside the home country (e.g. U.S. labs in Europe, Japanese labs in the United States).

*Regional Headquarters:* In the 1990s, multinationals began developing core networks of affiliates. These "regionally integrated, independently sustainable networks of overseas investments [are] centered on a Triad member", according to the UN Centre for Transnational Corporations, now DITE (UNCTC 1991:42). Each network tends to have a lead plant or regional headquarters in a member of the Triad plus affiliates located in regional spoke countries (e.g. lead plants in the United States with cluster plants in Canada and Mexico). By setting up a core network the MNE ensures that it has access to, and that its affiliates become regional insiders in, each of the three Triadic regions. DITE argues that regional core networks have both economic (comparative advantage, economies of scale) and political (avoidance of tariff and nontariff barriers) motivations.

### MNE Locational Responses to Regional Integration

Now, let us put the firm's value chain decisions in the context of the creation of a regional trade agreement. Three categories of firms can be identified that are likely to have different responses to the creation of an RTA (Eden 1994; Eden and Monteils 1998). We outline their reactions in Figure 5.

[Figure 5 goes about here]

*Insider multinationals* are well-established multinationals located inside the region, which have already invested in their partner countries prior to the RTA. *Insider domestics* are local firms that, prior to the RTA, are focused on their national market (or subunit within that market). While they may be exporting to other countries in the region, they have not used FDI to set up foreign plants. *Outsider firms* are foreign firms outside the region, which may either have been exporting into the area or have established foreign subsidiaries inside the region, prior to the RTA. The reactions of these three groups to the formation of a regional trade agreement is likely to differ.

For insider domestics, the formation of an RTA is both an opportunity (i.e. new markets, access to lower cost inputs) and a threat (i.e. more competition). These firms, with encouragement, may start to export or increase their exports within the region. New exporters, however, face the difficult task of breaking into established distribution networks.

Insider MNEs are better prepared to take advantage of the opportunities offered by the RTA. These MNEs see the benefits from lower intraregional barriers and respond by rationalizing product lines (horizontal integration) and/or production processes (vertical integration) to better exploit economies of scale and scope across the region. There is both a short-run response as the MNEs engage in locational reshufflings in response to the falling trade barriers, and a long-run response where insider firms locate, close and/or expand their plants with the whole regional market in mind.

When a free trade area is formed, some MNEs will already have plants within the market, each of which may have been primarily oriented to its own domestic market. With the fall in interregional barriers, there is a new possibility for the firm to rationalize production among the existing plants. The MNE may rationalize vertically (i.e. change plant functions such that the plants become vertically integrated) or horizontally (i.e. change product lines such that each plant specializes in a different product line and then intrafirm trades with the others). Buckley et al. (2004) break the insider firms' FDI strategies into two categories. *Reorganization investments* by insider firms reshuffle production within the integrated area, to capitalize on regional comparative advantage. *Rationalization investments* by insiders take advantage of the returns to scale possibilities in the integrated area. A third possible investment response is *offensive import substitution*, which is undertaken by both insider and outsider firms to take advantage of the growing intraregional market.

Outsider firms that are exporting into the region may shift to foreign direct investment in order to protect their market access and to avoid being seen as outsiders. They are likely to be drawn to the largest market or hub (e.g. the United States) unless cost differentials make location in the smaller countries

(Canada and Mexico) more attractive and/or interregional barriers are completely removed. Buckley et al. (2004) call the investment reaction by outsider MNEs *defensive import-substituting investment* based on the new balance of locational advantages between the rest of the world and the region. Moreover, tighter rules of origin in an RTA may force foreign subsidiaries to upgrade production and source more inputs locally. Thus, upstream parts and component manufacturers may be induced to follow assembly plants in order to meet regional content rules. Harris (2005) argues that

Hollowing out of high-skilled managerial jobs from the two spoke economies (Canada and Mexico) was also expected to occur. Head office functions are expected to move to the United States for two reasons. First, US multinationals closed head offices of their Canadian subsidiaries and shifted functions back to their US parents, as part of a regional consolidation of support services. In addition, as Canadian multinationals expanded their export and FDI activities in the United States, they moved headquarters functions south to support their US activities.

In summary, formation of a regional integration scheme is seen as a policy shock that affects MNE decision-making. The particulars of the RTA, the breadth and depth of pre-existing trade and FDI linkages between member countries, and country-level and region-level locational advantages (CSAs) are key environmental and policy factors that determine the attractiveness of the RTA to MNEs. How a firm is likely to respond to the RTA depends on its motivation for investment, its particular value-adding activities, and whether the firm is an insider MNE, outsider MNE or domestic. Each firm must decide which activity to move, how the activity is linked with the rest of the MNE's activities (horizontal integration in homogeneous products or differentiated products or vertical integration), where to put the activity, and how to structure its ownership (mode of entry). The location question can be analyzed from the perspective of macroregions and microregions (Eden 2002). In general, the key effects depend on (1) the type of firm (insider, outsider, domestic), (2) the motivation for entry, and (3) the linkages between the particular activity and the rest of the MNE. "Locational shuffling" is expected as MNEs allocate production and sales on a regional basis, taking advantage of the larger, barrier-free market to achieve economies of scale and scope (efficiency-seeking FDI). Therefore, investment diversion takes place not only between the integrated region and other locations, but also among regional member countries.

### **The Shift from Manufacturing to Services**

International trade and foreign direct investment patterns are increasingly shifting from manufacturing to services (Dossani and Kenney, 2003; UNCTAD, 2004). The reasons for the rapid growth in services FDI are several. First, manufacturing MNEs may set up foreign affiliates to provide support functions for the MNE group of affiliates. Financial, trading and marketing affiliates, often located in tax havens, are common examples. Moreover, service multinationals in industries such as airlines, banking, accounting and consulting are rapidly becoming internationalized. In addition, the privatization of former state-owned enterprises in sectors such as telecommunications, electricity and postal services, has encouraged inward FDI, particularly in Latin America and the transition economies in Central and Eastern Europe. More recently, information technology enabled services (ITES), providing back office and support functions (payroll, order fulfillment) and front office functions (customer care) are being relocated to emerging market economies such as India (more on this below).

This pattern is clearly evident in the Americas. business service sectors such as finance, insurance and banking, and public utilities such as telecommunications, hydro and electricity were closed to foreign investors. With the wave of privatizations in Latin America over the 1990s, and the inclusion of service sector provisions in RTAs and the Uruguay Round, these sectors have seen massive inflows of FDI over the past 15 years. At the same time, the information technology revolution (e.g., the Internet) has increased the mobility of services. Services are now being outsourced and offshored in ways that were not possible 15 years ago. As a result, FDI in services now exceeds FDI in manufacturing (UNCTAD 2005). We now see locational shufflings designed to rationalize the provision of business services within the MNE network, repeating the earlier pattern of rationalization of manufacturing plants. Economies of scale and scope, together with agglomeration economies, support the creation of regional headquarters, to direct and monitor the MNE's regional production network.

## Offshoring and Outsourcing Strategies

A critical change in the business strategies of multinationals over the past five years has been the rapid growth in offshoring and outsourcing of services, both business service operations (BSO) in sectors such as telecommunications, transportation and health care, and business process operations (BPO) such as human resource management, call centers and cheque processing. It is important, first, to distinguish between offshoring and outsourcing. See Table 7.

[Table 7 goes about here]

*Outsourcing* is the relocation of one or more stages of production from within the firm to an external party; that is, the firm shifts from “make” to “buy”. (These are cells 2 and 4 in the table). When a production stage is moved from inside to outside the firm’s boundaries, its level of vertical integration falls. During the 1990s, most firms attempted to restructure their value chains by selling off low-value stages of production and concentrating on their core, high-value-adding activities. The externalized production can be sold off to an arm’s length party in the same country as the MNE (the home country) or to an arm’s length party in a foreign country. When the transaction involves a domestic firm, we refer to as “domestic outsourcing”; when the activity involves a foreign firm, we call it “foreign or international outsourcing”. *Offshoring* is the relocation of one or more stages of production from the home country to a foreign country (GAO, 2004: 2). (These are cells 3 and 4 in the table.) Production can be shifted to a wholly or partly owned foreign affiliate in a foreign country (the host country), which is called “captive or internal or intrafirm offshoring” or, more simply, foreign direct investment (FDI). Production can also be shifted to an arm’s length party in the foreign country, where that firm could be either a domestic firm or another multinational enterprise; this can be referred to as “external offshoring”. An outsourced offshored activity is one that has both moved outside the firm (externalized) and outside the home country (internationalized); this is cell 4 in Table 6. We could refer to this either as “international outsourcing” or “external offshoring”; let us use “international outsourcing”. It is in this cell where the most recent changes in firm location strategy have occurred.

