

BASIC ISSUES IN THE GEOGRAPHY OF FOREIGN DIRECT INVESTMENT

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This paper provides a brief review of five broad topics that relate to the geography of foreign direct investment (FDI). The purpose of this paper is to establish some of the multiple concerns of FDI analyses now being conducted in several disciplines. The first topic concerns considerations of both types of investing industries and nations that serve as sources of FDI. The second topic covers factors in the decision to invest abroad. The third topic is the timing of FDI. The fourth topic involves the method of FDI. The fifth topic concerns the political-economic environments of host nations and includes discussion of political risk. The topics presented are artificially partitioned because they are all inter-related through a common geographical base.

The most visible and dynamic subset of the global industrial system consists of multinational corporations. The purpose of this article is to provide a base for continued and expanded geographical research concerning one feature of the locational behavior of multinational corporations (MNCs) by examining some current issues concerning the geography of foreign direct investment (FDI). FDI is defined here as the ownership of equity (e.g., physical plants) in establishments located in other than one's own country for the purpose of exercising immediate control over economic activity.

The geographical literature that does exist concerning MNCs is certainly not large, but it does reveal some of the research perspectives on the general topic. McNee correctly recognized that geographers have important research opportunities in the analysis of MNC spatial behavior (McNee, 1981). He also recognized that relatively little work has been done by geographers on this important topic. Radical geographers have often based their analyses on MNCs which are viewed as prime actors in neocolonial movements (Taylor and Thrift, 1982). Bergman, using a different paradigm, assessed the possible problems that can occur in a world subject to the often conflicting goals of MNCs and nation states (Bergman, 1973). Hakonson has considered the location of foreign research and development activities of Swedish MNCs (Hakonson, 1981). McConnell has been concerned with the location and sectoral structure of FDI in the United States (McConnell, 1980, 1981). In addition to this type of work, related analytical advances can be found in the industrial systems approach to research in industrial location (Hamilton and Linge, 1979). The industrial systems approach takes account of national and international political-economic environments and their interrelation with industrial location behavior and resulting regional patterns. Hakonson (1979) has developed a model of MNC expansion incorporating this methodology.

The plan of this paper consists of the examination of five broad questions (familiar to all journalists) that affect the geography of FDI. These questions are not practically discrete, so the division is somewhat arbitrary, but convenient. The first question is *Who-* and concerns

considerations of both types of investing industries and nations that serve as sources of FDI. The second question is *Why*- and covers factors in the decision to invest abroad. The third question is *When*- and considers the timing of FDI. The fourth question is *How*- and involves the method of FDI. The fifth question is often imbedded in the preceding four, it is *Where*- here concerned with the political-economic environments of host nations.

WHO

The question of *Who* can be divided into two parts. The first part concerns the characteristic international investment activity of certain industries or types of production, including locational considerations. Conventional location orientations for different types of production suggest that classical and neoclassical location theory helps to describe the geographical pattern of FDI (Vernon, 1975). International disequilibrium in labor and consumer markets and international inequality in resource endowments indicate that Weberian analysis, for example, can be fruitful to some degree. International disequilibrium in factors also indicates that international trade theory provides a worthwhile avenue of approach to the analysis of MNCs in general and FDI in particular (Corden, 1975). Johnson's (1981) intriguing, though constrained, marriage of trade theory and location provides further possible analytical paths. Economic based theory alone, however, usually fails to consider the entire political-economic environment in which FDI is undertaken. The level of a host nation's concern with FDI, for example, seems to vary with type of production (Channon and Jallard, 1979). The activities of foreign held interests producing strategic materials or maintaining infrastructure are usually of much more interest to host governments than those involving the production of goods for local consumption or the provision of personal services. Host government policy can be considered as a constraint to locational investment behavior that varies at the individual industry level.

