

**Center for Market Education**

1st Colloquium on Economics Education

Issues in Contemporary Economics Education

**Understanding FDI beyond  
neoclassical theory:**

The role of the eclectic paradigm

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## ***Background***

1. Development of theoretical models for FDI began in the 1960s, just when FDI flows started to arise (Jones and Wren, 2006; Almahmood, 2010).
2. There was no underlying theoretical model and FDI was explained based on trade theories.
3. But the rise of FDI flows in the post-world war two period has prompted researchers to develop a comprehensive theoretical model for FDI.
4. This paper discusses Dunning's eclectic paradigm which has been widely viewed as the most comprehensive theory on FDI to assess evolving investment motivations and to consider its relevance given the rising complexity and fragmentation in global production today.

# *Ricardian theory of Comparative Advantage*

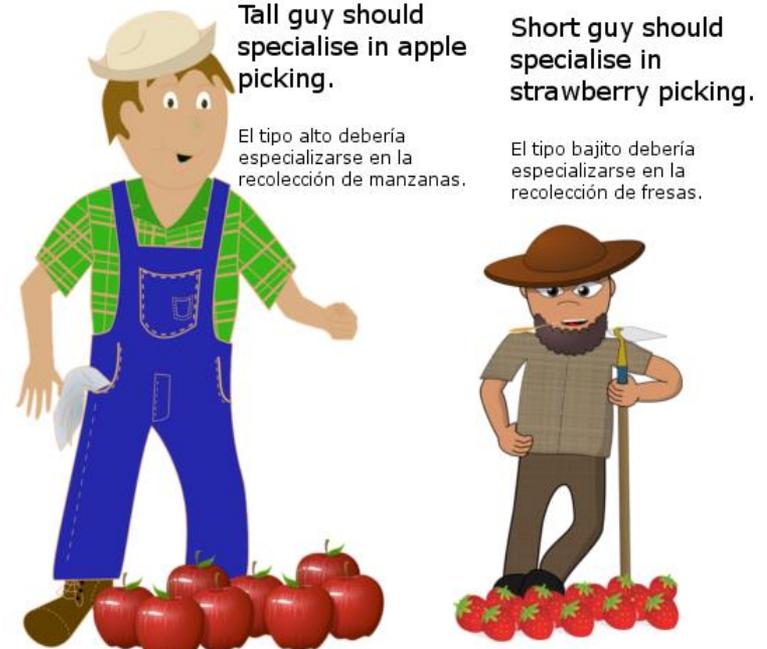
In traditional neoclassical theory, the firm is a 'black box', and no FDI is possible.

All firms have equal access to the same resources and capabilities *within* their own countries, while there is complete *immobility* of resources and capabilities *between* countries

- Static
- Industry-neutral
- Operate in vacuum
- Fragmentation of global production