Firms have been outsourcing and offshoring manufacturing operations for many years, typically to export processing zones and more recently to China. White collar, skilled jobs are now following manufacturing jobs, in areas such as basic data entry, telemarketing and claims processing (Mann, 2003; McKinsey Global Institute, 2003). In e-services such as call centers, data entry, software engineering, physical proximity is not necessary for efficient and effective delivery. The recent movement to international offshoring such activities, initially to Canada (e.g., call centers to New Brunswick in the late 1990s) and more recently to India, is a new version of the old-style offshoring of low-skilled manufacturing jobs to export processing zones. Scholars now distinguish between “first phase offshoring” when low-skilled manufacturing jobs shifted offshore to developing countries, and “second phase offshoring” of information technology enabled services (ITES) jobs to countries like India.

How fast is the second phase of offshoring growing? Bardhan and Kroll (2003: 2) estimate that India’s ITES sector directly employs over 200,000 people; generates approximately \$US 2.3 billion in exports, of which 70 percent goes to the United States; and is growing at 60 percent per year. By 2008, the ITES sector is expected to employ two million workers and exports to exceed \$US 50 billion. Bardhan and Kroll (2003: 4) suggest that “any job that involves mostly ‘...sitting at a desk, talking on the phone and working on a computer...’ is a job under potential threat” of being offshored.

Critical factors encouraging offshoring are (1) cost savings, (2) availability of English-speaking graduates, (3) good information technology (IT) infrastructure, and (4) a favorable government attitude towards FDI and international trade (Bardhan and Kroll, 2003; GAO, 2004: 10-11). Bardhan and Kroll (2003: 6) conclude that the occupations at risk of international outsourcing from the United States include office support, business and financial support, computer and math professionals, paralegals and legal assistants, diagnostic support services and medical transcriptionists, which represent 11 percent of the US work force in 2001.

Business functions (BPO) associated with offshoring tend to be those that are digitized, capable of being performed at a distance, and whose product delivery can be managed using relatively new forms

of advanced telecommunications. Examples of these business functions include software programming and design, call center operations, accounting and payroll operations, medical records transcription, paralegal services, and software research and testing (GAO, 2004: 14). Although occupations associated with services offshoring were predominantly in the IT sector, IT-enabled jobs are also vulnerable to offshoring and span several occupational classifications. These categories include business and financial operations, office and administrative support, medical transcriptionists, paralegals and legal assistants, and architecture and engineering. (GAO, 2004: 14).

The implications of the offshoring of BSO/BPO activities are only now beginning to be studied (Levine 2004, GAO 2004). Bardhan and Kroll (2003) argue that the first wave of offshoring affected blue-collar jobs in manufacturing, causing job losses and widening the wage gap between blue and white collar jobs. The second wave of offshoring should have a similar impact on low versus high skilled white collar employment, causing job losses and widening the income gap between white collar occupations.

While India and China are often discussed in terms of offshored business services, Canada is currently one of the core locations for business support services. However, it faces strong competition from Mexico and Brazil. A.T. Kearney has done an exhaustive study of the factors affecting offshoring across several industries including business process functions (Kearney, 2004). Offshore locations are evaluated on three factors: cost (40% of the total), environment (30%) and people (30%). Table 7 shows the country scores for Canada, Mexico and Brazil from Kearney's business process functions report, together with the average for all countries in the report.

[Table 7 goes about here]

Canada and Mexico are tied with an overall score of 6.2. Canada ranks the lowest of the 11 countries on cost, but is first on environment and second on people. Mexico's tied score with Canada is driven by a much better score on cost, but worse performances on environment and people. Immediately behind Canada and Mexico is Brazil, with an overall score of 6.1. This difference is probably not statistically significant, suggesting that Mexico and Brazil are in the same overall category as Canada and should be seen as its closest competitors. As the Americas become more closely linked through RTAs, and government barriers continue to decline, particularly in services, this suggests that MNEs will engage in more locational reshufflings, offshoring business service and activities to other countries in the region.

### **The Rise of the Regional Multinationals**

The terms "globalization", "global firms" and "global strategy" are ubiquitous in the international business literature and the popular press. However, Alan Rugman has persuasively argued that very few MNEs are truly global, in the sense that they produce and sell in all three regions of the Triad: North America, Europe and the Asia Pacific (Rugman and Verbeke, 2003; Rugman, 2005). He argues there are four basic categories of firms, depending on their distribution of sales across the Triad:

- Global MNEs: sales of 20 percent or higher in each of the three regions of the Triad
- Bi-regional MNEs: sales of 20 percent or higher in two regions of the Triad
- Host-region MNEs: sales of at least 50 percent in a host region of the Triad
- Home-region MNEs: sales of at least 50 percent in their home region of the Triad

Applying these definitions to the Fortune Global 500, Rugman is able to assemble data for 380 MNEs. That most MNEs are regional and not global in their sales focus has clear implications for firm strategy (Rugman and Verbeke, 2003). First, for international business scholars, there is a need to develop a mid-level range of theory between domestic strategy and global strategy that focuses on the firm's core region. There is a misalignment between business theories focusing on "global strategy" and the practicality that most firms are regional.

Second, the optimal market on which the firm should focus its strategy depends on the geographic reach of its firm specific advantages. We illustrate this in Figure 7.

[Figure 7 goes about here]

Firms with only local FSAs that have little to no application outside the home country are truly location bound, confined to cell 1 in Figure 5. Firms with FSAs that are applicable throughout their home region should focus on the regional market (cell 6). Firms with a global strategic focus need global FSAs that can be applied in all three regions of the Triad (cell 12). The fact that so few MNEs are truly global suggests that they have not yet developed these mobile capabilities. Most firm strategies should be focused on their core regional market in terms of exploiting potential growth rather than developing strategies for the “global” market. Jarillo (2003: 151) is therefore likely correct in saying that:

*Launching into international ventures because ‘it is in fashion’ or because ‘you have to have a world stature’, when the structural reality does not so advise only leads to problems, some serious, such as contract restructurings, chronic lack of profitability of international operations and even bankruptcy.*

Third, the formation of an RTA offers the opportunity for firms to scale up for the regional market. That suggests they need to develop FSAs that are applicable throughout the region. That is, firms need to invest in building FSAs to move themselves from cell 1 to cell 2 (regional FSAs) so that they can be successful in the regional market (cell 6). The FSAs must both be appropriate for the region’s CSAs and mobile throughout the region, for a successful transition from domestic firm to regional MNE. As Jarillo (2003: 137) says, for internationalization to be successful, the firm must have an advantage that is real, and must be able to transfer it internationally.

Fourth, for small countries within an RTA, Rugman’s double diamond framework is the appropriate theoretical framework for developing strategy (Rugman, Van den Broeck and Verbeke, 1995). Firms headquartered in small countries must build regional firm specific advantages (FSAs) in order to fully exploit the region specific locational advantages offered by an RTA. In fact, one can argue that multinationals in the Americas now face a “triple diamond” of their home country (the first diamond); the lead market or hub in their most important RTA (the “second diamond”), and the other co-joined region (the “triple diamond”). So, Mexico for example can benefit not only from the North American double diamond, but also from the Latin Americas triple diamond. In fact, Mexico is perhaps uniquely placed to benefit from both diamonds.

Lastly, the theory of internationalization (Johanson and Vahlne, 1977) suggests that the appropriate growth path is marked by the black arrows in Figure 7 as firms build their FSAs to move successively from the local to the regional, bi-regional and finally global marketplace. MNEs in the Americas, as they internationalize, in effect are regionalizing, moving from exploiting their own home country diamond to the region as a whole. More research is needed to explore this path of internationalization for MNEs in the Americas..

## CONCLUSIONS

In this paper, we have provided an overview of multinational strategies and foreign direct investment patterns in the Americas over the past 15 years. We examined the spaghetti bowl of RTAs that now imperfectly link economies worldwide. One of the clear implications of our paper is that the spatial unit for the MNE is changing from the nation state to the macro-region. We have argued in this paper that MNE responses to regional integration in the Americas must be differentiated into two groups because regional integration is less advanced in Latin America than in North America. North American multinationals have engaged in locational reshufflings, designed to bring Mexico into a rationalized regional production pattern for the continental market post-NAFTA. That process is now mainly complete, especially for manufacturing firms. On the other hand, in Latin America, the regional integration process is much less advanced. MNEs are still engaged in market-seeking investments, with some rationalization underway in the larger RTAs such as Mercosur.

From an economic perspective, the process of silent integration in the Americas appears inexorable. Perhaps Vernon (1998) was wrong and the Americas remain in the eye of the hurricane. Yet,

there are political storm clouds on the horizon with the election of populist leaders and rising anti-MNE sentiment in Latin America and the anti-offshoring/anti-globalization movement in North America. This suggests that MNE-state relations will continue to be a vital topic for researchers, policy makers and MNE managers in the 21<sup>st</sup> century.

ENDNOTES

---

<sup>1</sup> In the DITE dataset FDI regulatory changes are tracked for Latin America (Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Suriname, Uruguay and Venezuela), the Caribbean (Antigua and Barbuda, Bahamas, Barbados, Cayman Islands, Cuba, Jamaica, Puerto Rico, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, and Trinidad and Tobago) and North America (Canada and the United States).