The second part of *Who* concerns characteristics of investing nations, particularly home country political-economic environments. There has been some deconcentration, by nation of origin, of FDI in recent years (Table 1). Over ninety percent of FDI, however, is controlled from the heavily industrialized nations of West Europe, Anglo America, and Japan. These nations also account for over ninety percent of FDI in the United States (Arpan and Ricks, 1979). FDI originating from these sources can be viewed as the continued geographical expansion of mature national industrial systems that actually began in the 1800s (Wilkins, 1970). Part of the recent deconcentration of FDI has been the result of the expansion of national industrial systems to currently industrializing nations such as Brazil and the Republic of Korea. Another smaller part may be assigned to the attempt of capital surplus oil exporters to invest accumulations of foreign currency in assets of the nation of origin. This type of capital movement, however, has been targeted largely toward investments other than direct equity in producers. Deconcentration has also resulted because of the origination of FDI from other kinds of sources. For example, Curacao, which did not serve as the source of even one foreign controlled form in the United States before 1975, ranked tenth among all nations by 1978 with forty-one (Arpan and Ricks, 1979). Places such as Curacao or Panama, which are not undergoing either industrialization or currency accumulation due to trade may be serving in some part as 'flags of convenience' for investments that are not really foreign in origin but redirected in the interest of tax or regulation evasion.

The focus of attention concerning government policy and FDI is usually placed on the host nation and treated here under the issue of *Where*. Home country policy, however, also plays an important role in FDI activity. Channon and Jallard (1979) cite three basic forms of home government intervention in the FDI process. First, there are standard interventions which include currency regulations and earnings repatriation policies, as well as strategic technology transfer controls. Second, there are discriminatory interventions. These can take place on a

Table 1: Foreign Direct Investment Stocks, by Nation of Origin

Origin	1967		1976	
	\$ Billions (%)		\$ Billions (%)	
United States	56.6	(53.8)	137.2	(47.6)
United Kingdom	17.5	(16.6)	32.1	(11.2)
German Federal Republic	3.0	(2.8)	19.9	(6.9)
Japan	1.5	(1.4)	19.4	(6.7)
Switzerland	5.0	(4.8)	18.6	(6.5)
France	6.0	(5.7)	11.9	(4.1)
Canada	3.7	(3.5)	11.1	(3.9)
Netherlands	2.2	(2.1)	9.8	(3.4)
Sweden	1.7	(1.6)	5.0	(1.7)
Belgium-Luxembourg	2.0	(1.9)	3.6	(1.2)
Italy	2.1	(2.0)	2.9	(1.0)
Others	4.0	(3.8)	16.8	(5.8)
Total	105.3	(100.0)	287.2	(100.0)

Source: United Nations Economic and Social Council, Transnational Corporations in World Development (New York: UN, 1978).

sectoral basis, as in the case of investment in particular overseas industries which may lead to domestic unemployment, or on a national basis, for example U.S. restrictions on investment in Cuba and U.K. restrictions on investment in the Republic of South Africa. Third, there are selective interventions which come about on a case by case basis, targeted at either a particular firm or nation. Part of the reason for the growth of MNCs has been their skill and flexibility in circumventing government interventions. Home government intervention in the developing world has proven to be highly malleable when economic leverage from MNCs is applied. In the U.S. home country intervention can, in effect, take place at the state level since the Supreme Court decided in the 1980 *Mobil vs. Vermont* case that states can collect corporate income taxes on parts of the global earnings of American based MNCs doing business within the state (Business Week, 1981c).

WHY

The second broad question concerning FDI is *Why*. What are the forces underlying the decision of firms to make commitments of capital away from their home nations? Several paradigms have been posited to explain the motive of FDI.

For some time, analysis of the reasons for FDI was based on a market imperfections paradigm (Calvet, 1981). For example, government imposed distortions of international markets which can lead to FDI activity include the impositions of fixed exchange rates or wage controls. These types of actions can actually make a nation more or less attractive to FDI, depending upon the degree and direction of policies put into effect. Tariffs, quotas, and other trade barriers may also serve as attractions to FDI. Either an increase or expected increase in trade barriers serves as an incentive for nondomestic producers to establish production facilities within the boundaries of the protected market. The protected market must be sufficiently large, however, to make FDI profitable. Smaller markets may be served better by the use of a production license agreement with a foreign producer than by the direct establishment of an overseas subsidiary.