## Comparative advantage

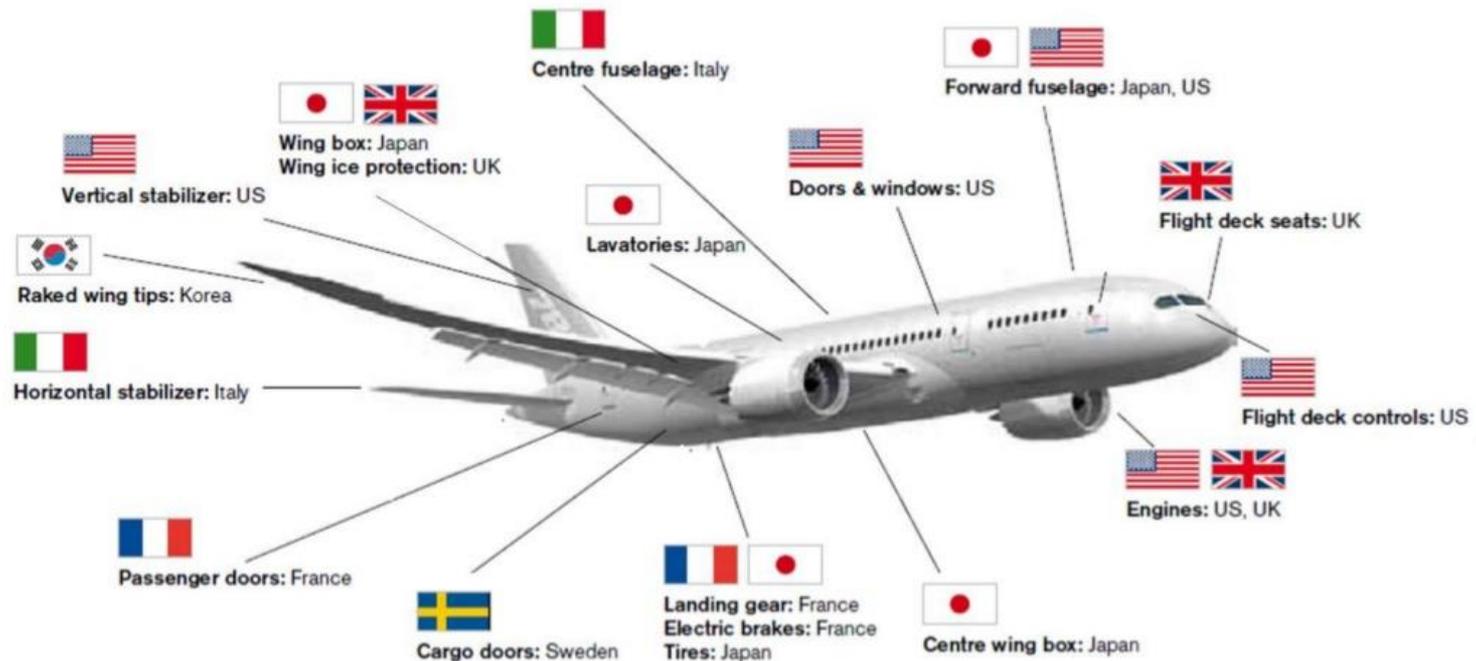
Ventaja comparativa



# Fragmentation of global production

## Global value chains in action

### Sourcing of Boeing 787 parts



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## ***Dunning's eclectic paradigm***

1. The eclectic (or OLI) paradigm has remained the dominant analytical framework for an operationally testable determinants of FDI.
2. MNEs undertake FDI to augment comparative advantage.
3. **Ownership (O)**: More likely to engage in FDI if competitive advantage is greater relative to those of other firms
4. **Locational (L)**: Favour foreign presence if resources are immobile, naturally-endowed and help to augment Ownership advantage
5. **Internalization (I)**: Favour FDI if there is net benefit to internalizing cross-border intermediate product markets rather than licensing the right or franchising

# *Dunning's four classic motives of FDI*

(1980, 1993, 2000)

**As countries have liberalized and the rules of global competition has changed, so have the motivations in entering foreign markets.**

4. Since the 1970s, rapidly rising production costs at home prompted **resource-seeking** & **efficiency-seeking** motives.
5. Focusing on relocating to developing countries to take advantage of lower cost and favourable policies.
6. The rise of HQs coordinating global activities in a modular fashion due to cost considerations.



1. During the post-WWII period, geo-political conditions were relatively regulated.
2. MNEs investment abroad was mostly conducted for **market-seeking** motives.
3. MNEs established production in the markets they wished to serve, and almost all stages of production were carried out in the same country.
7. By the 1990s, fragmentation of production favours integration of immediate goods production, final assembly and support services within a region – coordinated by regional HQs.
8. **Strategic asset-seeking** motives became more prominent to acquire foreign assets as to gain access to technology, resources and new markets.
9. This is followed by a period of consolidation of integrated production via offshoring & outsourcing.