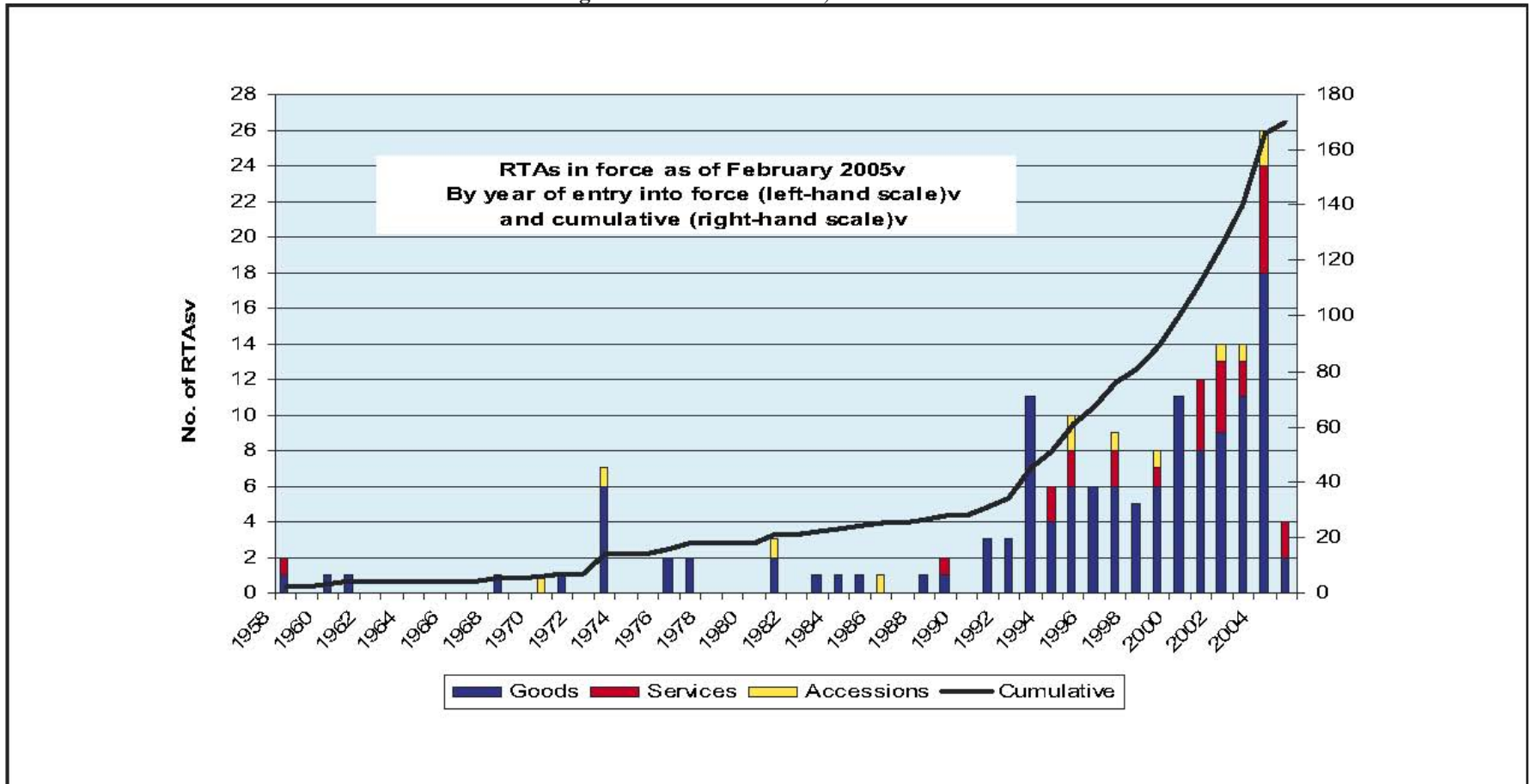
<sup>2</sup> The index formula is  $PERFORMANCE_i = FDI_i / FDI_w / GDP_i / GDP_w$  where PERFORMANCE  $i$  = the Inward FDI Performance Index of the  $i$ th country,  $FDI_i$  = FDI inflows in the  $i$ th country,  $FDI_w$  = World FDI inflows,  $GDP_i$  = GDP in the  $i$ th country and  $GDP_w$  = World GDP.

<sup>3</sup> See Deardorff (1998) for a history and analysis of gravity models in international trade.

<sup>4</sup> Regional integration in autos had an interesting policy spillover. As a result of Japan taking Canada to the WTO, Canada was forced in 2002 to end the 1965 Canada-U.S. Auto Pact and replace it with a uniform Canadian tariff on motor vehicle imports from non-NAFTA countries, ending the differentiation between the Big Three and Asian assemblers (Eden & Molot, 2002).

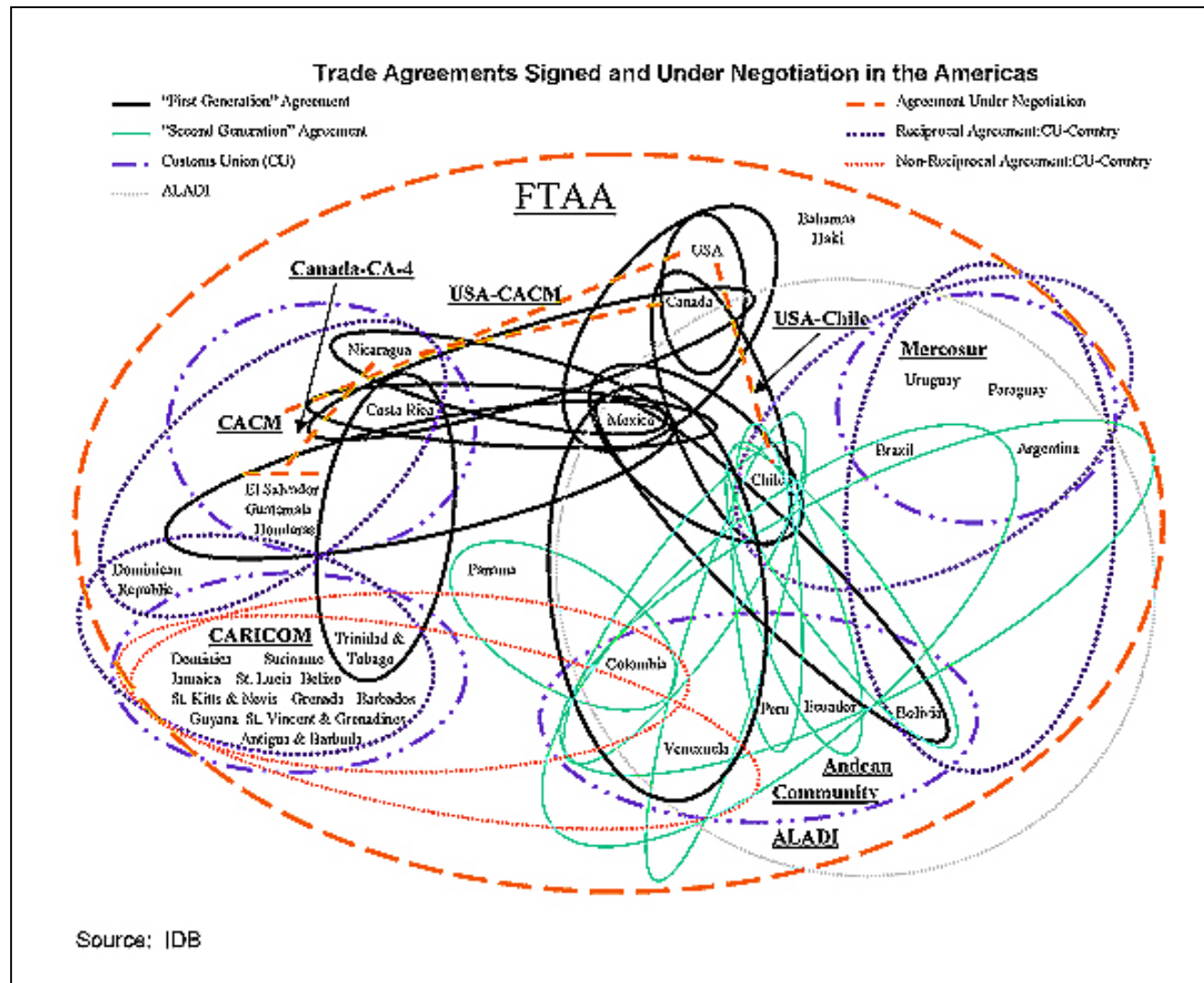
<sup>5</sup> See Eden (1994) for details; also Dunning (1993).