Another class of market imperfections is concerned with the persistent disequilibrium in international markets which exists since supply and demand are usually not balanced even after adjustment of international price levels. Several types of market disequilibrium can be considered as cause for FDI. For example, currency undervaluation can result in an MNC holding assets in nations with the undervalued currencies in the expectation of capital gains upon achievement of equilibrium in the foreign exchange market. The chance to purchase income producing assets with relatively overvalued currency was a major reason for the rapid increase of FDI in the United States during the early 1970s (Department of Commerce, 1976). Labor cost differentials can also be a reason for FDI activity, with low cost labor sources as the recipients of investment flows from nations with high cost labor. Disequilibrium in international capital markets, allowing unequal rates of return on real assets, may also result in FDI. International market disequilibrium conditions of any type, it should be noted, would only give rise to FDI of a finite time span. According to the market disequilibrium paradigm, once equilibrium is established in a market FDI would end and total attention be returned to domestic operations.

Several works by geographers have used other paradigms to analyze the *Why* of FDI. Radical geographers posit that power, greed, and the profit motive lead MNCs to exploit the opportunities in developing countries through the process of FDI (Santos, 1974; Peet, 1982). Geographers from yet a different perspective have addressed the *Why* question by considering product life cycles in conjunction with growth maximizing strategies of corporations (Hakonson, 1979; Thomas, 1980). The life cycle arguments are best considered, however, under the issue of *When* because they more directly deal with the timing of FDI addressed in the next section.

The contemporary portfolio theory of financial economics provides a more rigorous theoretical base for the analysis of the decision to engage in FDI. A portfolio may be defined as the combination of all the discrete assets, broadly defined, of an economic enterprise. Contemporary portfolio theory holds that assets are selected in order to minimize risk for a particular rate of return over an investor's entire portfolio. A single investment is not judged on its particular merits alone but in terms of its relationship to all other investments included in a portfolio (Markowitz, 1959; Tobin, 1952). This relationship is expressed in a mean-variance model as:

$$\bar{E}(R_p) = \sum_{i=1}^n X_i \bar{E}_i$$

where $\bar{E}(R_p)$ is the expected mean return of the portfolio,

\bar{E}_i is the expected return of the investments, and

X_i equals the proportion of total (n) portfolio investments in the investment so that the sum of all $X_i = 1$.

The risk of the return to the portfolio is defined as its variance:

$$\sigma^2(R_p) = \sum_{i=1}^n \sum_{j=1}^n X_i X_j \sigma_{ij}$$

where σ_{ij} is the covariance among all the returns of the individual investments held in the portfolio.

Risk is negatively associated with portfolio covariance so that diversification of portfolio holdings is an important method of risk reduction. An investor (be it an individual or an economic enterprise) may minimize its investment risk by holding several kinds of stock, different bonds, and other types of assets. The approach is in line with the conventional wisdom of not putting all one's eggs in one basket.

One method of portfolio risk reduction for an investor is international diversification. An investor can purchase stock in corporations of several different nations, expecting a small correlation among the stocks' returns because of the variety of economic and equity market conditions under which the various corporations operate (Rugman, 1977). This is an effective method of portfolio diversification if it can be accepted that the international capital market is partially segmented along national lines (Levy and Sarnat, 1970). Several of the reasons given for international capital market segmentation, including high transaction costs, legal restrictions, political instability, and localized information, affect the individual investor greatly and so inhibit geographical diversification of portfolios (Mathur and Hanayan, 1980). It has been suggested that MNCs provide individual stockholders with a type of international mutual fund by virtue of their international asset holdings. These international holdings, in effect, allow an investor to lower investment risk through geographical diversification without direct contact with foreign capital markets. There is some debate concerning investor recognition of the MNCs' role in portfolio risk reduction, but in an efficient stock market, such recognition would call for a premium to be placed on the price of MNC stock (Mikhail and Shawky, 1979, 1980; Agganwal 1980). This would result in an MNC stock having greater value than that of a comparable single nation corporation, providing a strong incentive for an MNC to engage in FDI.