# *Mind the Gap*

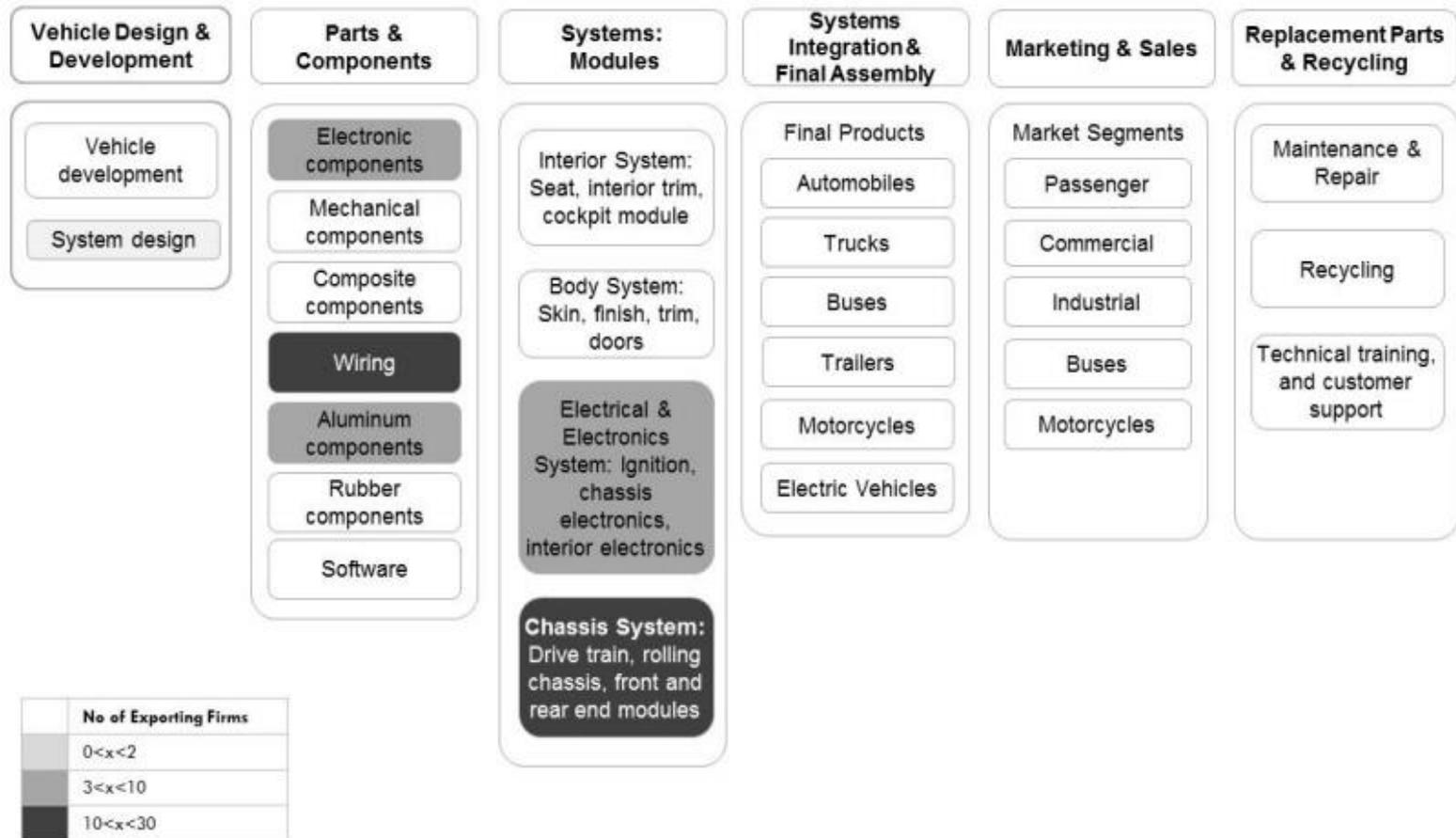
**Despite its popularity, Dunning's classic framework faces many criticisms especially when dealing with Emerging Multinational Enterprises (EMNEs)**

- 1. To understand upgrading at the firm-level along the value chain**
  - Rising trends of **fragmentation** and integration of global production activities may mean that MNEs have multiple or all of the motives of FDI simultaneously, rendering Dunning's classic framework less effective.
  - Also, existing literature mostly analyzes upgrading processes at the **industry level**, i.e. shifting from lower added-value to higher added-value sectors (Gereffi, 1999; Humphrey & Schmitz, 2002).
  
- 2. Assuming an all-powerful global "lead firm" and largely ignore the institutional context.**
  - There is an **evolutionary** context to how local firms become EMNEs.
  - EMNEs may have **weaker** positions compared to MNEs from developed countries. EMNEs often face higher home- and host-country **institutional constraints**, especially in the case of Chinese MNEs (Luo and Tung, 2007; Deng, 2011; Cuervo-Cazurra & Narula, 2015; Prananond, 2015).



# An example of a value chain

(The Philippines in the automotive GVC)



Source: Sturgeon *et al.*, (2016)

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## ***Policy Implications***

Potential implications for policy makers:

1. To link industrial upgrading to participation in GVCs. Policymakers should identify and target segments of value chains which our local firms have comparative advantage, and not to attract the entire value chain.
  - Perhaps targeting electronic component for electric vehicles with upgrading potential in e-battery, rather than the entire value chain.
2. To enhance policy clarity and signal in the types of FDI to attract and approve, bearing the nature of FDI motivation and GVCs in mind.
3. To encourage promotion of industrial development on a longer-term trajectory by addressing domestic institutional bottlenecks

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***Thank You***