Figure 1: Number of RTAs, 1958-2005



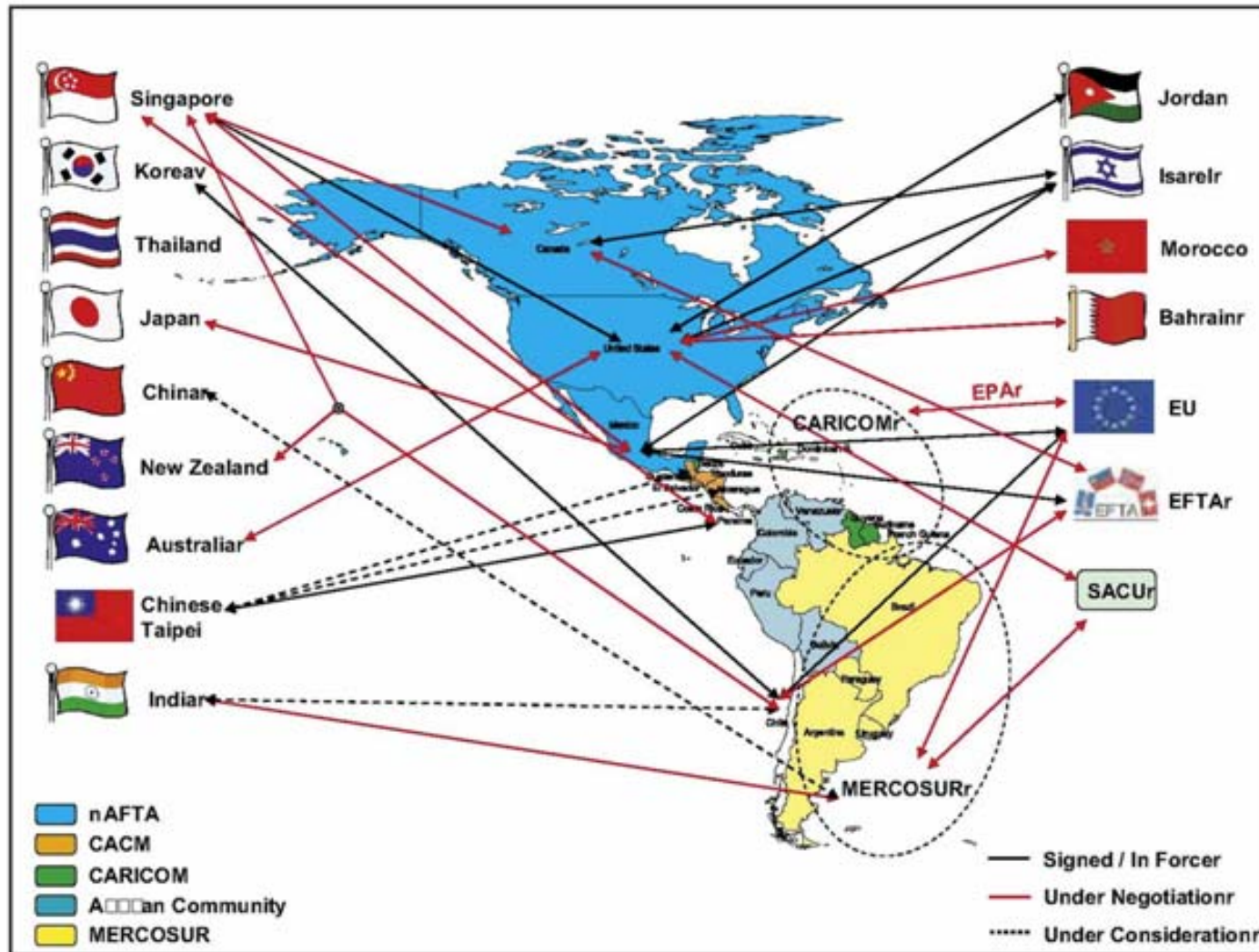
Source: Crawford and Fiorentino (2005).

Figure 2: The Spaghetti Bowl of Regionalism



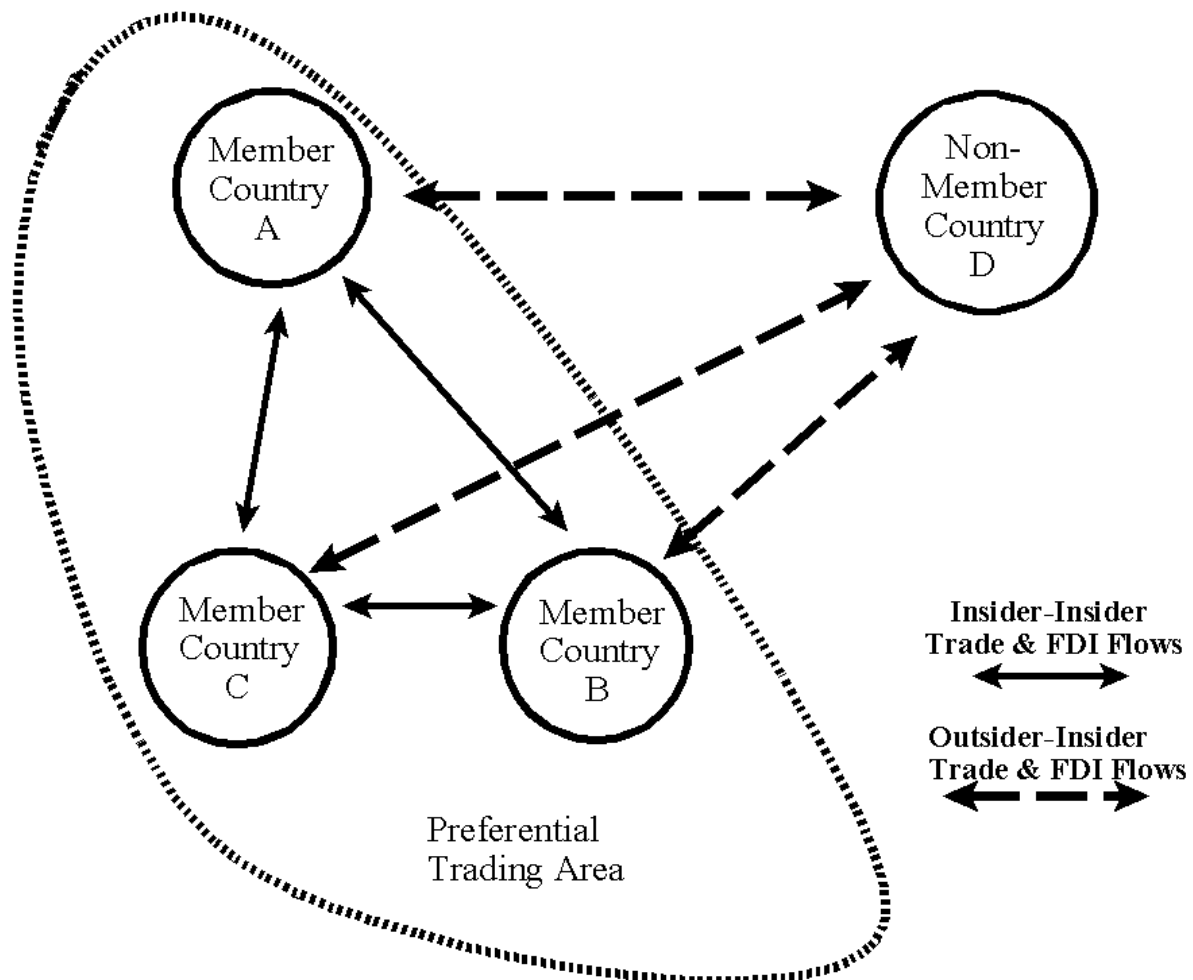
Source: IDB (2002).

Figure 3: Proliferation of RTAs in the Americas (2005)