Portfolio theory also can be applied at the corporate holding level as a rationale for FDI. Diversification provides a risk reduction strategy to firms that takes several paths. The three major forms of corporate risk reduction are product diversification, export diversification, and multinational diversification (Miller and Pras, 1980). Product diversification can provide earnings stability in relation to seasonal demand or business cycles, but the placing of all diversified production units within a single nation may still result in overall instability because of the common political-economic environment. Export diversification allows some geographical risk reduction through dealings with several national markets and in several currencies. Multinational diversification through FDI provides the same advantages as export diversification but with the additional benefits of providing several political-economic environments for production. While in practice all three types of diversification can be utilized in conjunction, there are empirical results that indicate multinational diversification is of primary importance in reducing the risk, as measured by profit stability, of corporate holdings (Miller and Pras, 1980; Wolf, 1977).

WHEN

The third general question concerns the timing of FDI. Hakonson (1979) provides a schematic of FDI timing based on market penetration. He divides a corporation's action space into the three spheres of core area, home country and foreign countries in describing five probable stages of corporate geographical expansion with growth. The first stage concerns the early life of the corporation and its ties to its core area. During the second stage sales offices are established outside the core area, but still within the home country, as penetration of national markets takes place. In the third stage the services of foreign sales agents are used to establish product outlets in selected foreign markets. At stage four direct sales offices are established in foreign countries, usually in replacement of sales agents, in order to better control international operations. Finally, by stage five, FDI is expanded as foreign production facilities are established and mature MNC has developed. Hakonson indicates that this model requires that growth maximization be the objective function of the corporation, but there is no real theoretical justification of this proposition. A stage of market penetration model which includes in sequence exporting, foreign licensing, and lastly FDI is just as easily developed based on cost minimization principles (Buckley and Casson, 1981). Market penetration strategy of this type can be shown to be a logical path for either growth or profit maximizing firms (Horst, 1975).

The market penetration models place the timing of FDI as a function of some market threshold. When the threshold is reached the foreign market is better served through the establishment of foreign production subsidiaries. Market considerations are also a basic element of models of FDI timing developed within the context of industrial organization theory. In the simplest case, with an industry organized on a competitive basis, a firm will pursue FDI if the return on the investment is expected to be greater than the return on a comparable domestic investment. This type of profit-maximizing FDI can be termed offensive-minded or aggressive (Baade, 1979). The timing issue becomes more complex conceptually if oligopolistic industrial organization is considered. Corporations in an oligopolistic environment compete along primarily non-price avenues. Advertising and product differentiation are typical competitive strategies toward increasing market share. Multinational expansion of product markets also serves to increase the share in a global market with nationally-based segmentation, each segment being considered at least partially available on a first come, first served basis. While the initial investment in a particular foreign country by a member of an oligopoly is essentially an aggressive move, there is evidence that the other members make parallel FDI commitments soon after (Knickerbocker, 1973). The timing of FDI in an oligopolistic industry is based largely on reaction to FDI by a lead firm. Such bandwagon or follow-the-leader behavior is really defensive, being made to protect overall market position through geographical expansion. Similarly, if an oligopoly exists at the international scale, FDI can be triggered by an exchange of threat action (Graham, 1974). In this case, when a firm from country X invests in country Y, its competitor in country Y will in turn invest in country X so that the competitive equilibrium of the oligopoly will not be endangered.

The product life cycle hypothesis can also be considered as explaining the timing of defensive FDI under monopoly conditions (Vernon, 1966). In this case a foreign production subsidiary is established when there is fear that an actual of perceived monopolistic advantage, in production technology for example, is in danger of being lost to a foreign producer. The establishment of an overseas production subsidiary and strong marketing may provide at least a temporary barrier to entry to the foreign producer even in its domestic market. The product life cycle hypothesis has proved useful in explaining initial FDI timing in a general way, but this usefulness has diminished with the maturation of a large number of MNC global networks. FDI activity continues, however the product life cycle hypothesis, as a root cause explanation, does not serve much of the contemporary FDI environment (Vernon, 1979).

Thompson's (1965) "trickle down" description of capital flows also explains one small element of FDI by advanced economies in less developed countries. Using what might be termed a "profit life cycle" argument, assets which have been rendered obsolete (often due to product life cycle developments) in an advanced country context can be transferred to expanding markets in developing countries where the market share is too small to attract modern, more costly assets.