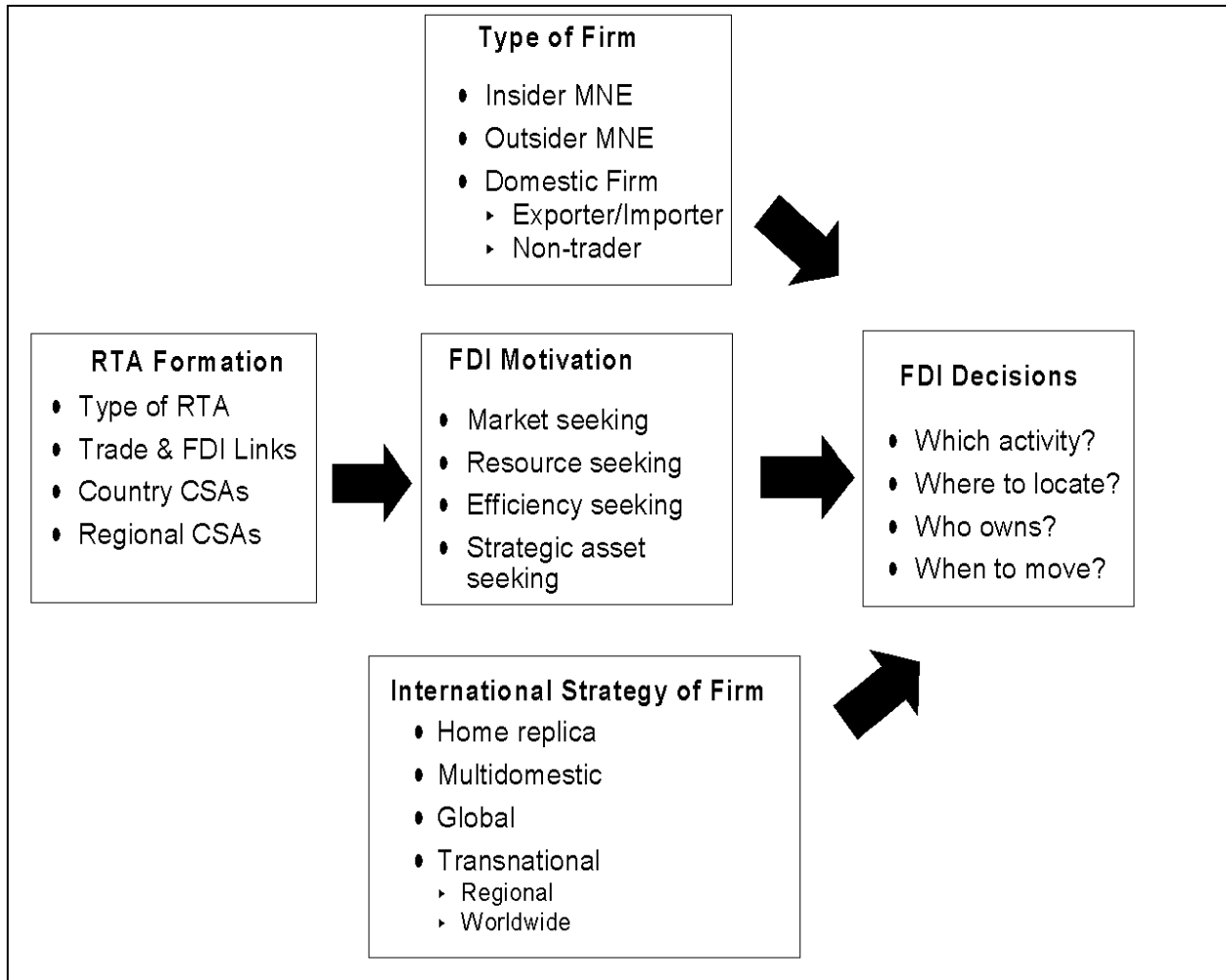


Source: Crawford and Fiorentino (2005)

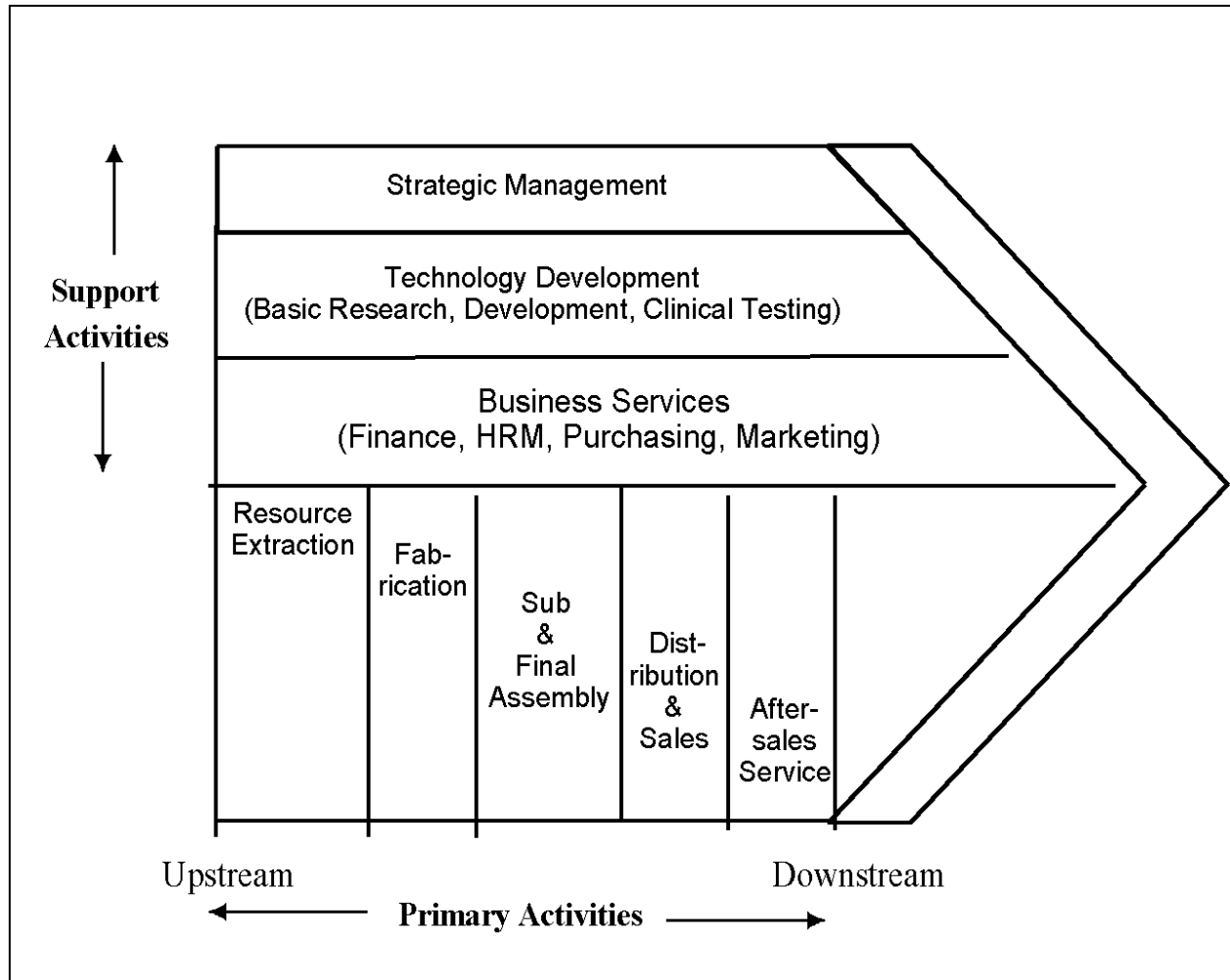
Figure 4: Impact of an RTA on FDI Patterns



**Figure 5 Firm Strategic Responses to Regional Integration**



**Figure 6: In/out-sourcing and In/out-shoring along the Value Chain**



**Figure 7: Moving from Domestic to Regional to Global Strategy**

		Firm Specific Advantages (FSAs)			
		Local FSAs	Regional FSAs	Bi-Regional FSAs	Global FSAs
Market Focus for the Firm	Local Market	1 Domestic Firms	2	3	4
	One Region	5	6 Regional MNEs	7	8
	Two Regions	9	10	11 Bi-Regional MNEs	12
	Global (Triad)	13	14	15	16 Global MNEs

**Table 1: FDI Regulatory Changes in the Americas, 1992-2002**

Year	REGION	Pro-FDI	Anti-FDI	Total	<i>Pro/Total</i>
All Yrs	Caribbean	30	2	32	<i>0.94</i>
<i>All Yrs</i>	<i>CAR/Americas</i>	<i>0.14</i>	<i>0.13</i>	<i>0.14</i>	
All Yrs	Latin America	164	14	178	<i>0.92</i>
<i>All Yrs</i>	<i>LA/Americas</i>	<i>0.75</i>	<i>0.88</i>	<i>0.76</i>	
All Yrs	North America	24	0	24	<i>1.00</i>
<i>All Yrs</i>	<i>NA/Americas</i>	<i>0.11</i>	<i>0.00</i>	<i>0.10</i>	
All Yrs	Americas	218	16	234	<i>0.93</i>

Source: Author's calculations based on confidential UNCTAD data.

**Table 2: FDI Regulatory Changes in the Americas, January 1992-January 2002**

Countries	More Favorable	Less Favorable	Total measures	Favorable/ Total	Ranked by % Less Favorable Changes	Ranked by Total No Reg Changes
Antigua and Barbuda	3	0	3	1.00	8	13
Argentina	12	1	13	0.92	7	5
Bahamas	3	2	5	0.60	1	11
Barbados	7	0	7	1.00	8	9
Belize	7	0	7	1.00	8	9
Bolivia	2	0	2	1.00	8	14
Brazil	13	3	16	0.81	4	3
Canada	18	0	18	1.00	8	2
Cayman Islands	2	0	2	1.00	8	14
Chile	6	2	8	0.75	2	8
Colombia	16	0	16	1.00	8	3
Costa Rica	6	0	6	1.00	8	10
Cuba	2	0	2	1.00	8	14
Dominican Republic	3	0	3	1.00	8	13
Ecuador	16	3	19	0.84	5	1
El Salvador	3	0	3	1.00	8	13
Guatemala	3	0	3	1.00	8	13
Guyana	1	0	1	1.00	8	15
Honduras	4	0	4	1.00	8	12
Jamaica	2	0	2	1.00	8	14
Mexico	15	0	15	1.00	8	4
Nicaragua	7	0	7	1.00	8	9
Panama	8	1	9	0.89	6	7
Paraguay	1	0	1	1.00	8	15
Peru	16	0	16	1.00	8	3
Puerto Rico	1	0	1	1.00	8	15
Saint Kitts and Nevis	6	0	6	1.00	8	10
Saint Lucia	2	0	2	1.00	8	14
Saint Vincent and the Grenadines	1	0	1	1.00	8	15
Suriname	1	0	1	1.00	8	15
Trinidad and Tobago	1	0	1	1.00	8	15
United States	6	0	6	1.00	8	10
Uruguay	10	0	10	1.00	8	6
Venezuela	14	4	18	0.78	3	2
Caribbean	30	2	32	0.94		
Latin America	164	14	178	0.92		
North America	24	0	24	1.00		
Total Americas	218	16	234	0.93		

Source: unpublished UNCTAD statistics.

**Table 3: Latin American Tax Havens by Region, Country Type and OECD (2000) Status**

	<b>Country</b>	<b>Region</b>	<b>Country Type/Linkages</b>	<b>On OECD (2000) List?</b>
1	Anguilla	Caribbean	UK overseas territory	YES
2	Antigua & Barbuda	Caribbean	Independent, Commonwealth member	YES
3	Aruba	Caribbean	Kingdom of the Netherlands	YES
4	Bahamas	Caribbean	Independent, Commonwealth member	YES
5	Barbados	Caribbean	Independent, Commonwealth member	YES
6	Belize	Caribbean	Independent, Commonwealth member	YES
7	Bermuda	Caribbean	UK overseas territory	COOP *
8	British Virgin Islands	Caribbean	UK overseas territory	YES
9	Cayman Islands	Caribbean	UK overseas territory	COOP
10	Dominica	Caribbean	Independent, Commonwealth member	YES
11	Grenada	Caribbean	Independent, Commonwealth member	YES
12	Montserrat	Caribbean	UK overseas territory	YES
13	Netherland Antilles	Caribbean	Kingdom of the Netherlands	YES
14	Puerto Rico	Caribbean	US possession	NO
15	St. Kitts & Nevis	Caribbean	Independent, Commonwealth member	YES
16	St. Lucia	Caribbean	Independent, Commonwealth member	YES
17	St. Vincent & Grenadines	Caribbean	Independent, Commonwealth member	YES
18	Turks & Caicos Islands	Caribbean	UK overseas territory	YES
19	US Virgin Islands	Caribbean	US overseas territory	YES
20	Costa Rica	Central America	Independent	NO
21	Panama	Central America	Independent	YES
22	Uruguay	South America	Independent	NO

\* COOP means that this jurisdiction agreed to eliminate its harmful tax practices and therefore was not included in the OECD (2000) list of abusive tax havens.

Table 4: Inward FDI Stock in the Americas, Selected Years 1988-2004

Country	Y1988	Y1992	Y1996	Y2000	Y2002	Y2004	% Non-US 1988	% Non-US 2004
Anguilla	..	33	103	230	303	441	0.00	0.04
Antigua and Barbuda	188	365	461	644	835	1,121	0.10	0.11
Argentina	6,839	16,303	33,557	67,601	43,146	53,697	3.60	5.23
Aruba	13	293	302	934	976	1,294	0.01	0.13
Bahamas	578	585	830	1,587	1,842	2,195	0.30	0.21
Barbados	152	193	241	308	344	451	0.08	0.04
Belize	50	122	192	296	465	693	0.03	0.07
Bermuda	14,037	19,569	27,968	56,393	71,894	77,602	7.38	7.55
Bolivia	604	1,188	1,991	5	6	10	0.32	0.00
Brazil	32,055	39,975	50,195	103,015	100,847	150,965	16.85	14.69
British Virgin Islands	37	-1	1,886	11,363	11,763	11,876	0.02	1.16
Canada	95,728	108,503	132,978	212,716	224,185	303,818	50.32	29.57
Cayman Islands	1,621	1,768	3,977	24,973	29,087	36,172	0.85	3.52
Chile	3,928	11,289	24,595	45,753	42,311	54,464	2.07	5.30
Colombia	3,011	3,891	11,773	10,992	17,830	22,278	1.58	2.17
Costa Rica	1,045	1,713	836	2,709	3,739	4,815	0.55	0.47
Cuba	1	19	59	74	81	74	0.00	0.01
Dominica	41	102	211	275	302	341	0.02	0.03
Dominican Republic	561	896	1,803	5,214	7,210	8,468	0.29	0.82
Ecuador	1,207	1,976	4,118	7,081	9,686	12,482	0.63	1.21
El Salvador	198	253	421	2,001	2,431	3,686	0.10	0.36
Grenada	47	111	196	364	486	613	0.02	0.06
Guatemala	1,599	1,919	2,278	3,420	4,155	4,441	0.84	0.43
Guyana	36	201	545	759	859	933	0.02	0.09
Haiti	131	161	157	215	226	240	0.07	0.02
Honduras	289	483	736	1,482	1,850	2,390	0.15	0.23
Jamaica	558	1,152	1,752	3,317	4,412	5,783	0.29	0.56
Mexico	16,615	35,680	46,912	97,170	155,151	182,536	8.73	17.76
Montserrat	25	53	60	77	80	85	0.01	0.01
Netherlands Antilles	382	481	304	78	81	-30	0.20	0.00
Nicaragua	122	210	462	1,395	1,749	2,201	0.06	0.21
Panama	2,011	2,451	3,660	6,775	7,413	9,217	1.06	0.90
Paraguay	316	597	829	1,325	778	1,024	0.17	0.10
Peru	1,217	1,501	6,720	11,062	12,549	13,310	0.64	1.30
Saint Kitts and Nevis	71	196	287	505	676	805	0.04	0.08

Country	Y1988	Y1992	Y1996	Y2000	Y2002	Y2004	% Non-US 1988	% Non-US 2004
Saint Lucia	243	417	543	825	943	1,157	0.13	0.11
St Vincent & Grenadines	30	72	224	500	558	669	0.02	0.07
Suriname	-309	-568	-626	-719	-819	-955	-0.16	-0.09
Trinidad and Tobago	1,834	2,408	3,953	7,008	8,633	10,443	0.96	1.02
Turks and Caicos Is	2	5	3	4	4	5	0.00	0.00
United States	314,754	423,131	598,021	1,256,867	1,340,011	1,473,860	165.47	143.43
Uruguay	592	715	1,265	2,088	1,403	2,110	0.31	0.21
Venezuela	2,516	6,033	10,432	35,480	39,007	43,575	1.32	4.24

Country	Y1988	Y1992	Y1996	Y2000	Y2002	Y2004	Share 1988	Share 2004
Caribbean & Other	20,551	28,875	45,320	114,888	140,738	159,806	0.041	0.064
South/Central America	73,941	125,933	200,906	399,746	444,630	563,947	0.146	0.225
North America	410,482	531,634	730,999	1,469,583	1,564,196	1,777,678	0.813	0.711
Total Americas	504,975	686,442	977,225	1,984,217	2,149,565	2,501,430	1.000	1.000
US as % Americas	62.33	63.10	61.64	61.20	61.20	59.54		
Canada as % Americas	18.96	18.03	15.81	14.03	13.61	10.96		
Mexico as % Americas	3.29	3.58	5.20	4.23	4.80	4.87		
Brazil as % Americas	6.35	5.95	5.82	7.20	5.14	6.79		

Source: author's calculations using data from the 2005 *World Investment Report*.

**Table 5: FDI Potential Indexes for the Americas, 1988-2003**

	Score			Rank (140 Countries)			Rank (Americas)		
	1988-1990	1999-2001	2001-2003	1988-1990	1999-2001	2001-2003	1988-1990	1999-2001	2001-2003
Argentina	0.139	0.218	0.187	59	52	66	14	7	9
Bahamas	0.260	0.269	0.235	28	38	48	3	3	3
Bolivia	0.106	0.163	0.158	81	83	83	21	18	13
Brazil	0.165	0.181	0.178	48	73	70	8	14	11
Canada	0.533	0.465	0.457	2	5	4	2	2	2
Chile	0.180	0.242	0.231	41	47	50	5	4	4
Colombia	0.141	0.146	0.132	58	101	103	13	22	21
Costa Rica	0.159	0.188	0.179	50	70	69	9	13	10
Dominican Republic	0.131	0.203	0.189	66	62	63	16	9	8
Ecuador	0.127	0.139	0.125	69	104	109	17	23	23
El Salvador	0.106	0.166	0.142	80	80	96	20	17	19
Guatemala	0.077	0.150	0.134	102	97	101	25	20	20
Guyana	0.079	0.201	0.144	101	63	94	24	10	18
Haiti	0.044	0.028	0.066	115	135	137	26	26	26
Honduras	0.106	0.148	0.114	83	98	118	22	21	25
Jamaica	0.135	0.342	0.158	61	75	84	15	15	14
Mexico	0.176	0.229	0.227	44	49	51	7	5	5
Nicaragua	0.094	0.128	0.116	95	109	113	23	25	24
Panama	0.151	0.219	0.211	54	51	56	10	6	7
Paraguay	0.127	0.136	0.129	70	107	105	18	24	22
Peru	0.109	0.169	0.153	78	78	89	19	16	16
Suriname	0.177	0.157	0.153	43	86	88	6	19	15
Trinidad and Tobago	0.145	0.200	0.215	57	64	54	12	11	6
United States	0.727	0.669	0.659	1	1	1	1	1	1
Uruguay	0.145	0.191	0.145	56	67	93	11	12	17
Venezuela	0.205	0.208	0.175	37	58	74	4	8	12