None of the market oriented explanations of FDI timing even implicitly consider that international production and marketing take place in actual geographical space that entails physical and cultural distances and environmental differences of great importance (Calvet, 1981). In partial response to this neglect, Dunning (1979) has offered an *eclectic theory* of FDI that considers both the firm specific and location specific factors required for international production to take place. This eclectic theory states that for a particular firm FDI will take place when three interlocking conditions are met. First, a firm must hold particular product related ownership advantages over foreign firms in their own home market. The second condition is that it must be more advantageous to the firm to retain these advantages internally by direct extension of its activities than to retain them externally, for example by licensing foreign

producers. The third condition is that it must be profitable for the firm to utilize the advantages in concert with some factor inputs located outside the home nation. If this last condition is not met, but the first two are, the foreign market will be better served by export than by FDI in production facilities.

Hirsch (1976) effectively formalizes the eclectic theory of FDI timing in the following manner. A firm in nation X invests in nation Y when:

$$P_y + C < P_y + K$$

$$\text{and } P_y + C < P_x + M$$

where P_x , P_y are the present value of production costs in nation X and Y, respectively, calculated in the same unit of account,

K is the present value of the maintenance cost of an intangible income producing proprietary asset,

C is the present value of the extra costs of managerial control incurred by operating in a foreign nation rather than at home, and

M is the present value of the export costs of marketing per unit of sales less domestic marketing costs per unit of sales.

When, in present value terms, the costs of foreign production and control are lower than the costs of foreign production and maintenance of particular ownership advantages, and at the same time lower than the costs of producing at home and exporting, the FDI should take place. Any operational version of this decision model must consider explicitly the comparative geographical cost issues that are critical to the timing of FDI. The production cost differentials between two countries, for example, are of fundamental concern, and the variables C and M can be considered as functions of both physical and cultural distance between home and prospective host nation.

Geographical analysis is equally important to FDI timing considered in a portfolio theory context. If international diversification is a key criterion of a firm's portfolio composition strategy, FDI should take place when the expected return on a foreign capital investment (which is calculated using geographical risk considerations) is greater than the expected return on the foreign risk-free investment plus a premium determined by the foreign capital investment's level of non-diversifiable risk (Mehra, 1978). As above, geographical considerations are always important in the assessment of risk in foreign operations.

HOW

The fourth major question of FDI is the manner in which the capital investment is made. The two basic formats for FDI are the establishment of a new production facility in a greenfield sense (starting from 'scratch') and the acquisition of an existing firm. From a narrow perspective the decision to acquire existing facilities or to establish new facilities in a foreign nation can be placed best within the context of discounted cash flow analysis. That form of investment with the higher net present value is selected, as long as other conditions are perceived to be equal. More broadly, there appear to be three interrelated factors that have an affect on the selection of a particular format for FDI; 1) firm specific, 2) industry organization, and 3) geographic.

Naturally the specific objectives of the investing firm play a strong role in the decision to acquire or establish new facilities in foreign countries. Conglomerates, for example, use the general psychology of expansion through acquisition. The decision on how to expand in foreign markets can also be related to a firm's level of experience. If the firm is expanding into

new product areas as part of an internationalization strategy then acquisition of an existing producer may be preferred to greenfield expansion. Similarly, if a firm is making an initial entry into a foreign market then acquisition is preferred. In these cases the acquiring firm limits investment risk by purchasing product or marketing experience as well as capital assets. Greenfield expansion would be more appropriate to the purposes of foreign market penetration or continued expansion in a previously entered nation. A great majority of FDI by American and European firms has been made by acquisition, however, within the same product lines (Daniels and Patil, 1980). The preference for acquisition as an FDI format can be related to the industry organization factor. A majority of those firms engaged in FDI activity are operating in oligopolistic environments. The essentially defensive FDI behavior that is their characteristic, whether of a bandwagon or exchange of threat nature, requires a rapid response. Acquisition of an existing firm is much more likely to maintain competitive equilibrium within the oligopoly than would a greenfield investment involving a lengthy delay in market penetration (Dubin, 1975). Even aggressive FDI, however, is apparently acquisition oriented because the financial risk is diminished due to immediate cash flows which would not be present in a greenfield investment.