Source: author's calculations using  
<http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2471&lang=1>

**Table 6: Inward FDI Performance Indexes for the Americas, 1988-2004**

	Score			Rank (140 Countries)			Rank (Americas)		
	1988-1990	1999-2001	2002-2004	1988-1990	1999-2001	2002-2004	1988-1990	1999-2001	2002-2004
Argentina	1.199	1.311	1.195	39	42	82	12	12	19
Bahamas	0.518	0.987	1.932	66	66	52	18	14	10
Bolivia	1.695	2.735	2.188	29	14	43	7	2	8
Brazil	0.408	1.443	1.610	77	37	62	20	11	13
Canada	1.256	1.642	0.734	38	30	94	11	7	21
Chile	3.107	2.273	3.472	10	19	21	1	4	3
Colombia	1.106	0.700	1.450	42	80	69	15	20	15
Costa Rica	2.550	0.871	1.937	18	73	51	2	17	9
Dominican Rep	1.877	1.633	1.769	26	31	58	6	8	12
Ecuador	1.485	1.523	2.750	32	35	34	8	10	7
El Salvador	0.256	0.459	1.360	89	95	73	22	21	17
Guatemala	2.003	0.405	0.003	22	99	120	4	22	24
Guyana	0.687	2.316	2.852	59	17	31	17	3	6
Haiti	0.366	0.119	0.122	82	123	133	21	25	25
Honduras	1.389	1.130	1.917	33	55	53	9	13	11
Jamaica	1.906	2.001	4.225	25	23	17	5	5	2
Mexico	1.337	0.900	1.236	35	72	79	10	16	18
Nicaragua	0.075	2.810	2.891	96	13	30	24	1	5
Panama	-2.786	1.581	3.034	116	32	29	25	9	4
Paraguay	0.699	0.372	0.484	58	104	107	16	24	22
Peru	0.136	0.726	1.576	91	78	64	23	18	14
Suriname	-18.691	-1.613	-3.996	117	140	140	26	26	26
Trinidad & Tobago	2.381	1.811	4.527	20	27	15	3	6	1
United States	1.115	0.719	0.376	41	79	114	14	19	23
Uruguay	0.496	0.394	1.434	71	100	70	19	23	16
Venezuela	1.177	0.902	0.980	40	71	86	13	15	20

Source: author's calculations using <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2471&lang=1>

**Table 7: Comparing In/Off-shoring and In/Out-sourcing**

		<b>Ownership of Production</b>	
		Insourced (internalized)	Outsourced (externalized)
<b>Location of Production</b>	Onshore Production (home country)	1 Production kept in-house at home	2 Production outsourced to third-parties at home
	Offshore Production (foreign country)	3 Production by foreign affiliates in a host country	4 Production outsourced to third-parties abroad

Source: Eden (2004) revision of GAO (2004, p. 58).

**Table 8: Country Scores for Offshoring Business Processing Functions, 2004  
(numerical scores)**

	<b>Canada</b>	<b>Mexico</b>	<b>Brazil</b>	<b>AVG</b>
<b>COST (40%)</b>	1.5	3	3.1	2.5
<b>COST RANK</b>	3	2	1	
Labor cost	0.8	2.2	2.5	1.8
MGMT & infrastructure costs	0.4	0.4	0.3	0.4
Tax/treasury impact	0.3	0.4	0.3	0.3
<b>ENVIRONMENT (30%)</b>	2.6	1.9	1.8	2.1
<b>ENV RANK</b>	1	2	3	
Intellectual property	0.4	0.3	0.3	0.3
Geographic proximity	0.5	0.5	0.4	0.5
Cultural compatibility	0.5	0.3	0.3	0.4
Country infrastructure	0.4	0.2	0.3	0.3
Risk (economic, political, government support)	0.8	0.6	0.5	0.6
<b>PEOPLE (30%)</b>	2.1	1.3	1.2	1.5
<b>PEOPLE RANK</b>	1	2	3	
Employee retention	0.4	0.4	0.5	0.4
Language barriers & literacy rates	0.5	0.4	0.3	0.4
Education level	0.5	0.1	0.1	0.2
Size of labor market	0.1	0.2	0.1	0.1
Outsourcing experience	0.6	0.2	0.2	0.3
<b>TOTAL (100%)</b>	6.2	6.2	6.1	6.2
<b>TOTAL RANK</b>	1	1	2	

Source: author's calculations using data from Kearney (2004: 2, 3, 4, 6 and 8).

## REFERENCES (INCOMPLETE)

- Baldwin, John R., Richard E. Caves and Wulong Gu. 2005. Responses to trade liberalization: changes in product diversification in foreign- and domestic-controlled plants. In Lorraine Eden and Wendy Dobson (editors). *Governance, Multinationals and Growth*. Cheltenham, UK: Edward Elgar Publishing.
- Baldwin, Robert and C. Wyplosz. 2003. The Economics of European Integration: Book manuscript downloadable from: <http://heiwww.unige.ch/~baldwin/papers/BW/bw.htm>.
- Bardhan, Ashok Deo and Cynthia A. Kroll. 2003. *The New Wave of Outsourcing*. Research Report. Fisher Center for Real Estate and Urban Economics · University of California, Berkeley · Fall.
- Bhagwati, J., Greenaway, D., & Panagariya, A. 1998. Trading Preferentially: Theory and Policy. *The Economic Journal*, 108: 1128-1148.
- Bhagwati, Jagdish and A. Panagariya. 1996. *The Economics of Preferential Trade Agreements*. Washington, DC: AEI Press.
- Bhagwati, Jagdish, David Greenway, and Arvind, Panagariya. 1998. Trading Preferentially: Theory and Policy. *The Economic Journal* (July) 108: 1128-1148.
- Brookfield, Jonathan, Lorraine Eden and Michael Hitt. 2004. The Changing Face of Political Risk: Terrorism, Corporate Security, and Firm Strategy. Presented at the annual meetings of the Academy of International Business, Stockholm, Sweden, July.
- Brown, Drusilla K., Kozo Kiyota and Robert M. Stern. 2005. Computational analysis of the Free Trade Area of the Americas (FTAA). *North American Journal of Economics and Finance* 16: 153-185.
- Buckley, Peter J., J. Clegg, Nicholas Forsans and Kevin T. Reilly. 2004. Evolution of FDI in the United States in the Context of Trade Liberalization and Regionalization. *Journal of Business Research*, 56(10):853-857.
- Carrillo, Jorge. 2004. Transnational Strategies and Regional Development: The Case of GM and Delphi in Mexico. *Industry and Innovation*: 11.1/2: 127-153.
- Casanova, Lourdes. 2004. East Asian, European, and North American Multinational Firm Strategies in Latin America. *Business and Politics*, 6.1: xx-xx.
- Cernat, Lucian. 2002. Assessing South-South Regional Integration: Same Issues, Many Metrics. Policy Issues in International Trade and Commodities Study Series No. 21. Geneva, Switzerland: UNCTAD.
- Chudnovsky, Daniel and Andres Lopez. Transnational corporations' strategies and foreign trade patterns in MERCOSUR countries in the 1990s. *Cambridge Journal of Economics*, 28.5: 635-652.
- Cooper, William H. *Free Trade Agreements: Impact on US Trade and Implications for US Trade Policy*. CRS Report for Congress. Order Code RL31356. December 6.
- Crawford, Jo-cerAnn and Roberto V. Fiorentino. 2005. *The Changing Landscape of Regional Trade Agreements*. WTO Discussion Paper No. 8. WTO: Geneva.
- CSC. 2002. *The Emergence of Business Process Management*. CSC Research Services. El Segundo, CA: Computer Sciences Corporation.
- Dawson, Laura Ritchie. 2004. Nationalism versus Interdependence in the Evolution of Canada's Post-War Investment Policies. Presented at the CTPL Trade and Investment Conference, University of Ottawa, November 19.
- Defever, Fabrice. 2004. Functional Specialization and the Location of Multinational Firms in the Enlarged Europe. Presented at the 2004 New Economic Geography conference, Hamburg Institute of International Economics. September.
- Devlin, R., & Estevadeordal, A. 2001. What's New in the New Regionalism in the Americas? INTAL-ITD-STA Working Paper No.6.
- Dossani, Rafiq and Martin Kenney. 2003. *Went for Cost, Stayed for Quality?: Moving the Back Office to India*. Asia-Pacific Research Center Working Paper. November. Stanford, CA: Stanford Institute