Geographical factors act in conjunction with the firm specific and industry organization factors in affecting selection of format for FDI. Cultural, market, and political-economic environments can play a role in the decision to make FDI commitments through acquisition or by greenfield expansion. Wilson (1980) has suggested a cultural basis for the low propensity of Japanese firms to expand internationally through acquisition, the preferred method of American and European firms. In addition, cultural differentiation or distance may be directly related to a firm's self perceived experience in a foreign market situation, so that the greater the cultural distance the more likely FDI will proceed through acquisition. Market conditions in both home and host countries have an affect on the format of FDI. A firm faced by slow market growth at home may prefer to acquire a share in more rapidly growing foreign markets, while a firm facing a more rapidly growing domestic market may be able to better absorb the early negative cash flows of overseas greenfield expansion. In addition, during weak periods in foreign stock markets the market value of some firms may dip below the replacement costs of their assets, making their acquisition relatively more attractive than an otherwise equivalent greenfield project. The political-economic environments of host nations can provide constraints to the selection of FDI format. Greenfield expansion is the more common, for example, in less developed countries (Wilson, 1980). Two possible reasons are that there is a smaller number of companies that are suitable acquisition targets in less developed economies and also the governments of these countries tend to encourage the greenfield establishment of subsidiaries rather than entry through acquisition, if direct investment is encouraged at all.

WHERE

The last major issue to be discussed is the explicitly geographical question of *Where*. The different political-economic environments and distances involved in FDI require that geographical considerations be made throughout the entire process. An attempt has been made to mention the geographical implications for each of the FDI issues discussed. The portfolio theory approach to FDI tells us that the most important criterion for the making of a particular foreign investment lies in the risk-return relationship of the investment to all other investments in the portfolio. Theoretically, risk and return should be used as an undivided measure of investment worth, but for practical purposes they can be artificially partitioned. For example, market size and growth rate, the presence of tariff and non-tariff trade barriers, and variations in input costs all can be considered as return oriented FDI location factors. These are all geographically diverse at the international scale and each has been considered in the

preceeding discussion. The risk characteristics of a particular FDI project can be considered in the same fashion as those of a domestic investment, with one major addition. Additional risk results for an individual FDI project because it is located in a foreign political-economic environment. This section focuses on the geographically based risk features that are peculiar to FDI, exchange risk and more broadly, political risk.

Fluctuations in currency exchange levels became an important consideration of international risk analysis when the American dollar, once an effective super currency, was allowed to float in value against other nations' currencies. Currency fluctuations do not really affect the financial position of an MNC unless funds are repatriated or otherwise transferred across national boundaries. In the event of a large scale devaluation of a foreign currency against that of the home country, assets, inventories, accounts receivable, and cash held in the foreign currency suffer the amount of the devaluation when exchanged for the home currency during repatriation. Before the recent devaluation of the Mexican peso, most American firms greatly reduced their peso denominated positions, except in accounts payable where gains were realized by taking on peso debt (Business Week, 1982). Exchange fluctuations affect the financial worth of an asset even when the economic value remains constant.

The locational behavior of American based MNCs has been severely constrained in recent years by the accounting treatment of paper exchange losses known as Financial Accounting Standards Number 8 (FAS-8), issued in 1975 by the Financial Accounting Standards Board (Bierman, 1980). FAS-8 required that gains and losses of foreign operations be recorded as they occurred, disallowing their deferral, and in addition required the use of two exchange rates. An historical rate is used for recording the cost of real assets while the current rate is used for cash, accounts receivable, real assets carried at market value, and all payables. Consider the example of a German subsidiary of a U.S. corporation that acquires a plant for 17,500,000 marks when the rate of exchange is one dollar for three and one half marks. The plant is carried on the books of the subsidiary at 17,500,000 marks and on the books of the parent at 5,000,000 dollars. Assume the purchase is financed by long term debt payable in marks, there is no depreciation, and during the first year the plant earns only enough to cover the interest payment on the debt. If by the end of the year the exchange rate has shifted to one dollar for three marks, the balance sheet of the parent shows a loss of over 800,000 dollars (Table 2). Foreign currency exposure that can result in this type of financial loss severely restricts the use of long term cash for investment and so limits the number or magnitude and location of foreign projects. A new rule, FAS-52, became mandatory in 1983. It allows a company to list its foreign currency position as a component of stockholder equity rather than in its income statement, greatly reducing the proportional effect of currency fluctuations on a company's financial position.

Table 2: Accounting Under Financial Accounting Standard No. 8

	Marks		Dollars	
	Beginning of Year	End of Year	Beginning of Year	End of Year
Plant	17,500,000	17,500,000	5,000,000	5,000,000
Debt	17,500,000	17,500,000	5,000,000	5,833,333

Directly unquantifiable political risk is probably the most difficult to assess risk feature of FDI, yet has been considered a critical factor in the FDI location decision (aharoni, 1966; Basi,

1963; Levis, 1979). Most definitions of political risk are difficult to operationalize because of the practical problem of correctly separating it from economic risk. In addition, the political environment involves a large measure of uncertainty which must be reduced to its risk equivalent for practical purposes. Root defines political risk as:

"...possible occurrence of a political event of any kind (such as war, revolution, coup d'etat, expropriation, taxation, devaluation, exchange controls, and import restrictions) at home or abroad that can cause a loss of profit or other goals of a particular enterprise" (Root, 1972, 355).

This definition may be overly broad, for example it includes devaluation which results, at least partially, from external forces, but it is a good one because it expresses the wide variety of political risk sources and also considers both home and host nations.

As a generalization, political risk can be considered in three categories which directly affect the magnitude and location of FDI (Root, 1972). The first category is transfers, including flows of capital, technology and personnel. Political risk associated with transfers appears to be least heavily weighed when considering FDI because government policies regarding them may be circumvented frequently with limited difficulty (Business Week, 1981b). The second category is operations and concerns policies that inhibit local activities. The third category is control and includes conditions that affect not only managerial control but also directly affect ownership (Clarke, 1976).

Concerns with political risk tend to focus on FDI in developing countries (Agodo, 1978; Carson, 1979; Root and Ahmed, 1978). Political stability, particularly in nations recently becoming independent, is of critical concern where the ultimate threat may be nationalization of foreign assets following a change in governments (Williams, 1975). However some MNCs are actually risk-takers vs. risk-averters — e.g., there is a fair amount of MNC speculative investment in Uganda now—definitely of a risk-taking nature. Recently, political risk has become an issue in industrialized nations as well. The Canadianization of the petroleum industry in Canada and the election of Mitterand and the Socialists in France has added the risk of nationalization of assets in these countries to FDI evaluations. More subtle initiatives in West Europe both at the Community and national levels, are currently constraining FDI activity by American MNCs (Business Week, 1981d,e). Operations policy is having a particular impact on limiting plant closing by these corporations (Business Week, 1981a). This type of constraint precludes any FDI activity from strategic planning. MNCs do not consider FDI a for better or worse commitment, and ease of exit is becoming as important a consideration as ease of entry in the international location of assets (Boddewyn, 1979).

CONCLUSION

The internationalization of direct investment is a lively and important subject of geographical research, but not much of this research is now being conducted by geographers. The brief review of each of the FDI issues presented above was made in order to establish some of the multiple concerns of FDI analyses now being conducted. The issues presented were artificially partitioned because they all are interrelated through a common geographical base. The industrial systems methodology is well suited to systematic research of the geographical complexity of FDI activity because of its emphasis on the dynamics of national and international political-economic environments. FDI related research, however, should not be limited to specialists in economic geography. Certainly the expertise of cultural, political, regional, and social geographers, particularly those with international experience, is critically important to meaningful analyses of the entire subject of FDI.

For example, in a recent plea for interdisciplinary research on the topic of political risk, Kobrin (1979), a management professor, calls on economists, psychologists, and

anthropologists for fruitful contributions. Geographers are not mentioned, even though political and regional geographers have, or can develop, particular insights concerning political risk from their perspectives that are not likely to arise in other disciplines. Similar explicitly geographical insights concerning other features of FDI activity would not only be of benefit to interdisciplinary research but would also be of benefit to private and public policy formulation concerning a dynamic international economy.

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