- for International Studies, Stanford University.
- Eaton, B. Curtis, Richard G. Lipsey and A. E. Safarian. 1994. The Theory of Multinational Plant Location in a Regional Trading Area. In L. Eden (Ed.), *Multinationals in North America*, Industry Canada Research Series Volume 3. Calgary: University of Calgary Press, 53-77.
- Eden, L. 1994. Who Does What After NAFTA? Location Strategies of US Multinationals”, in L. Eden (ed). *Multinationals in North America*, Industry Canada Research Series (Calgary: University of Calgary Press), pp. 193-252.
- Eden, L. 1996a. The Emerging North American Investment Regime. *Transnational Corporations*, 5(3): 61-98.
- Eden, Lorraine. 1996b. Deep Integration: Tax Harmonization and Investment Policies in North America. In *Investment Rules for the Global Economy: Enhancing Access to Markets*, edited by Pierre Sauvé and Daniel Schwanen. Policy Study No. 28. Toronto: C.D. Howe Institute, pp.293-323.
- Eden, Lorraine. 2002. Regional Integration and Foreign Direct Investment: Theory and Lessons from NAFTA. In M. Kotabe, P. Aulakh, & A. Phatak (Eds.), *The Challenge of International Business Research*, Cheltenham, UK: Edward Elgar Publishing.
- Eden, Lorraine and Robert Kudrle. 2005. Tax Havens: Renegade States in the International Tax Regime. *Law and Policy*. 27.1 (January): 100-127.
- Eden, Lorraine and Dan Li. 2004. The New Regionalism and Foreign Direct Investment in the Americas. In *Strengthening the North American Community: NAFTA at Ten*, edited by Sidney Weintraub. Washington, DC: Center for Strategic and International Studies.
- Eden, Lorraine and Antoine Monteils. 2000. Regional Integration: NAFTA and the Reconfiguration of North American Industry. In J. H. Dunning (Ed.), *Regions, Globalization and the Knowledge-Based Economy*, Oxford: Oxford University Press.
- Eden, Lorraine and Maureen Appel Molot. 1993. Insiders and Outsiders: Defining "Who Is Us?" in the North American Auto Industry. *Transnational Corporations*, 2(3): 31-64.
- Ernst, Christoph. 2005. *The FDI-employment link in a globalizing world: The case of Argentina, Brazil and Mexico*. Employment Strategy Papers. International Labor Organization.
- Ethier, W. 2001. The New Regionalism in the Americas: A theoretical Framework. *North American Journal of Economics and Finance*, 12: 159-172.
- Feinberg, Susan, M.P. Keane and M. Bognanno. 1998. Trade Liberalization and "Delocalization": New Evidence from Firm-level Panel Data. *Canadian Journal of Economics*, 31(4): 749-777.
- Frischtak, Claudio. 2004. Multinational Firms' Responses to Integration of Latin American Markets. *Business and Politics* 6.1: xx-xxx.
- General Accounting Office (GAO). 2004. Current Government Data Provide Limited Insight into Offshoring of Services. United States Government Accountability Office Report to Congressional Requesters.
- Globerman, Steven. 2002. Trade, FDI, and Regional Economic Integration: Cases of North America and Europe. Paper presented at the Conference "Enhancing Investment Cooperation in Northeast Asia", Hawaii, August 7-9.
- Harris, Richard. 2005. FDI in an FTA with uncertain market access. In Lorraine Eden and Wendy Dobson (editors). *Governance, Multinationals and Growth*. Cheltenham, UK: Edward Elgar Publishing.
- Harvey, Michael G. 1993. A Survey of Corporate Programs for Managing Terrorist Threats. *Journal of International Business Studies*, 24.3: 465-378.
- Hejazi, Walid and Peter Pauly. 2005. How do regional trade agreements affect intra-regional and inter-regional FDI? In Lorraine Eden and Wendy Dobson (editors). *Governance, Multinationals and Growth*. Cheltenham, UK: Edward Elgar Publishing.,
- Hejazi, Walid and A.E. Safarian. 2005. NAFTA effects and the level of development. *Journal of Business Research* 58: 1741-1749.
- Hogenbirk, Annelies E. and Hans L. van Kranenburg. 2005. Roles of foreign owned subsidiaries in a small economy. *International Business Review*, xx-xx.
- Iglesias, E. 2002. Global Positioning of the European Union and MERCOSUR: Towards a New Model of

- Inter-regional Cooperation. Paper presented at the Annual Lecture at the Chaire Mercosur of the Institut d'Etudes Politiques de Paris, Paris, April 4.
- InterAmerican Development Bank (IDB). 2002. *Beyond Borders: The New Regionalism in Latin America*. Washington, DC: Inter-American Development Bank.
- Jarillo, J.-C. 2003. *Strategic Logic*. New York, NY: Palgrave MacMillan.
- Johanson, J., & Vahlne, J.-E. 1977. The Internationalization Process of the Firm: A Model of Knowledge Development and Increasing Foreign Market Commitments. *Journal of International Business Studies*, 8: 23-32.
- Krueger, Anne. O. 2000. NAFTA's effects: A preliminary assessment. *The World Economy*, 23(June): 761-775.
- Levine, Linda. 2004. *Offshoring (a.k.a. Offshore Outsourcing) and Job Insecurity Among U.S. Workers*. CRS Report for Congress. Washington, DC: Congressional Research Service (CRS). June 18.
- Levy Yeyati, E. L., E. Stein and C. Daude. 2002. The FTAA and the Location of FDI. Paper presented at the IDB-Harvard Conference on the FTAA in Punta del Este, Uruguay, December 7.
- Lipsey, Richard G. 1960. The Theory of Customs Unions: A General Survey. *The Economic Journal*, 70.279: 496-513.
- Love, James H. and Francisco Lage-Hidalgo. 1999. Is There Competition for US Direct Investment? A Perspective on NAFTA. *The World Economy*, 22: 207-221.
- Mann, Catherine. 2003. *Globalization of IT services and white-collar jobs: The next wave of productivity growth*. Institute of International Economics, Policy Brief. Washington, D.C.: Institute for International Economics.
- Markusen, Jim. 2004. Regional Integration and Third-Country Inward Investment. *Business and Politics*, 6.1: xx-xxx.
- Maule, Christopher. 2004. Background Paper: CTPL Conference on Trade and Investment. Presented at the CTPL Trade and Investment Conference, University of Ottawa, November 19.
- McFetridge, Donald G. 2004. *Evaluation of Current Policy towards Inward FDI*. Presented at the CTPL Trade and Investment Conference, University of Ottawa, November 19.
- McKinsey Global Institute. 2003. *Offshoring: Is It a Win-Win Game?* San Francisco: McKinsey.
- Mold, Andrew. 2003. The Impact of the Single Market Programme on the Locational Determinants of US Manufacturing Affiliates: An Econometric Analysis. *Journal of Common Market Studies*, 41.1: 37-62.
- Monge-Naranjo, Alexander. 2002. *The Impact of NAFTA on Foreign Direct Investment Flows in Mexico and the Excluded Countries*. Northwestern University. Mimeograph.
- Muller, Alan and Rob van Tulder. 2005. The Search for Synergy between Institutions and Multinationals: Institutional Uncertainty and Patterns of Internationalization. ERIM Report Series Research in Management. ERS-2005-086-ORG. December.
- Rugman, Alan. 2005. *The Regional Multinationals: Multinationals and "Global" Strategic Management*. Oxford, UK: Oxford University Press.
- Rugman, Alan M., & C. Brain. 2003. Intra-regional Trade and Foreign Direct Investment in North America. Paper presented at the Canada-United States Business Conference, Indiana University, April 11-12.
- Rugman, Alan, J. Van den Broeck and A. Verbeke (eds.) *Global Strategic Management: Beyond the Diamond*. JAI Press: Greenwich, CN.
- Rugman, Alan and Alain Verbeke 2003. Regional and global strategies of multinational enterprises. *Journal of International Business Studies*,
- Scollay, Robert. 2003. *RTA Developments in the Asia-Pacific Region: State of Play*. PECC Trade Forum. Singapore: Asia Pacific Economic Cooperation Council.
- UNCTAD. 2004. *World Investment Report 2004: The Shift Towards Services*. Geneva: United Nations.
- Vernon, Raymond. 1994. Multinationals and Governments: Key Actors in NAFTA. In L. Eden (Ed.), *Multinationals in North America*, Calgary: University of Calgary Press.
- Vernon, Raymond. 1998. *In the Hurricane's Eye: The Troubled Prospects of Multinational Enterprises*.

- Cambridge, MA: Harvard University Press.
- Villarreal, M. Angeles. 2005. *Trade Integration in the Americas*. CRS Report for Congress. Order Code RL33162. Washington, DC: Congressional Research Service.
- Yeung, Henry Wai-chung, Jessie Poon and Martin Perry. 2001. Towards a Regional Strategy: The Role of Regional Headquarters of Foreign Firms in Singapore. *Urban Studies*, 38.1: 157-183.
- Wonnacott, R. 1996. Trade and Investment in a Hub-and-Spoke versus a Free Trade Area. *The World Economy*, 19: 237-25